

AMERICAN EAGLE OUTFITTERS INC
Form 10-Q
August 24, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 29, 2017

OR

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

Commission File Number: 1-33338

American Eagle Outfitters, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	No. 13-2721761 (I.R.S. Employer Identification No.)
77 Hot Metal Street, Pittsburgh, PA (Address of principal executive offices)	15203-2329 (Zip Code)

Registrant's telephone number, including area code: (412) 432-3300

Former name, former address and former fiscal year, if changed since last report:

N/A

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 177,048,991 Common Shares were outstanding at August 21, 2017.

AMERICAN EAGLE OUTFITTERS, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)	July 29, 2017 (Unaudited)	January 28, 2017	July 30, 2016 (Unaudited)
Assets			
Current assets:			
Cash and cash equivalents	\$ 192,558	\$ 378,613	\$ 247,934
Merchandise inventory	433,458	358,446	422,151
Accounts receivable	80,673	86,634	65,282
Prepaid expenses and other	110,496	77,536	90,852
Total current assets	817,185	901,229	826,219
Property and equipment, at cost, net of accumulated depreciation	719,127	707,797	700,270
Intangible assets, at cost, net of accumulated amortization	47,520	49,373	50,761
Goodwill	15,069	14,887	17,399
Non-current deferred income taxes	28,761	49,250	44,370
Other assets	58,661	60,124	54,169
Total assets	\$ 1,686,323	\$ 1,782,660	\$ 1,693,188
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable	\$ 275,479	\$ 246,204	\$ 286,691
Accrued compensation and payroll taxes	22,708	54,184	35,908
Accrued rent	78,697	78,619	78,621
Accrued income and other taxes	13,289	12,220	10,250
Unredeemed gift cards and gift certificates	32,573	52,966	31,532
Current portion of deferred lease credits	12,838	12,780	12,810
Other liabilities and accrued expenses	36,398	36,810	42,719
Total current liabilities	471,982	493,783	498,531
Non-current liabilities:			
Deferred lease credits	53,620	45,114	51,100
Non-current accrued income taxes	4,786	4,537	4,795
Other non-current liabilities	31,636	34,657	38,365
Total non-current liabilities	90,042	84,308	94,260
Commitments and contingencies	—	—	—
Stockholders' equity:			
Preferred stock, \$0.01 par value; 5,000 shares authorized; none	—	—	—

issued and outstanding

Common stock, \$0.01 par value; 600,000 shares authorized;

249,566 shares issued; 176,965, 181,886 and 180,907 shares

outstanding, respectively	2,496	2,496	2,496
Contributed capital	586,844	603,890	591,532
Accumulated other comprehensive loss	(30,121)	(36,462)	(29,356)
Retained earnings	1,772,233	1,775,775	1,693,371
Treasury stock, 72,601, 67,680 and 68,659 shares, respectively	(1,207,153)	(1,141,130)	(1,157,646)
Total stockholders' equity	1,124,299	1,204,569	1,100,397
Total liabilities and stockholders' equity	\$1,686,323	\$1,782,660	\$1,693,188

Refer to Notes to Consolidated Financial Statements

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Unaudited)

(In thousands, except per share amounts)	13 Weeks Ended		26 Weeks Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Total net revenue	\$844,557	\$822,594	\$1,606,393	\$1,572,010
Cost of sales, including certain buying, occupancy and warehousing expenses	551,908	515,499	1,035,922	971,463
Gross profit	292,649	307,095	570,471	600,547
Selling, general and administrative expenses	203,717	199,536	398,696	395,529
Restructuring charges	9,746	—	15,193	—
Depreciation and amortization expense	40,283	38,900	80,730	77,683
Operating income	38,903	68,659	75,852	127,335
Other (expense) income, net	(6,734)	(3,134)	(6,330)	1,801
Income before income taxes	32,169	65,525	69,522	129,136
Provision for income taxes	10,933	23,933	23,050	47,068
Net income	\$21,236	\$41,592	\$46,472	\$82,068
Net income per basic share	\$0.12	\$0.23	\$0.26	\$0.45
Net income per diluted share	\$0.12	\$0.23	\$0.26	\$0.45
Cash dividends per common share	\$0.125	\$0.125	\$0.250	\$0.250
Weighted average common shares outstanding - basic	177,228	181,048	178,475	180,872
Weighted average common shares outstanding - diluted	178,788	183,413	180,473	182,922
Retained earnings, beginning	\$1,774,315	\$1,675,031	\$1,775,775	\$1,659,267
Net income	21,236	41,592	46,472	82,068
Cash dividends and dividend equivalents	(22,783)	(23,246)	(45,385)	(46,405)
Reissuance of treasury stock	(535)	(6)	(4,629)	(1,559)
Retained earnings, ending	\$1,772,233	\$1,693,371	\$1,772,233	\$1,693,371

Refer to Notes to Consolidated Financial Statements

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)	13 Weeks Ended		26 Weeks Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net income	\$21,236	\$41,592	\$46,472	\$82,068
Other comprehensive income:				
Foreign currency translation income (expense)	2,550	(4,873)	6,341	511
Other comprehensive income (expense):	2,550	(4,873)	6,341	511
Comprehensive income	\$23,786	\$36,719	\$52,813	\$82,579

Refer to Notes to Consolidated Financial Statements

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	26 Weeks Ended	
	July 29, 2017	July 30, 2016
Operating activities:		
Net income	\$46,472	\$82,068
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	81,697	78,142
Share-based compensation	9,798	16,748
Deferred income taxes	20,423	20,262
Foreign currency transaction gain	(5,354)	(2,268)
Changes in assets and liabilities:		
Merchandise inventory	(70,979)	(115,371)
Accounts receivable	5,979	14,081
Prepaid expenses and other	(32,409)	(13,360)
Other assets	(96)	(3,482)
Accounts payable	28,055	92,027
Unredeemed gift cards and gift certificates	(20,598)	(16,953)
Deferred lease credits	8,251	718
Accrued compensation and payroll taxes	(30,387)	(42,796)
Accrued income and other taxes	1,884	(12,020)
Accrued liabilities	10,484	3,570
Total adjustments	6,748	19,298
Net cash provided by operating activities	53,220	101,366
Investing activities:		
Capital expenditures for property and equipment	(86,503)	(60,539)
Acquisition of intangible assets	(188)	(1,034)
Net cash used for investing activities	(86,691)	(61,573)
Financing activities:		
Payments on capital leases	(7,188)	(3,902)
Repurchase of common stock as part of publicly announced programs	(87,682)	—
Repurchase of common stock from employees	(12,035)	(6,868)
Net proceeds from stock options exercised	225	1,905
Excess tax benefit from share-based payments	—	486
Cash dividends paid	(44,251)	(45,213)
Net cash used for financing activities	(150,931)	(53,592)
Effect of exchange rates changes on cash	(1,653)	1,666
Net decrease in cash and cash equivalents	(186,055)	(12,133)
Cash and cash equivalents - beginning of period	378,613	260,067
Cash and cash equivalents - end of period	\$192,558	\$247,934
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	\$32,786	\$63,631
Cash paid during the period for interest	\$539	\$610

Refer to Notes to Consolidated Financial Statements

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AMERICAN EAGLE OUTFITTERS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Interim Financial Statements

The accompanying Consolidated Financial Statements of American Eagle Outfitters, Inc. (the “Company”) at July 29, 2017 and July 30, 2016 and for the 13 and 26 week periods ended July 29, 2017 and July 30, 2016 have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Certain notes and other information have been condensed or omitted from the interim Consolidated Financial Statements presented in this Quarterly Report on Form 10-Q. Therefore, these Consolidated Financial Statements should be read in conjunction with the Company’s Fiscal 2016 Annual Report. In the opinion of the Company’s management, all adjustments (consisting of normal recurring adjustments and those described in the footnotes that follow) considered necessary for a fair presentation have been included. The existence of subsequent events has been evaluated through the filing date of this Quarterly Report on Form 10-Q.

As used in this report, all references to “we,” “our” and the “Company” refer to American Eagle Outfitters, Inc. and its wholly owned subsidiaries. “American Eagle Outfitters,” “American Eagle,” “AEO” and the “AE Brand” refer to our American Eagle Outfitters stores. “Aerie” refers to our Aerie[®] by American Eagle[®] stores. “AEO Direct” refers to our e-commerce operations, www.ae.com and www.aerie.com. “Tailgate” refers to our Tailgate brand of vintage, sports-inspired apparel. “Todd Snyder” refers to our Todd Snyder New York premium menswear brand.

Our business is affected by the pattern of seasonality common to most retail apparel businesses. Historically, a large portion of total net revenue and operating income occurs in the third and fourth fiscal quarters, reflecting the increased demand during the back-to-school and year-end holiday selling seasons, respectively. The results for the current and prior periods are not necessarily indicative of future financial results.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. At July 29, 2017, the Company operated in one reportable segment.

Fiscal Year

The Company’s financial year is a 52/53 week year that ends on the Saturday nearest to January 31. As used herein, “Fiscal 2017” refers to the 53 week period ending February 3, 2018. “Fiscal 2016” refers to the 52 week period ended January 28, 2017.

Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of our contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, our management reviews the Company's estimates based on currently available information. Changes in facts and circumstances may result in revised estimates.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). ASU 2014-09 is a comprehensive new revenue recognition model that expands disclosure requirements and requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. Originally, ASU 2014-09 was effective for annual reporting periods beginning after December 15, 2016. In July 2015, the FASB voted to approve amendments deferring the effective date by one year to be effective for annual reporting periods beginning after December 15, 2017. Accordingly, the Company will adopt ASU 2014-09 on February 4, 2018. The Company does not expect a material impact of the adoption of this guidance on its Consolidated Financial Statements, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, Leases (“ASU 2016-02”) which replaces the existing guidance in ASC 840, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years and requires retrospective application. The Company will adopt in Fiscal 2019 and is currently evaluating the impact of ASU 2016-02 to its Consolidated Financial Statements, but expects that it will result in a significant increase to its long-term assets and liabilities on the Consolidated Balance Sheets.

In March 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718) (“ASU 2016-09”). ASU 2016-09 makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016. The Company adopted ASU 2016-09 prospectively on January 29, 2017 and it did not have a material impact to the Consolidated Financial Statements for the 13 or 26 weeks ended July 29, 2017.

Foreign Currency Translation

In accordance with Accounting Standards Codification (“ASC”) 830, Foreign Currency Matters, assets and liabilities denominated in foreign currencies were translated into United States dollars (“USD”) (the reporting currency) at the exchange rates prevailing at the balance sheet date. Revenues and expenses denominated in foreign currencies were translated into USD at the monthly average exchange rates for the period. Gains or losses resulting from foreign currency transactions are included in the results of operations, whereas, related translation adjustments are reported as an element of other comprehensive income in accordance with ASC 220, Comprehensive Income.

Revenue Recognition

Revenue is recorded for store sales upon the purchase of merchandise by customers. The Company’s e-commerce operation records revenue upon the estimated customer receipt date of the merchandise. Shipping and handling revenues are included in total net revenue. Sales tax collected from customers is excluded from revenue and is included as part of accrued income and other taxes on the Company’s Consolidated Balance Sheets.

Revenue is recorded net of estimated and actual sales returns and promotional price reductions. The Company records the impact of adjustments to its sales return reserve quarterly within total net revenue and cost of sales. The sales return reserve reflects an estimate of sales returns based on projected merchandise returns determined through the use of historical average return percentages.

Revenue is not recorded on the issuance of gift cards. A current liability is recorded upon issuance, and revenue is recognized when the gift card is redeemed for merchandise. Additionally, the Company recognizes revenue on unredeemed gift cards based on an estimate of the amounts that will not be redeemed (“gift card breakage”), determined through historical redemption trends. Gift card breakage revenue is recognized in proportion to actual gift card redemptions as a component of total net revenue. For further information on the Company’s gift card program, refer to the Gift Cards caption below.

The Company recognizes royalty revenue generated from its licensee or franchise agreements based on a percentage of merchandise sales by the licensee/franchisee. This revenue is recorded as a component of total net revenue when earned.

Cost of Sales, Including Certain Buying, Occupancy and Warehousing Expenses

Cost of sales consists of merchandise costs, including design, sourcing, importing and inbound freight costs, as well as markdowns, shrinkage and certain promotional costs (collectively “merchandise costs”) and buying, occupancy and warehousing costs.

Design costs are related to the Company's Design Center operations and include compensation, travel and entertainment, supplies and samples for our design teams, as well as rent and depreciation for our Design Center. These costs are included in cost of sales as the respective inventory is sold.

Buying, occupancy and warehousing costs consist of compensation, employee benefit expenses and travel and entertainment for our buyers and certain senior merchandising executives; rent and utilities related to our stores, corporate headquarters, distribution centers and other office space; freight from our distribution centers to the stores; compensation and supplies for our distribution centers, including purchasing, receiving and inspection costs; and shipping and handling costs related to our e-commerce operation. Gross profit is the difference between total net revenue and cost of sales.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of compensation and employee benefit expenses, including salaries, incentives and related benefits associated with our stores and corporate headquarters. Selling, general and administrative expenses also include advertising costs, supplies for our stores and home office, communication costs, travel and entertainment, leasing costs and services purchased. Selling, general and administrative expenses do not include compensation, employee benefit expenses and travel for our design, sourcing and importing teams, our buyers and our distribution centers as these amounts are recorded in cost of sales. Additionally, selling, general and administrative expenses do not include rent and utilities related to our stores, operating costs of our distribution centers, and shipping and handling costs related to our e-commerce operations.

Other (Expense) Income, Net

Other (expense) income, net consists primarily of foreign currency transaction gain/loss, interest income/expense and realized investment gains/losses.

Cash and Cash Equivalents and Investments

The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

As of July 29, 2017 and July 30, 2016, the Company held no investments.

Refer to Note 3 to the Consolidated Financial Statements for information regarding cash and cash equivalents investments.

Merchandise Inventory

Merchandise inventory is valued at the lower of average cost or market, utilizing the retail method. Average cost includes merchandise design and sourcing costs and related expenses. The Company records merchandise receipts when both title and risk of loss for the merchandise have transferred to the Company.

The Company reviews its inventory levels to identify slow-moving merchandise and generally uses markdowns to clear merchandise. Additionally, the Company estimates a markdown reserve for future planned permanent

markdowns related to current inventory. Markdowns may occur when inventory exceeds customer demand for reasons of style, seasonal adaptation, changes in customer preference, lack of consumer acceptance of fashion items, competition, or if it is determined that the inventory in stock will not sell at its currently ticketed price. Such markdowns may have a material adverse impact on earnings, depending on the extent and amount of inventory affected. The Company also estimates a shrinkage reserve for the period between the last physical count and the balance sheet date. The estimate for the shrinkage reserve, based on historical results, can be affected by changes in merchandise mix and changes in actual shrinkage trends.

Income Taxes

The Company calculates income taxes in accordance with ASC 740, Income Taxes (“ASC 740”), which requires the use of the asset and liability method. Under this method, deferred tax assets and liabilities are recognized based on the difference between the Consolidated Financial Statement carrying amounts of existing assets and liabilities and their respective tax bases as computed pursuant to ASC 740. Deferred tax assets and liabilities are measured using the tax rates, based on certain judgments regarding enacted tax laws and published guidance, in effect in the years when those temporary differences are expected to reverse. A valuation allowance is established against the deferred tax assets when it is more likely than not that some portion or all of the deferred taxes may not be realized. Changes in the Company’s level and composition of earnings, tax laws or the deferred tax valuation allowance, as well as the results of tax audits may materially impact the Company’s effective income tax rate.

The Company evaluates its income tax positions in accordance with ASC 740, which prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return, including a decision whether to file or not to file in a particular jurisdiction. Under ASC 740, a tax benefit from an uncertain position may be recognized only if it is “more likely than not” that the position is sustainable based on its technical merits.

The calculation of the deferred tax assets and liabilities, as well as the decision to recognize a tax benefit from an uncertain position and to establish a valuation allowance require management to make estimates and assumptions. The Company believes that its assumptions and estimates are reasonable, although actual results may have a positive or negative material impact on the balances of deferred tax assets and liabilities, valuation allowances or net income.

Refer to Note 10 to the Consolidated Financial Statements for additional information regarding income taxes.

Property and Equipment

Property and equipment is recorded on the basis of cost, including costs to prepare the asset for use, with depreciation computed utilizing the straight-line method over the assets’ estimated useful lives. The useful lives of our major classes of assets are as follows:

Buildings	25 years
Leasehold improvements	Lesser of 10 years or the term of the lease
Fixtures and equipment	5 years

Information technology 3-5 years

As of July 29, 2017, the weighted average remaining useful life of our assets is approximately 8.3 years.

In accordance with ASC 360, Property, Plant, and Equipment (“ASC 360”), the Company evaluates long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified, for stores that have been open for a period of time sufficient to reach maturity. Impairment losses are recorded on long-lived assets used in operations when events and circumstances indicate that the assets are impaired and the undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. When events such as these occur, the impaired assets are adjusted to their estimated fair value and an impairment loss is recorded. No long-lived asset impairment charges were recorded during the 13 or 26 weeks ended July 29, 2017 or July 30, 2016.

Refer to Note 6 to the Consolidated Financial Statements for additional information regarding property and equipment.

Goodwill

The Company's goodwill is primarily related to the acquisition of its importing operations, Canada business, Tailgate and Todd Snyder brands, and Hong Kong and China businesses. In accordance with ASC 350, Intangibles – Goodwill and Other (“ASC 350”), the Company evaluates goodwill for possible impairment on at least an annual basis and last performed an annual impairment test as of January 28, 2017. During the fourth quarter of Fiscal 2016, the goodwill was fully impaired for the Hong Kong and China businesses. All other goodwill for the Company was not impaired as a result of the annual impairment test.

Intangible Assets

Intangible assets are recorded on the basis of cost with amortization computed utilizing the straight-line method over the assets' estimated useful lives. The Company's intangible assets, which consists of trademark assets, are generally amortized over 15 to 25 years.

The Company evaluates intangible assets for impairment in accordance with ASC 350 when events or circumstances indicate that the carrying value of the asset may not be recoverable. Such an evaluation includes the estimation of undiscounted future cash flows to be generated by those assets. If the sum of the estimated future undiscounted cash flows are less than the carrying amounts of the assets, then the assets are impaired and are adjusted to their estimated fair value. No intangible asset impairment charges were recorded during the 13 or 26 weeks ended July 29, 2017 or July 30, 2016.

Refer to Note 7 to the Consolidated Financial Statements for additional information regarding intangible assets.

Gift Cards

The value of a gift card is recorded as a current liability upon issuance, and revenue is recognized when the gift card is redeemed for merchandise. The Company estimates gift card breakage and recognizes revenue in proportion to actual gift card redemptions as a component of total net revenue. The Company determines an estimated gift card breakage rate by continuously evaluating historical redemption data and the time when there is a remote likelihood that a gift card will be redeemed. The Company recorded \$2.0 million and \$1.7 million of revenue related to gift card breakage during the 13 weeks ended July 29, 2017 and July 30, 2016, respectively. During the 26 weeks ended July 29, 2017 and July 30, 2016, the Company recorded \$4.5 and \$3.8 million, respectively, of revenue related to gift card breakage.

Deferred Lease Credits

Deferred lease credits represent the unamortized portion of construction allowances received from landlords related to the Company's retail stores. Construction allowances are generally comprised of cash amounts received by the Company from its landlords as part of the negotiated lease terms. The Company records a receivable and a deferred lease credit liability at the lease commencement date (date of initial possession of the store). The deferred lease credit is amortized on a straight-line basis as a reduction of rent expense over the term of the original lease (including the pre-opening build-out period). The receivable is reduced as amounts are received from the landlord.

Co-branded Credit Card

The Company offers a co-branded credit card (the "AEO Visa Card") and a private label credit card (the "AEO Credit Card") under the AEO and Aerie brands. These credit cards are issued by a third-party bank (the "Bank") in accordance with a credit card agreement ("the Agreement"). The Company has no liability to the Bank for bad debt expense, provided that purchases are made in accordance with the Bank's procedures. We receive funding from the Bank based on the Agreement and card activity, which includes payments for new account activations and usage of the AEO credit card. We recognize revenue for this funding when the amounts are fixed or determinable and collectability is reasonably assured. This revenue is recorded in other revenue, which is a component of total net revenue in our Consolidated Statements of Operations and Retained Earnings.

Once a customer is approved to receive the AEO Visa Card or the AEO Credit Card and the card is activated, the customer is eligible to participate in the credit card rewards program. Customers who make purchases at AEO and Aerie earn discounts in the form of savings certificates when certain purchase levels are reached. Also, AEO Visa Card customers who make purchases at other retailers where the card is accepted earn additional discounts. Savings certificates are valid for 90 days from issuance.

Points earned under the credit card rewards program on purchases at AEO and Aerie are accounted for by analogy to ASC 605-25, Revenue Recognition, Multiple Element Arrangements (“ASC 605-25”). The Company believes that points earned under its point and loyalty programs represent deliverables in a multiple element arrangement rather than a rebate or refund of cash. Accordingly, the portion of the sales revenue attributed to the award points is deferred and recognized when the award is redeemed or when the points expire. Additionally, credit card reward points earned on non-AEO or Aerie purchases are accounted for in accordance with ASC 605-25. As the points are earned, a current liability is recorded for the estimated cost of the award, and the impact of adjustments is recorded in cost of sales.

Customer Loyalty Program

The Company offers its customers the AEREWARDS® loyalty program (the “Program”). Under the Program, customers accumulate points based on purchase activity and earn rewards by reaching certain point thresholds during three-month earning periods. Rewards earned during these periods are valid through the stated expiration date, which is approximately one month from the mailing date of the reward. These rewards can be redeemed for a discount on a purchase of merchandise. Rewards not redeemed during the one-month redemption period are forfeited. The Company determined that rewards earned using the Program should be accounted for in accordance with ASC 605-25. Accordingly, the portion of the sales revenue attributed to the award credits is deferred and recognized when the awards are redeemed or expire.

The Company is currently piloting a new customer loyalty program, which we expect to launch late in 2017. This new program will integrate the current credit card rewards program and the AEREWARDS® loyalty program into one combined customer offering. Under this new program, customers will earn discounts in the form of savings certificates, which will be accounted for in accordance with ASC 605-25.

Segment Information

In accordance with ASC 280, Segment Reporting (“ASC 280”), the Company has identified two operating segments (American Eagle Outfitters Brand and Aerie by American Eagle Outfitters Brand) that reflect the basis used internally to review performance and allocate resources. All operating segments have been aggregated and are presented as one reportable segment, as permitted by ASC 280.

3. Cash and Cash Equivalents and Investments

The following table summarizes the fair market values for the Company’s cash and marketable securities, which are recorded on the Consolidated Balance Sheets:

	July 29,	January	July 30,
(In thousands)	2017	2017	2016
Cash and cash equivalents:			
Cash	\$162,763	\$265,332	\$173,921
Interest bearing deposits	29,795	83,281	74,013
Commercial paper	—	30,000	—
Total cash and cash equivalents	\$192,558	\$378,613	\$247,934

There were no sales or purchases of investments for the 13 and 26 weeks ended July 29, 2017 and July 30, 2016.

4. Fair Value Measurements

ASC 820, Fair Value Measurement Disclosures (“ASC 820”), defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. Fair value is defined under ASC 820 as the exit price associated with the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date.

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Financial Instruments

Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. In addition, ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

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

Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Unobservable inputs (i.e., projections, estimates, interpretations, etc.) that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of July 29, 2017 and July 30, 2016, the Company held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents.

In accordance with ASC 820, the following table represents the Company's fair value hierarchy for its financial assets (cash equivalents) measured at fair value on a recurring basis at July 29, 2017 and July 30, 2016:

Fair Value Measurements at July 29, 2017				
Quoted Market				
Prices in Active				
Markets for				
Identical		Significant Other	Significant	
Assets		Observable Inputs	Unobservable	
		Inputs	Inputs	
(In thousands)	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
Cash and cash equivalents:				
Cash	\$ 162,763	\$ 162,763	—	—
Interest bearing deposits	29,795	29,795	—	—
Total cash and cash equivalents	\$ 192,558	\$ 192,558	—	—

Fair Value Measurements at July 30, 2016				
Quoted Market				
Prices in Active				
Markets for				
Identical		Significant Other	Significant	
Assets		Observable Inputs	Unobservable	
		Inputs	Inputs	
(In thousands)	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
Cash and cash equivalents:				

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Cash	\$ 173,921	\$ 173,921	—	—
Interest bearing deposits	74,013	74,013	—	—
Total cash and cash equivalents	\$ 247,934	\$ 247,934	\$ —	\$ —

In the event the Company holds Level 3 investments, a discounted cash flow model is used to value those investments. There were no Level 3 investments at July 29, 2017 or July 30, 2016.

Non-Financial Assets

The Company's non-financial assets, which include goodwill, intangible assets and property and equipment, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur, or if an annual impairment test is required, and the Company is required to evaluate the non-financial instrument for impairment, a resulting asset impairment would require that the non-financial asset be recorded at the estimated fair value.

5. Earnings per Share

The following is a reconciliation between basic and diluted weighted average shares outstanding:

13
Weeks
Ended