

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 September 28, 2003

OR

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

For the transition period from _____ to _____

Commission file number: 000-49850

BIG 5 SPORTING GOODS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

95-4388794

(State or Other Jurisdiction of Incorporation or Organization)

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

2525 East El Segundo Boulevard
El Segundo, California

90245

(Address of Principal Executive Offices)

(Zip Code)

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

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

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

There were 22,663,927 shares of common stock with a par value of \$0.01 per share outstanding at November 5, 2003.

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1

Condensed Consolidated Balance Sheets

Condensed Consolidated Statements of Operations

Consolidated Condensed Statements of Cash Flows

Notes to Unaudited Condensed Consolidated Financial Statements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

ITEM 4. CONTROLS AND PROCEDURES

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Item 2. Changes in Securities and Use of Proceeds

Item 3. Defaults Upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits and Reports on Form 8-K

SIGNATURES

EXHIBIT 31.1

EXHIBIT 31.2

EXHIBIT 32.1

EXHIBIT 32.2

BIG 5 SPORTING GOODS CORPORATION

INDEX

	Page
PART I – FINANCIAL INFORMATION	
Item 1	Condensed Consolidated Financial Statements (unaudited)
	Condensed Consolidated Balance Sheets
	Condensed Consolidated Statements of Operations
	Condensed Consolidated Statements of Cash Flows
	Notes to Condensed Consolidated Financial Statements
Item 2	Management’s Discussion and Analysis of Financial Condition and Results of Operations
Item 3	Quantitative and Qualitative Disclosures About Market Risk
Item 4	Controls and Procedures
PART II – OTHER INFORMATION	
Item 1	Legal Proceedings
Item 2	Changes in Securities and Use of Proceeds
Item 3	Defaults Upon Senior Securities
Item 4	Submission of Matters to a Vote of Security Holders
Item 5	Other Information
Item 6	Exhibits and Reports on Form 8-K
SIGNATURES	
Exhibit 31.1	
Exhibit 31.2	
Exhibit 32.1	
Exhibit 32.2	

BIG 5 SPORTING GOODS CORPORATIONCondensed Consolidated Balance Sheets
(unaudited)
(dollars in thousands)

	September 28, 2003	December 29, 2002
Assets		
Current assets:		
Cash	\$ 5,950	\$ 9,441
Trade and other receivables	3,924	9,057
Merchandise inventories	178,381	169,529
Prepaid expenses	2,321	2,385
Total current assets	190,576	190,412
Net property and equipment	43,554	45,104
Deferred income taxes, net	9,658	9,658
Leasehold interest	4,468	5,811
Other assets, at cost	2,337	2,557
Goodwill	4,433	4,433
Total assets	\$255,026	\$257,975
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 52,331	\$ 67,937
Accrued expenses	54,726	49,708
Total current liabilities	107,057	117,645
Deferred rent	11,590	11,525
Long-term debt	116,296	125,131
Total liabilities	234,943	254,301
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.01 par value. Authorized 50,000,000 shares; issued and outstanding 22,663,927 shares and 22,178,018 shares at September 28, 2003 and December 29, 2002, respectively	227	222
Additional paid-in capital	84,003	84,008
Accumulated deficit	(64,147)	(80,556)
Total stockholders' equity	20,083	3,674
Total liabilities and stockholders' equity	\$255,026	\$257,975

See accompanying notes to condensed consolidated financial statements.

BIG 5 SPORTING GOODS CORPORATIONCondensed Consolidated Statements of Operations
(unaudited)
(in thousands, except per share data)

	13 Weeks Ended		39 Weeks Ended	
	September 28, 2003	September 29, 2002	September 28, 2003	September 29, 2002
Net sales	\$183,275	\$170,913	\$517,917	\$490,749
Cost of goods sold, buying and occupancy	118,065	111,806	332,260	317,002
Gross profit	65,210	59,107	185,657	173,747
Operating expenses:				
Selling and administrative	48,348	44,450	139,991	132,370
Depreciation and amortization	2,585	2,335	7,628	7,157
Total operating expenses	50,933	46,785	147,619	139,527
Operating income	14,277	12,322	38,038	34,220
Premium and unamortized financing fees related to redemption of debt	—	4,491	1,483	4,557
Interest expense, net	2,848	3,487	8,744	12,298
Income before income taxes	11,429	4,344	27,811	17,365
Income taxes	4,685	1,748	11,402	7,110
Net income	6,744	2,596	16,409	10,255
Redeemable preferred stock dividends	—	4,010	—	7,999
Net income (loss) available to common stockholders	\$ 6,744	\$ (1,414)	\$ 16,409	\$ 2,256
Earnings (loss) per share:				
Basic	\$ 0.30	\$ (0.07)	\$ 0.72	\$ 0.13
Diluted	\$ 0.30	\$ (0.07)	\$ 0.72	\$ 0.12
Shares used to calculate earnings per share:				
Basic	22,664	21,430	22,646	17,202
Diluted	22,781	21,430	22,720	18,414

See accompanying notes to condensed consolidated financial statements.

BIG 5 SPORTING GOODS CORPORATIONConsolidated Condensed Statements of Cash Flows
(unaudited)
(dollars in thousands)

	39 Weeks Ended	
	September 28, 2003	September 29, 2002
Cash flows from operating activities:		
Net income	\$ 16,409	\$ 10,255
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,628	7,157
Amortization of deferred finance charge and discounts	452	2,068
Premium and unamortized financing fees related to redemption of debt	1,483	4,564
Loss on disposal of equipment and leasehold interest	140	6
Change in assets and liabilities:		
Merchandise inventories	(8,852)	(7,450)
Trade accounts receivable, net	5,133	3,288
Prepaid expenses and other assets	(537)	(155)
Accounts payable	(2,481)	(2,735)
Accrued expenses	(4,479)	(7,362)
Legal settlement	—	(2,465)
Net cash provided by operating activities	14,896	7,171
Cash flows from investing activities — purchase of property and equipment	(4,810)	(4,448)
Cash flows from financing activities:		
Net borrowings under revolving credit facilities, and other	7,518	16,669
Repurchase of long-term debt	(21,095)	(30,473)
Repurchase of Series A preferred stock	—	(67,921)
Issuance of stock, net of repurchases	—	79,363
Equity issuance costs	—	(1,664)
Net cash used in financing activities	(13,577)	(4,026)
Net decrease in cash	(3,491)	(1,303)
Cash at beginning of period	9,441	7,865
Cash at end of period	\$ 5,950	\$ 6,562
Supplemental disclosures of non-cash financing activities:		
Dividends on preferred stock	\$ —	\$ 7,999
Accrual of initial public offering costs	\$ —	\$ 523
Supplemental disclosures of cash flow information:		
Interest paid	\$ 6,382	\$ 6,906
Income taxes paid	\$ 10,099	\$ 11,842

See accompanying notes to condensed consolidated financial statements.

BIG 5 SPORTING GOODS CORPORATION

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Basis of Presentation and Description of Business

We operate in one business segment, as a sporting goods retailer under the Big 5 Sporting Goods name carrying a broad range of hardlines, softlines and footwear, operating 282 stores at September 28, 2003 in California, Washington, Arizona, Oregon, Texas, New Mexico, Nevada, Utah, Idaho and Colorado. We are a holding company that operates our business through Big 5 Corp., our wholly owned subsidiary.

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary to present fairly and in accordance with accounting principles generally accepted in the United States of America (GAAP) the financial position as of September 28, 2003 and December 29, 2002 and the results of operations and cash flows for the 13 and 39 week periods ended September 28, 2003 and September 29, 2002. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission; however, we believe that the disclosures are adequate to make the information presented not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 29, 2002.

(2) Reclassifications

Certain prior year balances in the accompanying condensed consolidated financial statements have been reclassified to conform to current year presentation.

(3) Initial Public Offering and Debt Redemption

In June 2002, we completed an initial public offering (IPO) of 8.1 million shares of common stock, of which 1.6 million shares were sold by selling stockholders. In July 2002, our underwriters exercised their right to purchase an additional 1.2 million shares through their over-allotment option, of which 0.5 million shares were sold by selling stockholders. With net proceeds of \$76.1 million from the offering and total net proceeds of \$84.0 million after exercise of the underwriters' over-allotment option, and together with borrowings under our credit facility, we redeemed all of our outstanding senior discount notes and preferred stock, paid bonuses to executive officers and directors which were funded by a reduction in the redemption price otherwise applicable to our preferred stock and repurchased 0.5 million shares of our common stock from non-executive employees. In the first quarter of fiscal 2003 we redeemed \$20.0 million face value of our 10.875% senior notes due 2007 using borrowings under our credit facility.

Our accompanying statements of operations report net income and earnings per diluted share in accordance with GAAP. In addition, we internally use pro forma reporting

[Table of Contents](#)

to evaluate our operating performance without regard to certain non-recurring financial effects of the IPO in 2002, including the exercise of the underwriters' over-allotment option, or certain financial effects of the 2003 partial senior note redemption. We believe this presentation will provide investors with additional insight into our operating results. The pro forma figures assume that the IPO took place at the beginning of 2002 and exclude the effects of certain IPO-related expenses and debt redemption premiums. The following table contains a reconciliation of the pro forma adjustments to GAAP for the 13 weeks ended September 29, 2002 and 39 weeks ended September 29, 2002 and September 28, 2003. There were no pro forma adjustments related to the IPO or debt redemption for the 13 weeks ended September 28, 2003.

	13 Weeks Ended September 29, 2002	39 Weeks Ended	
		September 28, 2003	September 29, 2002
	(unaudited)	(unaudited)	
	(in thousands except earnings per share data)		
Reported net income (loss) available to common stockholders	\$ (1,414)	\$16,409	\$ 2,256
Redeemable preferred stock dividends (a)	4,010	—	7,999
Reported net income	2,596	16,409	10,255
Bonus expense (b)	471	—	1,962
Management fees (c)	—	—	1,044
Interest expense (d)	2	—	1,775
Premium and unamortized financing fees related to redemption of debt (e)	4,491	1,483	4,557
Income taxes (f)	(2,029)	(608)	(3,822)
Pro forma net income available to common stockholders	\$ 5,531	\$17,284	\$15,771
Pro forma earnings per share – diluted	\$ 0.24	\$ 0.76	\$ 0.70
Pro forma weighted average shares outstanding – diluted	22,664	22,720	22,664

- (a) To eliminate dividends and redemption premium on preferred stock redeemed in connection with the IPO.
- (b) To eliminate from selling and administrative expenses, the payment of bonuses that was funded through a reduction of the redemption price that would otherwise have been applicable to redemption of the company's outstanding preferred stock.
- (c) To eliminate from selling and administrative expenses, management services agreement fees and the management services agreement termination cost incurred in connection with the IPO.
- (d) To eliminate interest expense and amortization of debt issue costs associated with the senior discount notes redeemed in connection with the IPO and to reflect interest expense on incremental borrowings under the credit facility in connection with the IPO.
- (e) To eliminate the premium and unamortized financing fees associated with the 2003 partial redemption of senior notes (2003 adjustment only) and the redemption of the senior discount notes in connection with the IPO (2002 adjustment only).
- (f) To reflect tax expense (benefit) for items (b) through (e) noted above at the effective tax rate.

(4) Earnings Per Share

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

	13 weeks ended		39 weeks ended	
	September 28, 2003	September 29, 2002	September 28, 2003	September 29, 2002
	(unaudited)		(unaudited)	
	(in thousands except earnings per share data)			
Net income	\$ 6,744	\$ 2,596	\$16,409	\$10,255
Less: Preferred stock dividends	—	4,010	—	7,999
Net income (loss) available to common stockholders	\$ 6,744	\$ (1,414)	\$16,409	\$ 2,256
Basic earnings (loss) per share:				
Net income (loss)	\$ 0.30	\$ (0.07)	\$ 0.72	\$ 0.13
Diluted earnings (loss) per share:				
Net income (loss)	\$ 0.30	\$ (0.07)	\$ 0.72	\$ 0.12
Weighted average shares of common stock outstanding				
Basic	22,664	21,430	22,646	17,202
Dilutive effect of options	117	—	55	—
Dilutive effect of unvested restricted stock	—	—	—	726
Dilutive effect of outstanding warrant	—	—	19	486
Diluted	22,781	21,430	22,720	18,414

The outstanding warrant was exercised in the first quarter of fiscal 2003. Options to purchase an additional 59,000 shares of common stock that were outstanding at September 28, 2003 were not included in the computation of diluted earnings per share for the 39 weeks ended September 28, 2003 because the exercise price of these options was greater than the average market price of our common stock during this period and thus would be antidilutive. However, these same options were included in the computation of diluted earnings per share for the 13 weeks ended September 28, 2003 as the exercise price of these options was less than the average market price of our common stock during this period.

(5) Stock-Based Compensation

In December 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - An Amendment of FASB Statement No. 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair-value-based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in

[Table of Contents](#)

both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for interim and annual periods beginning after December 15, 2002.

As permitted under SFAS No. 123, we continue to apply the provisions of Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" (APB Opinion No. 25), and related interpretations and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants made in 1995 and future years as if the fair-value-based method defined in SFAS No. 123 had been applied. Therefore, compensation expense for stock options issued to employees is recorded on the date of grant only if the then-current market price of the underlying stock exceeded the exercise price. If we had determined compensation cost based upon the fair value at the grant date for our stock options under SFAS No. 123 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:

	13 Weeks Ended		39 Weeks Ended	
	September 28, 2003	September 29, 2002	September 28, 2003	September 29, 2002
Net income (loss), as reported	\$6,744	\$(1,414)	\$16,409	\$2,256
Deduct: Total stock-based employee compensation expense determined under fair-value-based methods for all awards, net of related tax effects	107	62	275	159
Pro forma net income (loss)	\$6,637	\$(1,476)	\$16,134	\$2,097
Earnings (loss) per share:				
Basic – as reported	0.30	(0.07)	0.72	0.13
Basic – pro forma	0.29	(0.07)	0.71	0.12
Diluted – as reported	0.30	(0.07)	0.72	0.12
Diluted – pro forma	0.29	(0.07)	0.71	0.11
Risk free interest rate	—	3.6%	3.3%	3.6%
Expected lives	—	9 years	9 years	9 years
Expected volatility	—	60%	65%	60%
Expected dividends	—	—	—	—

The assumptions used in the Black Scholes calculations are reflective of the information at the date of grant. There was one grant date during the 39 weeks ended September 28, 2003 and two grant dates during the 39 weeks ended September 29, 2002.

(6) Vendor Payments

In November 2002, the Emerging Issues Task Force (EITF) issued EITF Issue No. 02-16, "*Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor.*" EITF Issue No. 02-16 addresses the timing of recognition and classification of consideration received from vendors, including rebates or allowances. EITF Issue No. 02-16 presumes that cash consideration received from a vendor represents a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction in cost of sales unless (i) it is a payment for assets or services delivered to the vendor, in which case the cash consideration should be characterized as revenue, or (ii) it is a reimbursement of costs incurred to sell the vendor's products, in which case the cash consideration should be characterized as a reduction of that cost. EITF No. 02-16 became effective for us in the first quarter of 2003, and had no impact on our financial statements, as we have historically accounted for vendor payments in accordance with the provisions of this standard.

(7) Repurchase of Debt

In January 2003, we adopted the provisions of SFAS No. 145, "*Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.*" SFAS No. 145 provides that the gain or loss recognized upon early debt extinguishment may no longer be classified as extraordinary, but rather must be recognized as a component of net income before extraordinary items, if any. We recognized \$1.5 million and \$4.6 million in premium and related unamortized financing fees in the 39 weeks ended September 28, 2003 and September 29, 2002, respectively. The \$1.5 million charge in the first 39 weeks of 2003 resulted from a \$1.1 million premium related to the redemption of \$20.0 million face value of our 10.875% senior notes and the related carrying value of applicable deferred financing costs which totaled \$0.4 million in the first quarter of 2003. The \$4.6 million charge in the first 39 weeks of 2002 resulted from the repurchase of \$2.5 million face value of our senior discount notes and \$0.5 million face value of our 10.875% senior notes in the first quarter of 2002 and redemption in the third quarter of 2002 of all of our remaining senior discount notes for an aggregate redemption price of approximately \$27.5 million. The \$4.6 million charge consists of \$4.0 million in redemption premium and \$0.6 million in unamortized deferred financing costs associated with the related debt.

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 merchandise returns. Same store sales for a period reflect net sales from stores operated throughout that period as well as the corresponding prior period. New store sales for a period reflect net sales from stores opened in that period as well as net sales from stores opened during the prior fiscal year. Stores that are relocated during any period are treated as new stores.

Gross Profit

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

Selling and Administrative

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

Depreciation and Amortization

Depreciation and amortization consists primarily of the depreciation of leasehold improvements, fixtures and equipment owned by us, amortization of leasehold interest and non-cash rent expense.

DISCUSSION OF CRITICAL ACCOUNTING POLICIES

In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America. 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.

Table of Contents

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 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.

RESULTS OF OPERATIONS

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

13 Weeks Ended September 28, 2003 Compared to 13 Weeks Ended September 29, 2002

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			
	September 28, 2003		September 29, 2002	
	(unaudited) (dollars in thousands)			
Net sales	\$183,275	100.0%	\$170,913	100.0%
Cost of sales	118,065	64.4	111,806	65.4
Gross profit	65,210	35.6	59,107	34.6
Operating expenses:				
Selling and administrative	48,348	26.4	44,450	26.0
Depreciation and amortization	2,585	1.4	2,335	1.4
Total operating expenses	50,933	27.8	46,785	27.4
Operating income	14,277	7.8	12,322	7.2
Premium and unamortized financing fees related to redemption of debt	—	0.0	4,491	2.6
Interest expense, net	2,848	1.6	3,487	2.1
Income before income taxes	11,429	6.2	4,344	2.5
Income taxes	4,685	2.5	1,748	1.0
Net income	\$ 6,744	3.7%	\$ 2,596	1.5%

1. **Net Sales.** Net sales increased by \$12.4 million, or 7.2%, to \$183.3 million in the 13 weeks ended September 28, 2003 from \$170.9 million in the same period last year. This growth reflected an increase of \$5.6 million in same store sales and an increase of \$7.1 million in new store sales, which reflected the opening of 21 new stores since June 30, 2002. The remaining variance was attributable to net sales from closed stores. Same store sales increased 3.3% in the 13 weeks ended September 28, 2003 versus the same period last year, representing the thirty-first consecutive quarterly increase in same store sales over comparable prior periods. This 3.3% increase in same store sales was attributable to higher sales in each of our three major product categories of footwear, hard goods and apparel, with the apparel category providing the strongest performance. Store count at September 28, 2003 was 282 versus 265 at September 29, 2002. We opened seven new stores in the 13 weeks ended September 28, 2003 and we opened four new stores in the 13 weeks ended September 29, 2002. We expect to open eleven new stores during the remainder of fiscal 2003. Subsequent to September 28, 2003, there were a significant number of fires throughout the Southern California region. While we initially saw a slight decrease in our sales as a result of the fires, we do not believe these fires will have a significant impact on our fourth quarter or full fiscal year sales.

2. **Gross Profit.** Gross profit increased by \$6.1 million, or 10.3%, to \$65.2 million in the 13 weeks ended September 28, 2003 from \$59.1 million in the same period last year.

Table of Contents

Gross profit margin was 35.6% in the 13 weeks ended September 28, 2003 compared to 34.6% in the same period last year. We were able to achieve higher gross profit margins primarily due to improved product selling margin comparisons in each of our three major product categories. These increases were partially offset by a 0.1% increase in distribution costs when measured as a percentage of sales resulting primarily from increased trucking-related costs.

3. **Selling and Administrative.** Selling and administrative expenses increased by \$3.8 million, or 8.8%, to \$48.3 million in the 13 weeks ended September 28, 2003 from \$44.5 million in the same period last year. The increase was driven by a \$2.5 million increase in store-related expenses primarily resulting from the need to support our store growth, increased employee health benefit costs, increased workers' compensation costs and higher credit and debit card fees related to increased use of credit and debit cards by our customers. Our advertising expenses increased by \$1.6 million due to a difference in the timing of advertising expenses, an increase in the number of stores since the same period last year, and a printing cost credit recorded in the third quarter of last year. These absolute and percentage increases in selling and administrative were not as high as they otherwise might have been, because during the 13 weeks ended September 29, 2002, we incurred expenses in connection with our IPO. These expenses include bonuses paid to our executive officers and directors which totaled \$0.5 million and were funded through a reduction of the redemption price that would otherwise have been applicable to the redemption of our outstanding preferred stock. When measured as a percentage of net sales, selling and administrative expenses were 26.4% for the 13 weeks ended September 28, 2003 compared to 26.0%, including IPO related expenses, for the same period last year.

4. **Depreciation and Amortization.** Depreciation and amortization expense increased \$0.3 million, or 10.7%, to \$2.6 million for the 13 weeks ended September 28, 2003 from \$2.3 million for the same period last year, primarily due to the increase in store count to 282 stores at the end of the third quarter of fiscal 2003 from 265 stores at the end of the third quarter of fiscal 2002.

5. **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 September 28, 2003 versus \$4.5 million in the 13 weeks ended September 29, 2002. The \$4.5 million charge in the 13 weeks ended September 29, 2002 resulted from the redemption in the third quarter of fiscal 2002 following our IPO of all of our remaining senior discount notes for an aggregate redemption price of approximately \$27.5 million.

6. **Interest Expense, Net.** Interest expense, net decreased by \$0.7 million, or 18.3%, to \$2.8 million in the 13 weeks ended September 28, 2003 from \$3.5 million in the same period last year. This decrease reflected lower overall debt balances in the 13 weeks ended September 28, 2003 versus the 13 weeks ended September 29, 2002, lower average interest rates on our credit facility in the 13 weeks ended September 28, 2003 versus the 13 weeks ended September 29, 2002, and lower average interest costs associated with the use of borrowings from our credit facility to redeem \$20.0 million of our 10.875% senior notes during the first quarter of fiscal 2003. In the third quarter of fiscal 2002, we used some of

[Table of Contents](#)

the proceeds from our IPO to redeem all of our remaining senior discount notes for an aggregate redemption price of approximately \$27.5 million.

7. Income Taxes. Provision for income taxes was \$4.7 million for the 13 weeks ended September 28, 2003 and \$1.7 million for the 13 weeks ended September 29, 2002. Our effective income tax rate was 41% for both periods. Income taxes are based upon the estimated effective tax rate for the entire fiscal year applied to pre-tax income for the year. The effective rate is subject to ongoing evaluation by management.

39 Weeks Ended September 28, 2003 Compared to 39 Weeks Ended September 29, 2002

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

	39 Weeks Ended			
	September 28, 2003	(unaudited) (dollars in thousands)		September 29, 2002
Net sales	\$517,917	100.0%	\$490,749	100.0%
Cost of sales	332,260	64.2	317,002	64.6
Gross profit	185,657	35.8	173,747	35.4
Operating expenses:				
Selling and administrative	139,991	27.0	132,370	27.0
Depreciation and amortization	7,628	1.5	7,157	1.4
Total operating expenses	147,619	28.5	139,527	28.4
Operating income	38,038	7.3	34,220	7.0
Premium and unamortized financing fees related to redemption of debt	1,483	0.2	4,557	1.0
Interest expense, net	8,744	1.7	12,298	2.5
Income before income taxes	27,811	5.4	17,365	3.5
Income taxes	11,402	2.2	7,110	1.4
Net income	\$ 16,409	3.2%	\$ 10,255	2.1%

1. **Net Sales.** Net sales increased by \$27.2 million, or 5.5%, to \$517.9 million in the first 39 weeks of fiscal 2003 from \$490.7 million in the same period last year. This growth reflected an increase of \$8.0 million in same store sales and an increase of \$19.4 million in new store sales, which reflected the opening of eight new stores during the first 39 weeks of fiscal 2003 and 15 new stores in fiscal 2002. The remaining variance was attributable to net sales from closed stores. Same store sales increased 1.6% in the first 39 weeks of fiscal 2003 versus the same period last year. The increase in same store sales was attributable to higher sales in each of our three major product categories of footwear, hard goods and apparel, with the apparel category providing the strongest performance. Store count at September 28, 2003 was 282 versus 265 at September 29, 2002. We opened eight new stores and closed one store in the first 39 weeks of fiscal 2003 and we opened five new stores in the first 39 weeks of fiscal 2002. We expect to open approximately eleven new stores during the remainder of fiscal 2003. Subsequent to September 28, 2003, there were a significant number of fires throughout the Southern California region. While we initially saw a slight decrease in our sales as a result of the fires, we do not believe these fires will have a significant impact on our fourth quarter or full fiscal year sales.

2. **Gross Profit.** Gross profit increased by \$12.0 million, or 6.9%, to \$185.7 million in the first 39 weeks of fiscal 2003 from \$173.7 million in the same period last year. Gross profit margin was 35.8% in the first 39 weeks of fiscal 2003 compared to 35.4% in the same period last year. We were able to achieve higher gross profit margins primarily due to improved selling margins in each of our three major product categories, partially offset by higher occupancy and distribution center costs when measured as a percentage of sales resulting from a smaller than expected growth in net sales.

Table of Contents

3. **Selling and Administrative.** Selling and administrative expenses increased by \$7.6 million, or 5.8%, to \$140.0 million in the first 39 weeks of fiscal 2003 from \$132.4 million in the same period last year. The increase was driven by a \$7.0 million increase in store-related expenses primarily resulting from the need to support our store growth, increased employee health benefit costs, increased workers' compensation costs and higher credit and debit card fees related to increased use of credit and debit cards by our customers. Our advertising expenses increased by \$2.5 million due to our store growth and a printing cost credit received in the third quarter of last year. Insurance-related costs increased by \$0.3 million, primarily as a result of increased directors' and officers' insurance premiums after our IPO. These absolute and percentage increases in selling and administrative were not as high as they otherwise might have been, because during the 39 weeks ended September 29, 2002, we incurred expenses in connection with our IPO. These expenses include management services agreement fees and termination costs paid to Leonard Green & Associates, L.P., an affiliate of Leonard Green & Partners, L.P., which were \$1.0 million in the 39 weeks ended September 29, 2002, as well as bonuses paid to our executive officers and directors during the 39 weeks ended September 29, 2002. The bonuses for that period totaled \$2.0 million and were funded through a reduction of the redemption price that would otherwise have been applicable to the redemption of our outstanding preferred stock. When measured as a percentage of net sales, selling and administrative expenses were 27.0% for the first 39 weeks of fiscal 2003 compared to 27.0%, including IPO related expenses, for the same period last year.

4. **Depreciation and Amortization.** Depreciation and amortization expense increased by \$0.4 million, or 6.6%, to \$7.6 million in the first 39 weeks of fiscal 2003 from \$7.2 million in the same period last year, primarily due to the increase in store count to 282 stores at the end of the third quarter of fiscal 2003 from 265 stores at the end of the third quarter of fiscal 2002.

5. **Premium and Unamortized Financing Fees Related to Redemption of Debt.** Premium and unamortized financing fees related to redemption of debt were \$1.5 million in the first 39 weeks of fiscal 2003 versus \$4.6 million in the first 39 weeks of fiscal 2002. The \$1.5 million charge in the first 39 weeks of fiscal 2003 resulted from a \$1.1 million premium related to the redemption of \$20.0 million face value of our 10.875% senior notes and the related carrying value of applicable deferred financing costs which totaled \$0.4 million in the first quarter of fiscal 2003. The \$4.6 million charge in the first 39 weeks of fiscal 2002 resulted from the repurchase of \$2.5 million face value of our senior discount notes and \$0.5 million face value of our 10.875% senior notes in the first quarter of fiscal 2002 and redemption of all of our remaining senior discount notes for an aggregate redemption price of approximately \$27.5 million in the third quarter of fiscal 2002 following our IPO. The \$4.6 million charge consists of \$4.0 million in redemption premium and \$0.6 million in unamortized deferred financing costs associated with the related debt.

6. **Interest Expense, Net.** Interest expense, net decreased by \$3.6 million, or 28.9%, to \$8.7 million in the first 39 weeks of fiscal 2003 from \$12.3 million in the same period last year. This decrease reflected lower interest rates on our credit facility in the first 39 weeks of fiscal 2003 versus the first 39 weeks of fiscal 2002 and lower average interest costs associated with the use of borrowings from our credit facility to redeem \$20.0 million of our 10.875% senior notes during the first quarter of fiscal 2003. In the third quarter of fiscal

Table of Contents

2002, we used some of the proceeds from our IPO to redeem all of our outstanding senior discount notes for an aggregate redemption price of approximately \$27.5 million. Accordingly, interest expense, net included no expense related to those senior discount notes in the first 39 weeks of fiscal 2003 versus \$2.1 million in the first 39 weeks of fiscal 2002.

7. **Income Taxes.** Provision for income taxes was \$11.4 million for the first 39 weeks of fiscal 2003 and \$7.1 million for the first 39 weeks of fiscal 2002. Our effective income tax rate was 41% for both periods. Income taxes are based upon the estimated effective tax rate for the entire fiscal year applied to pre-tax income for the year. The effective rate is subject to ongoing evaluation by management.

LIQUIDITY AND CAPITAL RESOURCES

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

Net cash provided by operating activities for the first 39 weeks of fiscal 2003 and fiscal 2002 was \$14.9 million and \$7.2 million, respectively. The change between periods primarily reflects higher net income in the first 39 weeks of fiscal 2003 and the payment of a legal settlement of a wage/hour class action lawsuit during the 39 weeks ended September 29, 2002.

Capital expenditures for the first 39 weeks of fiscal 2003 and 2002 were \$4.8 million and \$4.4 million, respectively. We expect capital expenditures for the remaining 13 weeks of fiscal 2003 will range from \$6.0 to \$7.0 million, primarily to fund the opening of 11 new stores, store improvements and remodelings, warehouse and headquarters improvements and computer hardware and software expenditures. Our store format requires a low investment in furniture and equipment (approximately \$0.4 million), working capital (approximately \$0.4 million, net of amount financed by vendors through trade payables, which is typically one-third) and real estate (leased "built-to-suit" locations). Based on our expected net sales and store growth, we currently plan to replace our existing distribution center during the next 15 to 18 months at a cost of approximately \$15 million. We expect to fund these capital expenditures from operating cash flows and borrowings under our revolving credit facility. We anticipate that these expenditures will be incurred primarily in the fourth quarter of fiscal 2004 and the first half of fiscal 2005.

Net cash used by financing activities for the first 39 weeks of fiscal 2003 and fiscal 2002 was \$13.6 million and \$4.0 million, respectively. As of September 28, 2003, we had borrowings of \$33.4 million and letter of credit commitments of \$5.8 million outstanding under our credit facility and \$82.9 million of our 10.875% senior notes outstanding. These balances compare to borrowings of \$44.7 million and letter of credit commitments of \$7.9 million outstanding under our prior credit facility and \$103.3 million of our 10.875% senior notes outstanding as of September 29, 2002. In the third quarter of fiscal 2002 we redeemed our senior discount notes following the consummation of the IPO. During the first 39 weeks ended September 29, 2002, we also repurchased \$0.5 million face value of our 10.875% senior notes. In the first quarter of fiscal 2003 we redeemed \$20.0 million face value of our 10.875% senior notes. We had cash of \$6.0 million and \$6.6 million at September 28, 2003 and September 29, 2002, respectively.

We believe we will be able to fund our future cash requirements for operations from operating cash flows, cash on hand and borrowings under our credit facility. We believe these sources of funds will be sufficient to continue our operations and planned capital

[Table of Contents](#)

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

Our principal future obligations and commitments, excluding periodic interest payments, include the following:

	Payments Due by Period				
	Total	1 Year	1-3 Years	4-5 Years	After 5 Years
			(in thousands)		
Long-term debt	\$ 82,870	\$ —	\$ —	\$ 82,870	\$ —
Revolving credit facility	33,426	—	33,426	—	—
Letters of credit	5,834	5,834	—	—	—
Operating lease commitments	267,257	36,855	69,844	54,710	105,848
Total	\$389,387	\$42,689	\$103,270	\$137,580	\$105,848

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

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

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

The credit facility bears interest at various rates based on our performance, with a floor of LIBOR plus 1.50% or the JPMorgan Chase Bank prime lending rate and a ceiling of LIBOR plus 2.50% or the JPMorgan Chase Bank prime lending rate plus 0.75%, and is secured by our trade accounts receivable, merchandise inventory and general intangible

Table of Contents

assets (including trademarks and trade names). At September 28, 2003, loans under the credit facility bear interest at a rate of LIBOR (1.12% at September 28, 2003) plus 1.50% or the JPMorgan Chase Bank prime lending rate (4.00% at September 28, 2003). An annual fee of 0.325%, payable monthly, is assessed on the unused portion of the credit facility. On September 28, 2003, we had \$33.4 million in LIBOR and prime lending rate borrowings and letters of credit of \$5.8 million outstanding. Our maximum eligible borrowing available under the credit facility is limited to 70% of the aggregate value of eligible inventory during November through February and 65% of the aggregate value of eligible inventory during the remaining months of the year. Available borrowings over and above actual LIBOR and prime rate borrowings and letters of credit outstanding on the credit facility amounted to \$67.3 million at September 28, 2003.

We recently announced that we will redeem \$35 million principal amount of our 10.875% senior notes due 2007, using borrowings available under our credit facility. Following the redemption, which is scheduled to be completed in early December 2003, the outstanding balance of our 10.875% senior notes will be reduced to \$48.1 million from an original face amount of \$131 million when the notes were first issued in November 1997.

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

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

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

SEASONALITY

We experience seasonal fluctuations in our net sales and operating results. In fiscal 2002, we generated 26.5% of our net sales and 35.2% of our operating income in the fourth fiscal quarter, which includes the holiday selling season as well as the peak winter sports selling season. As a result, we incur significant additional expenses in the fourth fiscal quarter due to higher purchase volumes and increased staffing. If we miscalculate the demand for our products generally or for our product mix during the fourth fiscal quarter, our net sales could decline, resulting in excess inventory, which could harm our financial performance. Because a substantial portion of our operating income is derived from our fourth fiscal quarter net sales, a shortfall in expected fourth fiscal quarter net sales could cause our annual operating results to suffer significantly.

IMPACT OF INFLATION

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

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 elsewhere in this report and other risks and uncertainties more fully described in our other filings with the Securities and Exchange Commission. We caution that the risk factors set forth in this report are not exclusive. We disclaim any obligation to revise or update any forward-looking statement that may be made from time to time by us or on our behalf.

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

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

Risks Related to Our Business

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

We have a substantial amount of debt. As of September 28, 2003, the aggregate principal amount of our outstanding indebtedness was approximately \$116.3 million. Our highly leveraged financial position means:

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

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

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

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

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

The terms of our debt instruments impose operating and financial restrictions on us, including, among other things, restrictions on our ability to incur additional indebtedness, create or allow liens, pay dividends, engage in mergers, acquisitions or reorganizations or

[Table of Contents](#)

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

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

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

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

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

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

Our stores are located in the western United States. Because of this, we are subject to regional risks, such as the economy, weather conditions, power outages, the increasing cost of electricity and earthquakes and other natural disasters specific to the states in which we operate. For example, particularly in southern California where we have a high concentration of stores, seasonal factors such as unfavorable snow conditions, such as those that occurred in the winter of 2002-2003, inclement weather or other localized conditions

Table of Contents

such as flooding, fires (such as the recent major fires), earthquakes or electricity blackouts could harm our operations. If the region were to suffer an economic downturn or other adverse regional event, our net sales and profitability and our ability to implement our planned expansion program could suffer. 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 to attract a sufficient number of employees, and increases in the federal minimum wage or other employee benefits costs could increase our operating expenses. If we are unable to attract and retain personnel as needed in the future, our net sales growth and operating results may suffer.

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

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

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

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

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 twelve months ended September 28, 2003, our dependence on principal suppliers involves risk. Our 20 largest vendors collectively accounted for 35.9% of our total purchases during the twelve months ended September 28, 2003. If there is a disruption in supply from a principal supplier or

[Table of Contents](#)

distributor, we may be unable to obtain merchandise that we desire to sell and that consumers desire to purchase. In addition, a significant portion of the products that we purchase, including those purchased from domestic suppliers, are manufactured abroad. A vendor could discontinue selling products to us at any time for reasons that may or may not be in our control. Our net sales and profitability could decline if we are unable to promptly replace a vendor who is unwilling or unable to satisfy our requirements with a vendor providing equally appealing products.

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

We currently rely on a single distribution center in Fontana, California. Any natural disaster or other serious disruption to this distribution center due to fire, earthquake or any other cause could damage a significant portion of our inventory and could materially impair both our ability to adequately stock our stores and our net sales and profitability. If the security measures used at our distribution center do not prevent inventory theft, our gross margin may significantly decrease. In August 2002, we entered into a two-year lease for an additional 136,000 square foot satellite distribution center to handle seasonal merchandise and returns. In addition, because of limited capacity at the current distribution center, we will need to build a replacement distribution center in the next 15 to 18 months. Any disruption to, or delay in, this process could harm our future operations.

Because an equity owner of a substantial stockholder is a member of the board of directors of one of our competitors, there may be conflicts of interest.

Green Equity Investors, L.P., an affiliate of Leonard Green & Partners, L.P., holds approximately 27% of our outstanding common stock and also holds approximately 12.8% of the outstanding common stock of The Sports Authority, Inc., one of our competitors. John G. Danhagl, an equity owner of Leonard Green & Partners, L.P., currently serves on our board of directors. Jonathan D. Sokoloff, an equity owner of Leonard Green & Partners, L.P. and a former member of our board of directors, currently serves on The Sports Authority, Inc.'s board of directors. Mr. Danhagl may have conflicts of interest with respect to certain matters affecting us, including the pursuit of certain business opportunities presented to Leonard Green & Partners, L.P. All potential conflicts may not be resolved in a manner that is favorable to us. We believe it is impossible to predict the precise circumstances under which future potential conflicts may arise and therefore intend to address potential conflicts on a case-by-case basis. Under Delaware law, directors have a fiduciary duty to act in good faith and in what they believe to be in the best interest of the corporation and its stockholders. Such duties include the duty to refrain from impermissible self-dealing and to deal fairly with respect to transactions in which the directors, or other companies with which such directors are affiliated, have an interest.

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

The Sarbanes-Oxley Act of 2002 (the "Act") that became law in July 2002, as well as new rules and regulations subsequently implemented by the Securities and Exchange Commission (the "SEC"), have required and will require changes in some of our corporate

[Table of Contents](#)

governance practices. The Act also requires the SEC to promulgate additional new rules on a variety of subjects. In addition to final rules and rule proposals already made by the SEC, Nasdaq has proposed revisions to its requirements for companies that are quoted on The Nasdaq Stock Market, Inc.'s National Market. We expect these new rules and regulations may increase our legal and financial compliance costs and to make some activities more difficult, time consuming and/or costly. We also expect these new rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance, depending in part on overall conditions in that insurance market, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These new rules and regulations could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee, and qualified executive officers.

Risks Related to Our Industry

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

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

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

We experience seasonal fluctuations in our net sales and operating results. In fiscal 2002, we generated 26.5% of our net sales and 35.2% of our operating income in the fourth fiscal quarter, which includes the holiday selling season as well as the peak winter sports selling season. As a result, we incur significant additional expenses in the fourth fiscal quarter due to higher purchase volumes and increased staffing. If we miscalculate the demand for our products generally or for our product mix during the fourth fiscal quarter, our net sales could decline, resulting in excess inventory, which could harm our financial performance. Because a substantial portion of our operating income is derived from our fourth fiscal quarter net sales, a shortfall in expected fourth fiscal quarter net sales could cause our annual operating results to suffer significantly.

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, JC Penney and Sears;

Table of Contents

- specialty sporting goods shops and pro shops, such as The Athlete's Foot and Foot Locker;
- sporting goods superstores, such as The Sports Authority, Inc., and its other operating units, Oshman's, Sportmart and Gart Sports Company; and
- internet retailers.

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

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

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

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

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 in the United States 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. The military action taken by the United States and its allies in Iraq could have a short or long-term negative economic impact upon the financial markets and our business in general.

Other Risks

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 28, 2003, there were 22,663,927 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 reduce our ability to raise capital by offering equity securities.

Green Equity Investors, L.P. owns 6,171,074 shares of our common stock and has the right, on two occasions, to require us to register these shares of common stock at any time pursuant to a registration rights agreement entered into in 1992. Pursuant to the

[Table of Contents](#)

exercise by Green Equity Investors, L.P. of this right, we filed a registration statement with the Securities and Exchange Commission on October 8, 2003 to register for resale all of the shares of our common stock owned by it. The registration statement was declared effective on October 16, 2003. In addition, holders of approximately 9.1 million shares of our common stock, which includes the shares held by Green Equity Investors, L.P., have piggyback registration rights with respect to certain offerings of our common stock. The exercise by Green Equity Investors, L.P. of its right to require us to register its shares for resale, or the offering for resale or resale of such shares, could cause the market price of our common stock to decline.

Our executive officers, directors and a substantial stockholder may be able to exert significant control over our future direction.

Our executive officers and directors, their affiliates and affiliates of Leonard Green & Partners, L.P., together control approximately 43.0% of our outstanding common stock. As a result, these stockholders, if they act together, may be able to control, as a practical matter, all matters requiring our stockholders' approval, including the election of directors and approval of significant corporate transactions. In addition, we are a party to an amended and restated stockholders agreement with Green Equity Investors, L.P., Steven G. Miller and Robert W. Miller that entitles Green Equity Investors, L.P. to nominate one director to our board of directors for as long as it and its affiliates hold at least 5% of our outstanding shares. The agreement also provides that Steven G. Miller and Robert W. Miller will vote their shares in favor of Green Equity Investors, L.P.'s nominee and that Green Equity Investors, L.P. will vote its shares to elect Steven G. Miller and Robert W. Miller to our board of directors. If Green Equity Investors, L.P. sells all of the shares of our common stock that we have registered for resale with the Securities and Exchange Commission, the amended and restated stockholders agreement will terminate, and our executive officers and directors, their affiliates and affiliates of Leonard Green & Partners, L.P. together will control approximately 15.2% of our outstanding common stock, and thus will not have the ability to exert as much control over us as they do now. We are also a party to employment agreements with Steven G. Miller and Robert W. Miller that require us to use our best efforts to ensure that each of them continues to be a member of our board of directors. As a result, this concentration of ownership and representation on our board of directors may delay, prevent or deter a change in control, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of the company or its assets and might reduce the market price of our common stock.

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;

Table of Contents

- 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 credit facility are based on variable rates. If the LIBOR rate were to increase 1.0% in 2003 as compared to the rate at September 28, 2003, our interest expense for 2003 would increase \$0.3 million based on the outstanding balance of our credit facility at September 28, 2003. We do not hold any derivative instruments and do not engage in hedging activities.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that (1) information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified by the Securities and Exchange Commission and (2) this information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Under the supervision and review of our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as of September 28, 2003. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective in alerting them in a timely manner to material information regarding us that is required to be included in our periodic reports. In addition, there have been no significant changes in our internal controls or in other factors that could

[Table of Contents](#)

significantly affect those controls since September 28, 2003, the date as of which our disclosure controls and procedures were last evaluated.

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are from time to time involved in routine litigation incidental to the conduct of our business. We regularly review all pending litigation matters in which we are involved and establish reserves deemed appropriate by management for such litigation matters. We believe no litigation currently pending against us will have a material adverse effect on our financial position or results of operations.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

On October 8, 2003, we filed a registration statement with the Securities and Exchange Commission to register for resale the 6,171,074 shares of our common stock owned by Green Equity Investors, L.P. The registration statement was declared effective on October 16, 2003. We have agreed to maintain the effectiveness of the registration statement for a period of 180 days unless the distribution of shares pursuant to the registration statement is completed prior to the end of that period.

On November 5, 2003, we announced that we will redeem \$35 million principal amount of our 10.875% senior notes due 2007, using funds available under our revolving credit facility. Following the redemption, which is scheduled to be completed in early December 2003, the outstanding balance of our 10.875% senior notes will be reduced to \$48.1 million from an original face amount of \$131 million when the notes were issued in November 1997.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit Number	Description of Document
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

[Table of Contents](#)

Exhibit Number	Description of Document
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

(b) Reports on Form 8-K

A Current Report on Form 8-K was filed on July 30, 2003 to report the issuance of a press release on July 30, 2003 announcing our financial information for the quarter ended June 29, 2003.

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: November 5, 2003

By: /s/ Steven G. Miller

Steven G. Miller
President and Chief Executive Officer

Date: November 5, 2003

By: /s/ Charles P. Kirk

Charles P. Kirk
Senior Vice President and
Chief Financial Officer
(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 quarterly 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 quarterly report;
 3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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)) for the registrant and we 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 quarterly report is being prepared;
 - b) 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
 - c) 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 financing 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: November 5, 2003

/s/ Steven G. Miller

Steven G. Miller
President and Chief Executive Officer

Exhibit 31.2

CERTIFICATIONS

I, Charles P. Kirk, Senior Vice President and Chief Financial 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 quarterly 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 quarterly report;
 3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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)) for the registrant and we 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 quarterly report is being prepared;
 - b) 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
 - c) 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 financing 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: November 5, 2003

/s/ Charles P. Kirk

Charles P. Kirk
Senior Vice President and Chief Financial Officer

SECTION 1350 CERTIFICATIONS

In connection with the Quarterly Report of Big 5 Sporting Goods Corporation (the "Company") on Form 10-Q for the period ending September 28, 2003 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 result of operations of the Company.

/s/ Steven G. Miller

Steven G. Miller
President and Chief Executive Officer
November 5, 2003

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.

SECTION 1350 CERTIFICATIONS

In connection with the Quarterly Report of Big 5 Sporting Goods Corporation (the "Company") on Form 10-Q for the period ending September 28, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Charles P. Kirk, Senior Vice President and Chief Financial 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 result of operations of the Company.

/s/ Charles P. Kirk

Charles P. Kirk
Senior Vice President and Chief Financial Officer
November 5, 2003

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.