

AMERICAN EAGLE OUTFITTERS INC

Form 10-Q

November 30, 2011

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended October 29, 2011**

**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)**



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<p><b>Delaware</b> (State or other jurisdiction of  incorporation or organization)</p> <p><b>77 Hot Metal Street, Pittsburgh, PA</b> (Address of principal executive offices)</p> <p><b>Registrant's telephone number, including area code: (412) 432-3300</b></p>	<p><b>No. 13-2721761</b> (I.R.S. Employer  Identification No.)</p> <p><b>15203-2329</b> (Zip Code)</p>
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**Former name, former address and former fiscal year, if changed since last report:**

N/A

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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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: 193,746,676 Common Shares were outstanding at November 28, 2011.



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**Table of Contents****PART I- FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS.****AMERICAN EAGLE OUTFITTERS, INC.****CONSOLIDATED BALANCE SHEETS**

<i>(In thousands, except per share amounts)</i>	October 29, 2011 (Unaudited)	January 29, 2011	October 30, 2010 (Unaudited)
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ 380,284	\$ 667,593	\$ 630,775
Short-term investments	101,036	67,102	3,700
Merchandise inventory	571,751	301,208	409,509
Accounts receivable	41,138	36,721	40,346
Prepaid expenses and other	64,378	53,727	52,757
Deferred income taxes	47,254	48,059	50,910
Total current assets	1,205,841	1,174,410	1,187,997
Property and equipment, at cost, net of accumulated depreciation	629,486	643,120	652,361
Intangible assets, at cost, net of accumulated amortization	40,088	7,485	6,694
Goodwill	11,511	11,472	11,395
Long-term investments	648	5,915	5,915
Non-current deferred income taxes	8,833	19,616	27,475
Other assets	14,045	17,980	17,287
Total assets	\$ 1,910,452	\$ 1,879,998	\$ 1,909,124
<b>Liabilities and Stockholders' Equity</b>			
Current liabilities:			
Accounts payable	\$ 222,894	\$ 167,723	\$ 196,504
Accrued compensation and payroll taxes	18,677	34,954	30,289
Accrued rent	74,888	70,390	71,133
Accrued income and other taxes	19,552	32,468	11,620
Unredeemed gift cards and gift certificates	22,456	41,001	20,266
Current portion of deferred lease credits	15,512	16,203	16,465
Other liabilities and accrued expenses	22,570	25,098	21,285
Total current liabilities	396,549	387,837	367,562
Non-current liabilities:			
Deferred lease credits	74,981	78,606	81,730
Non-current accrued income taxes	38,527	38,671	36,302
Other non-current liabilities	17,853	23,813	22,246
Total non-current liabilities	131,361	141,090	140,278
Commitments and contingencies			
Stockholders' equity:			
Preferred stock, \$0.01 par value; 5,000 shares authorized; none issued and outstanding	2,496	2,496	2,496



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Common stock, \$0.01 par value; 600,000 shares authorized; 249,566, 249,566 and 249,559 shares issued; 193,553, 194,366 and 195,683 shares outstanding, respectively			
Contributed capital	550,110	546,597	543,265
Accumulated other comprehensive income	29,174	28,072	26,751
Retained earnings	1,744,280	1,711,929	1,745,912
Treasury stock, 56,013, 55,200 and 53,876 shares, respectively	(943,518)	(938,023)	(917,140)
Total stockholders' equity	1,382,542	1,351,071	1,401,284
Total liabilities and stockholders' equity	\$ 1,910,452	\$ 1,879,998	\$ 1,909,124

Refer to Notes to Consolidated Financial Statements



**Table of Contents****AMERICAN EAGLE OUTFITTERS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS****(Unaudited)**

	13 Weeks Ended		39 Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
<i>(In thousands, except per share amounts)</i>				
Net sales	\$ 831,826	\$ 751,507	\$ 2,117,091	\$ 2,051,471
Cost of sales, including certain buying, occupancy and warehousing expenses	522,859	439,198	1,344,302	1,241,758
Gross profit	308,967	312,309	772,789	809,713
Selling, general and administrative expenses	190,583	185,050	516,173	519,188
Depreciation and amortization expense	35,199	35,804	105,754	107,378
Operating income	83,185	91,455	150,862	183,147
Realized loss on sale of investments		(24,201)		(24,426)
Other (expense) income, net	(407)	1,986	5,536	1,222
Income before income taxes	82,778	69,240	156,398	159,943
Provision for income taxes	30,351	36,049	55,977	65,047
Income from continuing operations	52,427	33,191	100,421	94,896
Loss from discontinued operations, net of tax		(167)		(41,287)
Net income	\$ 52,427	\$ 33,024	\$ 100,421	\$ 53,609
Basic income per common share:				
Income from continuing operations	\$ 0.27	\$ 0.17	\$ 0.52	\$ 0.47
Loss from discontinued operations	\$ 0.00	\$ 0.00	\$ 0.00	(\$ 0.20)
Basic net income per common share	\$ 0.27	\$ 0.17	\$ 0.52	\$ 0.27
Diluted income per common share:				
Income from continuing operations	\$ 0.27	\$ 0.17	\$ 0.51	\$ 0.46
Loss from discontinued operations	\$ 0.00	\$ 0.00	\$ 0.00	(\$ 0.20)
Diluted net income per common share	\$ 0.27	\$ 0.17	\$ 0.51	\$ 0.26
Cash dividends per common share	\$ 0.11	\$ 0.11	\$ 0.33	\$ 0.32
Weighted average common shares outstanding - basic	194,378	195,590	194,659	201,678
Weighted average common shares outstanding - diluted	195,985	197,323	196,430	203,539
Retained earnings, beginning	\$ 1,713,778	\$ 1,735,503	\$ 1,711,929	\$ 1,764,049
Net income	52,427	33,024	100,421	53,609
Cash dividends and dividend equivalents	(21,817)	(21,697)	(65,419)	(65,214)
Reissuance of treasury stock	(108)	(918)	(2,651)	(6,532)
Retained earnings, ending	\$ 1,744,280	\$ 1,745,912	\$ 1,744,280	\$ 1,745,912

Refer to Notes to Consolidated Financial Statements







**Table of Contents****AMERICAN EAGLE OUTFITTERS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	39 Weeks Ended	
	October 29, 2011	October 30, 2010
<i>(In thousands)</i>		
<b>Operating activities:</b>		
Net income	\$ 100,421	\$ 53,609
Loss from discontinued operations		41,287
Income from continuing operations	100,421	94,896
<b>Adjustments to reconcile income from continuing operations to net cash from operating activities:</b>		
Depreciation and amortization	107,694	110,247
Share-based compensation	9,065	21,929
Provision for deferred income taxes	11,253	5,222
Tax benefit from share-based payments	293	12,848
Excess tax benefit from share-based payments	(152)	(4,265)
Foreign currency transaction (gain) loss	(277)	44
Net impairment loss recognized in earnings		1,248
Realized loss on sale of investment securities		24,426
<b>Changes in assets and liabilities:</b>		
Merchandise inventory	(270,538)	(89,988)
Accounts receivable	(4,426)	(7,454)
Prepaid expenses and other	(10,627)	(4,879)
Other assets	3,935	(677)
Accounts payable	60,033	40,326
Unredeemed gift cards and gift certificates	(18,609)	(18,916)
Deferred lease credits	(4,354)	(2,868)
Accrued compensation and payroll taxes	(16,297)	(24,379)
Accrued income and other taxes	(13,036)	(13,647)
Accrued liabilities	(2,461)	2,336
<b>Total adjustments</b>	<b>(148,504)</b>	<b>51,553</b>
<b>Net cash (used for) provided by operating activities from continuing operations</b>	<b>(48,083)</b>	<b>146,449</b>
<b>Investing activities:</b>		
Capital expenditures for property and equipment	(96,745)	(65,363)
Acquisition of intangible assets	(33,886)	(1,849)
Purchase of available-for-sale securities	(186,328)	
Sale of available-for-sale securities	157,994	177,472
<b>Net cash (used for) provided by investing activities from continuing operations</b>	<b>(158,965)</b>	<b>110,260</b>
<b>Financing activities:</b>		
Payments on capital leases	(2,343)	(1,774)
Repayment of note payable		(30,000)
Repurchase of common stock as part of publicly announced programs	(15,160)	(192,268)
Repurchase of common stock from employees	(2,189)	(18,024)
Net proceeds from stock options exercised	2,680	5,762
Excess tax benefit from share-based payments	152	4,265
Cash used to net settle equity awards		(6,434)
Cash dividends paid	(64,273)	(64,659)



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<b>Net cash used for financing activities from continuing operations</b>	<b>(81,133)</b>	<b>(303,132)</b>
Effect of exchange rates changes on cash	872	1,553
Cash flows of discontinued operations		
Net cash used for operating activities		(18,309)
Net cash used for investing activities		(6)
Net cash used for financing activities		
Effect of exchange rates changes on cash		
<b>Net cash used for discontinued operations</b>		<b>(18,315)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(287,309)</b>	<b>(63,185)</b>
Cash and cash equivalents - beginning of period	667,593	693,960
Cash and cash equivalents - end of period	<b>\$ 380,284</b>	<b>\$ 630,775</b>
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	\$ 61,625	\$ 36,262
Cash paid during the period for interest	\$ 0	\$ 191

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 October 29, 2011 and October 30, 2010 and for the 13 and 39 week periods ended October 29, 2011 and October 30, 2010 have been prepared in accordance with accounting principles generally accepted 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 2010 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, AE and the AE Brand refer to our U.S. and Canadian American Eagle Outfitters stores. "aerie" refers to our U.S. and Canadian aerie® by American Eagle® stores. "77kids" refers to our 77kids by american eagle® stores. AEO Direct refers to our e-commerce operations, ae.com, aerie.com and 77kids.com. MARTIN+OSA or M+O refers to the MARTIN+OSA stores and e-commerce operation which we operated until its closure during the second quarter of Fiscal 2010.

The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. 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 October 29, 2011, the Company operated in one reportable segment.

On March 5, 2010, the Company's Board of Directors (the "Board") approved management's recommendation to proceed with the closure of the M+O brand. The Company completed the closure of the M+O stores and e-commerce operation during the second quarter of Fiscal 2010. These Consolidated Financial Statements reflect the results of M+O as a discontinued operation for all periods presented.

***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 2012" and "Fiscal 2011" refer to the 53 and 52 week periods ending February 2, 2013 and January 28, 2012, respectively. "Fiscal 2010" and "Fiscal 2009" refer to the 52 week periods ended January 29, 2011 and January 30, 2010, respectively.

***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 its estimates based on currently available information. Changes in facts and circumstances may result in revised estimates.



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### ***Recent Accounting Pronouncements***

In June 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-05, *Presentation of Comprehensive Income* ( ASU 2011-05 ). ASU 2011-05 requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income and the total of comprehensive income. For public entities, the amendments in ASU 2011-05 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and are to be applied retrospectively, with early adoption permitted. The Company is currently evaluating the impact of ASU 2011-05 on its financial statement presentation of comprehensive income.

In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment* ( ASU 2011-08 ). ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. ASU 2011-08 applies to all companies that have goodwill reported in their financial statements. The provisions of ASU 2011-08 are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company will adopt ASU 2011-08 in Fiscal 2012. As a result of the adoption, the Company does not expect an impact to its Consolidated Financial Statements.

### ***Foreign Currency Translation***

The Canadian dollar is the functional currency for the Canadian business. In accordance with Accounting Standards Codification ( ASC ) 830, *Foreign Currency Matters*, assets and liabilities denominated in foreign currencies were translated into U.S. dollars (the reporting currency) at the exchange rate prevailing at the balance sheet date. Revenues and expenses denominated in foreign currencies were translated into U.S. dollars at the monthly average exchange rate 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* (refer to Note 9 to the Consolidated Financial Statements).

### ***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 net sales. 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 deductions for coupon redemptions and other promotions. The Company records the impact of adjustments to its sales return reserve quarterly within net sales 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 purchase of gift cards. A current liability is recorded upon purchase, 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 net sales. For further information on the Company's gift card program, refer to the Gift Cards caption below.

The Company recognizes revenue generated from its franchise agreements based upon a percentage of merchandise sales by the franchisee. This revenue is recorded as a component of net sales when earned.

The Company sells off end-of-season, overstock and irregular merchandise to a third-party. The proceeds from these sales are presented on a gross basis, with proceeds and cost of sell-offs recorded in net sales and cost of sales, respectively.



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### ***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. Buying, occupancy and warehousing costs consist of compensation, employee benefit expenses and travel 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. Merchandise profit is the difference between net sales and merchandise costs. Gross profit is the difference between net sales 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.

### ***Other Income (Expense), Net***

Other income (expense), net consists primarily of interest income/expense, foreign currency transaction gain/loss and realized investment gains/losses other than those realized upon the sale of investment securities, which are recorded separately on the Consolidated Statements of Operations.

### ***Other-than-Temporary Impairment***

The Company evaluates its investments for impairment in accordance with ASC 320, *Investments – Debt and Equity Securities* (ASC 320). ASC 320 provides guidance for determining when an investment is considered impaired, whether impairment is other-than-temporary, and measurement of an impairment loss. An investment is considered impaired if the fair value of the investment is less than its cost. If, after consideration of all available evidence to evaluate the realizable value of its investment, impairment is determined to be other-than-temporary, then an impairment loss is recognized in the Consolidated Statement of Operations equal to the difference between the investment's cost and its fair value. Additionally, ASC 320 requires additional disclosures relating to debt and equity securities both in the interim and annual periods as well as requires the Company to present total other-than-temporary impairment (OTTI) with an offsetting reduction for any non-credit loss impairment amount recognized in other comprehensive income (OCI).

There was no net impairment loss recognized in earnings during the 39 weeks ended October 29, 2011. During the 39 weeks ended October 30, 2010, there was \$1.2 million of net impairment loss recognized in earnings which consisted of gross other-than-temporary losses of \$5.1 million, partially offset by \$3.9 million of OTTI losses recognized in other comprehensive income.

Refer to Note 4 to the Consolidated Financial Statements for additional information regarding net impairment losses.

### ***Cash and Cash Equivalents, Short-term Investments and Long-term Investments***

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

As of October 29, 2011, short-term investments included treasury bills, term deposits and corporate bonds purchased with a maturity of greater than three months, but less than one year. It also includes auction rate securities (ARS) classified as available for sale that the Company expects to be redeemed at par within 12 months.

As of October 29, 2011, long-term investments include the Company's ARS Call Option related to investment sales during Fiscal 2010. The ARS Call Option expires on October 29, 2013.

Unrealized gains and losses on the Company's available-for-sale securities are excluded from earnings and are reported as a separate component of stockholders' equity, within accumulated other comprehensive income, until realized. The components of OTTI losses related to credit losses,



as defined by ASC 320, are considered by the



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Company to be realized and are recorded in earnings. When available-for-sale securities are sold, the cost of the securities is specifically identified and is used to determine any realized gain or loss.

Refer to Note 3 to the Consolidated Financial Statements for information regarding cash and cash equivalents, short-term investments and long-term 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 at the time merchandise is delivered to the foreign shipping port by the manufacturer (FOB port). This is the point at which title and risk of loss transfer 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 our 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.

### ***Property and Equipment***

Property and equipment is recorded on the basis of cost 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

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 as the undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. When







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events such as these occur, the impaired assets are adjusted to their estimated fair value and an impairment loss is recognized within selling, general and administrative expenses on the Consolidated Statements of Operations.

No asset impairment charges were recorded during the 39 weeks ended October 29, 2011. Based on the Company's decision to close all M+O stores in Fiscal 2010, the Company determined that the stores not previously impaired would not be able to generate sufficient cash flow over the life of the related leases to recover the Company's initial investment in them and an impairment charge of \$18.0 million was recorded during the 39 weeks ended October 30, 2010. The asset impairment charges during Fiscal 2010 are recorded within Loss from Discontinued Operations on the Consolidated Statements of Operations.

Refer to Note 13 to the Consolidated Financial Statements for additional information regarding the discontinued operations of M+O.

### ***Goodwill***

The Company had approximately \$11.5 million of goodwill as of October 29, 2011 and as of January 29, 2011. The Company's goodwill is primarily related to the acquisition of its importing operations and Canadian business. The change in recorded goodwill is due to fluctuations in the foreign exchange spot rate at which the Canadian goodwill is translated. 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 29, 2011. As a result of the Company's annual goodwill impairment test, the Company concluded that its goodwill was not impaired.

### ***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 primarily include trademark assets, are 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 in either the 13 or 39 weeks ended October 29, 2011 and October 30, 2010.

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 purchase, 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 net sales. 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. During the 13 weeks ended October 29, 2011 and October 30, 2010, the Company recorded \$0.9 million and \$0.7 million, respectively, of revenue related to gift card breakage. During the 39 weeks ended October 29, 2011 and October 30, 2010, the Company recorded \$2.9 million and \$2.5 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) and any subsequent renewal terms. The receivable is reduced as amounts are received from the landlord.



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### ***Co-branded Credit Card and Customer Loyalty Program***

The Company offers a co-branded credit card (the AEO Visa Card ) and a private label credit card (the AEO Credit Card ) under the American Eagle, aerie and 77kids brands. These credit cards are issued by a third-party bank (the Bank ), and the Company has no liability to the Bank for bad debt expense, provided that purchases are made in accordance with the Bank's procedures. 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 AE, aerie and 77kids 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 AE, aerie and 77kids 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-AE, aerie or 77kids 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.

The Company offers its customers the AEREWARDS<sup>sm</sup> 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.

### ***Segment Information***

In accordance with ASC 280, *Segment Reporting* ( ASC 280 ), the Company has identified four operating segments (American Eagle Brand US and Canadian retail stores, aerie retail stores, 77kids retail stores and AEO Direct) that reflect the basis used internally to review performance and allocate resources. All of the operating segments have been aggregated and are presented as one reportable segment, as permitted by ASC 280.

### ***Reclassification***

Certain reclassifications have been made to the Consolidated Financial Statements for prior periods in order to conform to the current period presentation.



**Table of Contents****3. Cash and Cash Equivalents, Short-term Investments and Long-term Investments**

The following table summarizes the fair market values for the Company's cash and marketable securities, which are recorded as cash and cash equivalents, short-term investments and long-term investments on the Consolidated Balance Sheets:

<i>(In thousands)</i>	October 29, 2011	January 29, 2011	October 30, 2010
<b>Cash and cash equivalents:</b>			
Cash	\$ 325,152	\$ 122,578	\$ 157,921
Money-market	32,214	397,440	310,764
Treasury bills	22,918	102,996	100,393
Corporate bonds		3,695	
Commercial paper		40,884	61,697
<b>Total cash and cash equivalents</b>	<b>\$ 380,284</b>	<b>\$ 667,593</b>	<b>\$ 630,775</b>
<b>Short-term investments:</b>			
Treasury bills	\$ 76,078	\$	\$
Term-deposits	10,082	63,402	
Corporate bonds	9,376		
State and local government ARS	5,500	3,700	3,700
<b>Total short-term investments</b>	<b>\$ 101,036</b>	<b>\$ 67,102</b>	<b>\$ 3,700</b>
<b>Long-term investments:</b>			
ARS Call Option	\$ 648	\$ 415	\$ 415
State and local government ARS		5,500	5,500
<b>Total long-term investments</b>	<b>\$ 648</b>	<b>\$ 5,915</b>	<b>\$ 5,915</b>
<b>Total</b>	<b>\$ 481,968</b>	<b>\$ 740,610</b>	<b>\$ 640,390</b>

Proceeds from the sale of investments were \$158.0 million and \$177.5 million for the 39 weeks ended October 29, 2011 and October 30, 2010, respectively. The purchase of investments for the 39 weeks ended October 29, 2011 was \$186.3 million. There were no purchases of investments during the 39 weeks ended October 30, 2010. As of October 29, 2011 and October 30, 2010, the fair value of all ARS investments approximated par, with no gross unrealized holding losses.

During Fiscal 2010, the Company liquidated ARS investments with \$191.4 million of carrying value for proceeds of \$177.5 million and a realized loss of \$24.4 million (of which \$10.9 million had previously been included in OCI on the Company's Consolidated Balance Sheets). The ARS securities sold during Fiscal 2010 included \$119.7 million of par value ARS securities whereby the Company entered into a settlement agreement under which a financial institution (the "purchaser") purchased the ARS at a discount to par, plus accrued interest. Additionally, under this agreement, the Company retained a right (the "ARS Call Option"), for a period ending October 29, 2013 to: (a) repurchase any or all of the ARS securities sold at the agreed upon purchase prices received from the purchaser plus accrued interest; and/or (b) receive additional proceeds from the purchaser upon certain redemptions of the ARS securities sold. The ARS Call Option is cancelable by the purchaser for additional cash consideration.

The Company is required to assess the value of the ARS Call Option at the end of each reporting period, with any changes in fair value recorded within the Consolidated Statement of Operations. Upon origination, the Company determined that the fair value was \$0.4 million. The fair value of the ARS Call Option was included as an offsetting amount within the net loss on liquidation of \$24.4 million referenced above. As of October 29, 2011, the Company determined that the remaining value of the ARS Call Option, which is classified as a long-term investment on the Consolidated Balance Sheets, was \$0.6 million.

**4. Fair Value Measurements**



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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 October 29, 2011 and October 30, 2010, the Company held certain assets that are required to be measured at fair value on a recurring basis. These include cash equivalents and short and long-term investments, including ARS.

In accordance with ASC 820, the following table represents the Company's fair value hierarchy for its financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of October 29, 2011 and October 30, 2010:

	\$000,000,000	\$000,000,000	\$000,000,000	\$000,000,000
		Fair Value Measurements at October 29, 2011		
		Quoted Market		
		Prices in Active	Significant Other	Significant
		Markets for	Observable	Unobservable
		Identical Assets	Inputs	Inputs
(In thousands)	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
Cash and cash equivalents:				
Cash	\$ 325,152	\$ 325,152	\$	\$
Money-market	32,214	32,214		
Treasury bills	22,918	22,918		
Total cash and cash equivalents	\$ 380,284	\$ 380,284	\$	\$
Short-term investments:				
Treasury bills	\$ 76,078	\$ 76,078	\$	\$
Term-deposits	10,082	10,082		
Corporate bonds	9,376	9,376		
State and local government ARS	5,500			5,500
Total short-term investments	\$ 101,036	\$ 95,536	\$	\$ 5,500
Long-term investments:				
ARS Call Option	\$ 648	\$	\$	\$ 648
Total long-term investments	\$ 648	\$	\$	\$ 648
Total	\$ 481,968	\$ 475,820	\$	\$ 6,148







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		Fair Value Measurements at October 30, 2010		
		Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(In thousands)	Carrying Amount			
<b>Cash and cash equivalents:</b>				
Cash	\$ 157,921	\$ 157,921	\$	\$
Money-market	310,764	310,764		
Treasury bills	100,393	100,393		
Commercial paper	61,697	61,697		
Total cash and cash equivalents	\$ 630,775	\$ 630,775	\$	\$
<b>Short-term investments:</b>				
State and local government ARS	\$ 3,700	\$	\$	\$ 3,700
Total short-term investments	\$ 3,700	\$	\$	\$ 3,700
<b>Long-term investments:</b>				
State and local government ARS	\$ 5,500	\$	\$	\$ 5,500
ARS Call Option	415			415
Total long-term investments	\$ 5,915	\$	\$	\$ 5,915
Total	\$ 640,390	\$ 630,775	\$	\$ 9,615

The Company uses a discounted cash flow model to value its Level 3 investments. At October 29, 2011, the assumptions in the Company's model for Level 3 investments, excluding the ARS Call Option, included a recovery period of eight months, a discount factor for yield of 0.1% and illiquidity of 0.5%. At October 30, 2010, the assumptions in the Company's model included different recovery periods, ranging from eight months to 20 months depending on the type of security, varying discount factors for yield, ranging from 0.3% to 0.4%, and illiquidity of 0.5%. These assumptions are subjective. They are based on the Company's current judgment and its view of current market conditions. The use of different assumptions would result in a different valuation and related charge.

As a result of the discounted cash flow analysis, no impairment loss was recorded for the 13 or 39 weeks ended October 29, 2011. For the 39 weeks ended October 30, 2010, the Company recognized a net impairment loss of \$0.6 million (\$0.4 million, net of tax), which increased the total cumulative impairment recognized in OCI from \$10.3 million (\$6.4 million, net of tax) at the end of Fiscal 2009 to \$10.9 million (\$6.8 million, net of tax) prior to the Company's liquidation of auction rate securities during the 13 weeks ended October 30, 2010. Additionally, during the 39 weeks ended October 30, 2010, as a result of the credit downgrade on a student-loan backed ARS, the Company recorded an impairment loss in earnings of \$1.2 million, which is recorded within other expense on the Consolidated Statements of Operations.

As of October 29, 2011, the Company's Level 3 investments (unobservable inputs) included \$5.5 million of state and local government ARS and \$0.6 million for the ARS Call Option. The \$5.5 million of state and local government ARS are presented net of \$3.7 million of settlements that occurred during the 39 weeks ended October 29, 2011. Additionally, there was a \$0.2 million increase in the carrying value of the ARS Call Option reported in earnings during the 39 weeks ended October 29, 2011.

The reconciliation of the Company's assets measured at fair value on a recurring basis using unobservable inputs (Level 3) as of October 30, 2010 is as follows:



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(In thousands)	Total	Level 3 (Unobservable inputs)			
		Auction-Rate Municipal Securities	Student Loan- Backed Auction-Rate Securities	Auction-Rate Preferred Securities	ARS Call Option
Carrying value at January 30, 2010	\$ 202,448	\$ 40,244	\$ 149,431	\$ 12,773	\$
Settlements	(177,472)	(29,101)	(141,246)	(7,125)	
Gains and (losses):					
Reported in earnings	(25,674)	(2,399)	(16,755)	(6,935)	415
Reported in OCI	10,313	456	8,570	1,287	
Balance at October 30, 2010	\$ 9,615	\$ 9,200	\$	\$	\$ 415

**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. As a result of the Company's annual goodwill impairment test performed as of January 29, 2011, the Company concluded that its goodwill was not impaired. During the 13 and 39 weeks ended October 29, 2011, there were no triggering events that prompted an asset impairment test of the Company's goodwill.

Certain long-lived assets were measured at fair value on a non-recurring basis using Level 3 inputs as defined in ASC 820. Based on the decision to close all M+O stores in Fiscal 2010, the Company determined that the M+O stores not previously impaired would not be able to generate sufficient cash flow over the life of the related leases to recover the Company's initial investment in them. Therefore, during Fiscal 2010, the M+O stores not previously impaired were written down to their fair value, resulting in a loss on impairment of assets of \$18.0 million. The fair value of those stores were determined by estimating the amount and timing of net future cash flows and discounting them using a risk-adjusted rate of interest. The Company estimates future cash flows based on its experience and knowledge of the market in which the store is located.

Refer to Note 13 to the Consolidated Financial Statements for additional information regarding the discontinued operations of M+O.

**5. Earnings per Share**

ASC 260-10-45, *Participating Securities and the Two-Class Method* (ASC 260-10-45), addresses whether awards granted in unvested share-based payment transactions that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and therefore are included in computing earnings per share under the two-class method, as described in ASC 260, *Earnings Per Share* (ASC 260). Participating securities are securities that may participate in dividends with common stock and the two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that would otherwise have been available to common shareholders. Under the two-class method, earnings for the period are allocated between common shareholders and other shareholders, based on their respective rights to receive dividends. Restricted stock awards granted to certain employees under the Company's 2005 Stock Award and Incentive Plan (2005 Plan) are considered participating securities as these employees receive non-forfeitable dividends at the same rate as common stock. There were no participating securities outstanding during the 13 and 39 weeks ending October 29, 2011. During the 13 and 39 weeks ended October 30, 2010, the allocation of earnings to participating securities was not significant. The application of ASC 260-10-45 resulted in no change to basic or diluted income from continuing operations per common share for either the 13 or 39 weeks ended October 29, 2011 and October 30, 2010.



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

(In thousands)	13 Weeks Ended		39 Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
Weighted average common shares outstanding:				
Basic number of common shares outstanding	194,378	195,590	194,659	201,678
Dilutive effect of stock options and non-vested restricted stock	1,607	1,733	1,771	1,861
Diluted number of common shares outstanding	195,985	197,323	196,430	203,539

Equity awards to purchase approximately 7.6 million and 7.5 million shares of common stock during the 13 and 39 weeks ended October 29, 2011, respectively, and approximately 6.9 million and 7.9 million shares of common stock during the 13 and 39 weeks ended October 30, 2010, respectively, were outstanding, but were not included in the computation of weighted average diluted common share amounts as the effect of doing so would be anti-dilutive.

Approximately 1.9 million shares of restricted stock units for both the 13 and 39 weeks ended October 29, 2011 and approximately 0.8 million shares of restricted stock units for both the 13 and 39 weeks ended October 30, 2010 were not included in the computation of weighted average diluted common share amounts because the number of shares ultimately issued is contingent on the Company's performance compared to pre-established annual performance goals. Additionally, there were approximately 24,000 shares for the 13 weeks ended October 29, 2011 and 27,000 shares for the 39 weeks ended October 30, 2010 of time-based restricted stock units that were outstanding, but not included in the computation of weighted average diluted common share amounts as the effect of doing so would have been anti-dilutive.

Refer to Note 10 to the Consolidated Financial Statements for additional information regarding share-based compensation.

## 6. Property and Equipment

Property and equipment consists of the following:

(In thousands)	October 29, 2011	January 29, 2011	October 30, 2010
Property and equipment, at cost	\$ 1,503,858	\$ 1,432,802	\$ 1,414,453
Less: Accumulated depreciation	(874,372)	(789,682)	(762,092)
Property and equipment, net	\$ 629,486	\$ 643,120	\$ 652,361

## 7. Intangible Assets

Intangible assets include costs to acquire and register the Company's trademark assets. During the 39 weeks ended October 29, 2011, the Company purchased \$33.9 million of trademark assets primarily to support its international expansion strategy. The following table represents intangible assets as of October 29, 2011, January 29, 2011 and October 30, 2010.

(In thousands)	October 29, 2011	January 29, 2011	October 30, 2010
Trademarks, at cost	\$ 43,847	\$ 9,967	\$ 9,009
Less: Accumulated amortization	(3,759)	(2,482)	(2,315)
Intangible assets, net	\$ 40,088	\$ 7,485	\$ 6,694



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Intangible assets are recorded on the basis of cost with amortization computed utilizing the straight-line method over the assets estimated useful life of 15 to 25 years. Amortization expense was \$0.5 million and \$1.3 million for the 13 and 39 weeks ended October 29, 2011, respectively, and \$0.2 million and \$0.5 million for the 13 and 39 weeks ended October 30, 2010, respectively.



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The table below summarizes the estimated future amortization expense through Fiscal 2015:

<i>(In thousands)</i>	Future Amortization
Remainder of 2011	\$ 493
2012	1,937
2013	1,935
2014	1,935
2015	1,931

**8. Other Credit Arrangements**

The Company has borrowing agreements with four separate financial institutions under which it may borrow an aggregate of \$295.0 million United States Dollars ( USD ) and \$25.0 million Canadian Dollars ( CAD ). Of this amount, \$185.0 million USD can be used for demand letter of credit issuances, \$50.0 million USD and \$25.0 million CAD can be used for demand line borrowings and the remaining \$60.0 million USD can be used for either letters of credit or demand line borrowings at the Company's discretion. These lines are provided at the discretion of the respective financial institutions and are subject to their periodic review.

As of October 29, 2011, the Company had outstanding demand letters of credit of \$43.7 million USD and no demand line borrowings. The availability of any future borrowings is subject to acceptance by the respective financial institutions.

**9. Comprehensive Income**

Comprehensive income is comprised of the following:

<i>(In thousands)</i>	13 Weeks Ended		39 Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
Net income	\$ 52,427	\$ 33,024	\$ 100,421	\$ 53,609
Other comprehensive (loss) income:				
Temporary impairment reversal related to ARS, net of tax (1)		6,722		6,361
Foreign currency translation adjustment	(3,518)	779	1,102	3,552
Other comprehensive (loss) income:	(3,518)	7,501	1,102	9,913
Total comprehensive income	\$ 48,909	\$ 40,525	\$ 101,523	\$ 63,522

(1) Amounts are shown net of tax of (\$4.2) million and (\$4.0) million for the 13 and 39 weeks ended October 30, 2010, respectively.

**10. Share-Based Compensation**

The Company accounts for share-based compensation under the provisions of ASC 718, *Compensation - Stock Compensation* ( ASC 718 ), which requires companies to measure and recognize compensation expense for all share-based payments at fair value. Total share-based compensation expense included in the Consolidated Statements of Operations for the 13 and 39 weeks ended October 29, 2011 was \$3.2 million (\$2.0 million, net of tax) and \$9.1 million (\$5.6 million net of tax) and for the 13 and 39 weeks ended October 30, 2010 was \$3.5 million (\$2.2 million, net of tax) and \$21.9 million (\$13.5 million, net of tax), respectively.

**Stock Option Grants**



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The Company grants both time-based and performance-based stock options under its 2005 Plan. Time-based stock option awards vest over the requisite service period of the award or to an employee's eligible retirement date, if earlier. Performance-based stock option awards vest over three years and are earned if the Company meets pre-established performance goals during each year.



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A summary of the Company's stock option activity for the 39 weeks ended October 29, 2011 follows:

	Options (In thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding - January 29, 2011	12,124	\$ 15.25		
Granted	47	\$ 15.02		
Exercised (1)	(260)	\$ 10.28		
Cancelled	(131)	\$ 21.09		
Outstanding - October 29, 2011	11,780	\$ 15.29	2.8	\$ 29,157
Vested and expected to vest - October 29, 2011	11,658	\$ 15.31	2.8	\$ 28,914
Exercisable - October 29, 2011 (2)	3,970	\$ 6.99	1.8	\$ 26,127

- (1) Options exercised during the 39 weeks ended October 29, 2011 had exercise prices ranging from \$4.54 to \$11.66.  
(2) Options exercisable are determined based upon the weighted average exercise price of vested options compared to the Company's stock price at October 29, 2011.

The weighted-average grant date fair value of stock options granted during the 39 weeks ended October 29, 2011 and October 30, 2010 was \$4.73 and \$5.19, respectively. The aggregate intrinsic value of options exercised during the 39 weeks ended October 29, 2011 and October 30, 2010 was \$1.3 million and \$10.7 million, respectively.

Cash received from the exercise of stock options was \$2.7 million for the 39 weeks ended October 29, 2011 and \$5.8 million for the 39 weeks ended October 30, 2010. The actual tax benefit realized from stock option exercises totaled \$0.3 million for the 39 weeks ended October 29, 2011 and \$12.8 million for the 39 weeks ended October 30, 2010.

The fair value of stock options was estimated based on the closing market price of the Company's common stock on the date of the grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

Black-Scholes Option Valuation Assumptions	39 Weeks Ended	
	October 29, 2011	October 30, 2010
Risk-free interest rate (1)	2.1%	2.3%
Dividend yield	2.6%	2.1%
Volatility factor (2)	42.7%	40.2%
Weighted-average expected term (3)	5.0 years	4.5 years
Expected forfeiture rate (4)	8.0%	8.0%

- (1) Based on the U.S. Treasury yield curve in effect at the time of grant with a term consistent with the expected life of our stock options.  
(2) Based on a combination of historical volatility of the Company's common stock and implied volatility.  
(3) Represents the period of time options are expected to be outstanding, based on historical experience.  
(4) Based upon historical experience.

As of October 29, 2011, there was \$1.8 million of unrecognized compensation expense related to non-vested stock option awards that is expected to be recognized over a weighted average period of 1.1 years.

## Restricted Stock Grants



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Time-based restricted stock awards are comprised of time-based restricted stock units. These awards vest over three years; however, they may be accelerated to vest over one year if the Company meets pre-established performance goals in the year of grant. Time-based restricted stock units receive dividend equivalents in the form of additional time-based restricted stock units, which are subject to the same restrictions and forfeiture provisions as the original award.



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Performance-based restricted stock awards include performance-based restricted stock units. These awards cliff vest at the end of a three year period based upon the Company's achievement of pre-established goals throughout the term of the award. Performance-based restricted stock units receive dividend equivalents in the form of additional performance-based restricted stock units, which are subject to the same restrictions and forfeiture provisions as the original award. The grant date fair value of all restricted stock awards is based on the closing market price of the Company's common stock on the date of grant.

A summary of the Company's restricted stock activity is presented in the following tables:

(Shares in thousands)	Time-Based Restricted Stock Units		Performance-Based Restricted Stock Units	
	39 Weeks Ended October 29, 2011		39 Weeks Ended October 29, 2011	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Nonvested - January 29, 2011	877	\$ 17.45	630	\$ 12.59
Granted	1,406	15.03	1,240	15.03
Vested	(372)	17.45		
Cancelled	(110)	16.09	(108)	12.64
Nonvested - October 29, 2011	1,801	\$ 15.73	1,762	\$ 14.23

As of October 29, 2011, there was \$20.7 million of unrecognized compensation expense related to non-vested time-based restricted stock unit awards that is expected to be recognized over a weighted average period of 2.0 years.

As of October 29, 2011, the Company had 25.0 million shares available for all equity grants.

**11. Income Taxes**

The provision for income taxes from continuing operations is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for quarterly events. The effective income tax rate from continuing operations based on actual operating results for the 13 weeks ended October 29, 2011 was 36.7% compared to 52.1% for the 13 weeks ended October 30, 2010. The effective income tax rate from continuing operations based on actual operating results for the 39 weeks ended October 29, 2011 was 35.8% compared to 40.7% for the 39 weeks ended October 30, 2010. The higher effective income tax rate for the 13 and 39 weeks ended October 30, 2010 was primarily due to losses on the sale of certain ARS investments for which no income tax benefits were recognized.

The Company records accrued interest and penalties related to unrecognized tax benefits in income tax expense.

The Company recognizes income tax liabilities related to unrecognized tax benefits in accordance with ASC 740 and adjusts these liabilities when its judgment changes as the result of the evaluation of new information not previously available. There were no significant changes in unrecognized tax benefits during the 39 weeks ended October 29, 2011 and October 30, 2010, respectively. The Company does not anticipate any significant changes to the unrecognized tax benefits recorded at the balance sheet date within the next 12 months.

**12. Legal Proceedings**

The Company is subject to certain legal proceedings and claims arising out of the conduct of its business. In accordance with ASC 450, *Contingencies* (ASC 450), management records a reserve for estimated losses when the loss is probable and the amount can be reasonably estimated. If a range of possible loss exists and no anticipated loss within the range is more likely than any other anticipated loss, the Company records the accrual at the low end of the range, in accordance with ASC 450. As the Company believes that it has provided adequate reserves, it anticipates that the ultimate outcome of any matter currently pending against the Company will not materially affect the consolidated financial position or results of operations of the Company.

**13. Discontinued Operations**

On March 5, 2010, the Company's Board approved management's recommendation to proceed with the closure of the M+O brand. The Company completed the closure of the M+O stores and e-commerce operation during the







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second quarter of Fiscal 2010. These Consolidated Financial Statements reflect the results of M+O as a discontinued operation for all periods presented.

Costs associated with exit or disposal activities are recorded when incurred. A summary of the exit and disposal costs recognized within Loss from Discontinued Operations on the Consolidated Income Statement for the 39 weeks ended October 30, 2010 are included in the table as follows. Results from discontinued operations were nominal for the 13 weeks ended October 30, 2010.

<i>(In thousands)</i>	39 Weeks Ended October 30, 2010
Non-cash charges:	
Asset impairments	\$ 17,980
Cash charges:	
Lease-related charges (1)	15,377
Inventory charges	2,422
Severance charges	7,660
<b>Total Charges</b>	<b>\$ 43,439</b>

(1) Presented net of the reversal of non-cash lease credits.

The table below presents the significant components of M+O's results included in Loss from Discontinued Operations on the Consolidated Statement of Operations for the 13 and 39 weeks ended October 30, 2010.

<i>(In thousands)</i>	13 Weeks Ended October 30, 2010	39 Weeks Ended October 30, 2010
Net sales	\$	\$ 21,881
Loss from discontinued operations, before income taxes	\$ (271)	\$ (66,959)
Income tax benefit	104	25,672
Loss from discontinued operations, net of tax	\$ (167)	\$ (41,287)
Loss per common share from discontinued operations:		
Basic	\$	\$ (0.20)
Diluted	\$	\$ (0.20)

There were no assets or liabilities included in the Consolidated Balance Sheets for M+O as of October 29, 2011 or January 29, 2011. The major classes of assets and liabilities included in the Consolidated Balance Sheets for M+O as of October 30, 2010 are as follows:

<i>(In thousands)</i>	October 30, 2010
Current assets	\$ 226
Non-current assets	
<b>Total assets</b>	<b>\$ 226</b>
Total current liabilities	\$ 2,793
Total non-current liabilities	



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Total liabilities	\$	2,793
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### **Review by Independent Registered Public Accounting Firm**

Ernst & Young LLP, our independent registered public accounting firm, has performed a limited review of the unaudited Consolidated Financial Statements as of and for the thirteen and thirty-nine week periods ended October 29, 2011 and October 30, 2010, as indicated in their report on the limited review included below. Since they did not perform an audit, they express no opinion on the unaudited Consolidated Financial Statements referred to above.

### **Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

American Eagle Outfitters, Inc.

We have reviewed the consolidated balance sheets of American Eagle Outfitters, Inc. (the Company) as of October 29, 2011 and October 30, 2010, and the related consolidated statements of operations and retained earnings for the thirteen and thirty-nine week periods ended October 29, 2011 and October 30, 2010 and the consolidated statements of cash flows for the thirty-nine week periods ended October 29, 2011 and October 30, 2010. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of American Eagle Outfitters, Inc. as of January 29, 2011, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the year then ended not presented herein, and in our report dated March 11, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of January 29, 2011, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Pittsburgh, Pennsylvania  
November 30, 2011



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### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

The following discussion and analysis of financial condition and results of operations should be read in conjunction with our Fiscal 2010 Management's Discussion and Analysis of Financial Condition and Results of Operations which can be found in our Fiscal 2010 Annual Report on Form 10-K.

In addition, the following discussion and analysis of financial condition and results of operations are based upon our Consolidated Financial Statements and should be read in conjunction with these statements and notes thereto.

This report contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which represent our expectations or beliefs concerning future events, including the following:

the planned opening of 11 new American Eagle stores, 12 new 77kids stores and 10 new aerie stores in the United States and Canada during Fiscal 2011;

the selection of approximately 60 to 65 American Eagle stores in the United States and Canada for remodeling during Fiscal 2011;

the potential closure of 15 to 25 American Eagle stores in the United States and Canada during Fiscal 2011;

the planned opening of 17 new franchised American Eagle stores during Fiscal 2011;

the success of aerie by American Eagle and aerie.com;

the success of 77kids by american eagle and 77kids.com;

the expected payment of a dividend in future periods;

the possibility to engage in future franchise agreements, growth through acquisitions and/or internally developing additional new brands;

the possibility that our credit facilities may not be available for future borrowings;

the possibility that rising prices of raw materials, labor, energy and other inputs to our manufacturing process, if unmitigated, will have a significant impact to our profitability; and

the possibility that we may be required to take additional store impairment charges related to underperforming stores.

We caution that these forward-looking statements, and those described elsewhere in this report, involve material risks and uncertainties and are subject to change based on factors beyond our control as discussed within Item 1A of this Quarterly Report on Form 10-Q and Item 1A of our Fiscal 2010 Annual Report on Form 10-K. Accordingly, our future performance and financial results may differ materially from those expressed or implied in any such forward-looking statements.



## Key Performance Indicators

Our management evaluates the following items, which are considered key performance indicators, in assessing our performance:

*Comparable store sales* - Comparable store sales provide a measure of sales growth for stores open at least one year over the comparable prior year period. In fiscal years following those with 53 weeks, the prior year period is shifted by one week to compare similar calendar weeks. A store is included in comparable store sales in the thirteenth month of operation. However, stores that have a gross square footage increase of 25% or greater due to a remodel are removed from the comparable store sales base, but are included in total sales. These stores are returned to the comparable store sales base in the thirteenth month following the remodel. Sales from American Eagle, aerie and 77kids stores are included in comparable stores sales. Sales from AEO Direct are not included in comparable store sales.

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

*Gross profit* - Gross profit measures whether we are optimizing the price and inventory levels of our merchandise and achieving an optimal level of sales. Gross profit is the difference between net sales and cost of sales. Cost of sales consists of: merchandise costs, including design, sourcing, importing and inbound freight costs, as well as markdowns, shrinkage, certain promotional costs and buying, occupancy and warehousing costs. Buying, occupancy and warehousing costs consist of: compensation, employee benefit expenses and travel for our buyers; rent and



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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. The inability to obtain acceptable levels of sales, initial markups or any significant increase in our use of markdowns could have an adverse effect on our gross profit and results of operations.

*Operating income* - Our management views operating income as a key indicator of our success. The key drivers of operating income are comparable store sales, gross profit, our ability to control selling, general and administrative expenses, and our level of capital expenditures.

*Store productivity* - Store productivity, including net sales per average square foot, sales per productive hour, average unit retail price ( AUR ), conversion rate, the number of transactions per store, the number of units sold per store and the number of units per transaction, is evaluated by our management in assessing our operational performance.

*Inventory turnover* - Our management evaluates inventory turnover as a measure of how productively inventory is bought and sold. Inventory turnover is important as it can signal slow moving inventory. This can be critical in determining the need to take markdowns on merchandise.

*Cash flow and liquidity* - Our management evaluates cash flow from operations, investing and financing in determining the sufficiency of our liquidity. Cash flow from operations has historically been sufficient to cover our uses of cash. Our management believes that cash flow from operations will be sufficient to fund anticipated capital expenditures and working capital requirements.

## **Results of Operations**

### **Overview**

During the third quarter, we made progress in several major areas of our business and continued to drive our long-term strategy. Merchandise improvements, combined with promotions during peak shopping periods, led to strong sales growth. Inventory investments in key items enabled us to capitalize on mall traffic, leading to positive conversion and a low double-digit increase in units sold. Net sales for the third quarter increased 11% to \$831.8 million and comparable store sales increased to 5%, against a 1% increase last year. By brand, AE comparable store sales increased 5% to last year, aerie comparable store sales increased 8% and sales for AEO Direct increased 21% in the third quarter.

Gross profit decreased 1% from last year. However, gross margin declined 450 basis points to 37.1% as a rate to sales. Increased product costs, caused primarily by higher cotton prices, together with promotional activity resulted in significant pressure on the merchandise margin. Buying, occupancy and warehousing costs improved by 30 basis points, which was driven by the 11% sales increase. Additionally, strong sales led to the leveraging of fixed costs, including rent and selling, general and administrative expenses.

Operating income for the third quarter was \$83.2 million compared to \$91.5 million last year. Operating income as a rate to net sales was 10.0% this year compared to 12.2% last year. Income from continuing operations increased to \$52.4 million compared to \$33.2 million a year ago. Income from continuing operations was \$0.27 per diluted share this year compared to \$0.17 per diluted share, which includes a realized loss from the sale of investment securities of \$0.12 per diluted share, last year.

We had \$482.0 million in cash and cash equivalents, short-term and long-term investments as of October 29, 2011. Merchandise inventory at October 29, 2011 was \$571.8 million, compared to \$409.5 million last year, reflecting our investment in a key item strategy to expand market share and underscore our strong value offering. The increase in inventory reflects a low double-digit percent increase in the average unit cost.

Our business is affected by the pattern of seasonality common to most retail apparel businesses. The results for the current and prior periods are not necessarily indicative of future financial results.



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The following table shows the percentage relationship to net sales of the listed line items included in our Consolidated Statements of Operations.

	13 Weeks Ended		39 Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales, including certain buying, occupancy and warehousing expenses	62.9	58.4	63.5	60.5
Gross profit	37.1	41.6	36.5	39.5
Selling, general and administrative expenses	22.9	24.6	24.4	25.3
Depreciation and amortization expense	4.2	4.8	5.0	5.3
Operating income	10.0	12.2	7.1	8.9
Realized loss on sale of investment securities	0.0	(3.2)	0.0	(1.2)
Other (expense) income, net	0.0	0.2	0.3	0.1
Income before income taxes	10.0	9.2	7.4	7.8
Provision for income taxes	3.7	4.8	2.7	3.2
Income from continuing operations	6.3	4.4	4.7	4.6
Loss from discontinued operations	0.0	0.0	0.0	(2.0)
Net income	6.3%	4.4%	4.7%	2.6%

The following table shows our adjusted consolidated store data for the 13 and 39 weeks ended October 29, 2011 and October 30, 2010.

	13 Weeks Ended		39 Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010 (2)
Number of stores:				
Beginning of period	1,103	1,083	1,086	1,103
Opened	13	10	33	28
Closed	0	(4)	(3)	(42)
End of period	1,116	1,089	1,116	1,089
Total gross square feet at end of period	6,536,564	6,323,099	6,536,564	6,323,099
International franchise stores at end of period (1)	12	2	12	2

(1) International franchise stores are not included in the consolidated store data or the total gross square feet calculation.

(2) Closed stores during the 39 weeks ended October 30, 2010 include all 28 M+O stores.

Our operations are conducted in one reportable segment, which includes 937 U.S. and Canadian AE retail stores, 158 aerie stand-alone retail stores, 21 77kids retail stores and AEO Direct.

## Comparison of the 13 weeks ended October 29, 2011 to the 13 weeks ended October 30, 2010



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### *Net Sales*

Net sales increased 11% to \$831.8 million compared to \$751.5 million last year. The change in net sales resulted primarily from a comparable store sales increase of 5% for the period, combined with a 21% increase in AEO Direct sales.

AE men's comparable store sales increased 6% and women's comparable stores increased 5%. For the third quarter, transactions increased in the high single-digits, driven by higher traffic and conversion. AUR declined in the low



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single-digits as a result of promotional offerings; however, the number of units sold increased in the low double-digits, which was consistent with inventory unit growth and our promotional strategy.

### *Gross Profit*

Gross profit decreased 1% to \$309.0 million, or 37.1% as a rate to net sales, from \$312.3 million, or 41.6% as a rate to net sales last year. On a rate to sales basis, gross margin declined 450 basis points as a result of rising product costs and increased markdowns. Our results reflect the strategy to mitigate the significant pressure from higher cotton costs by driving top line sales and leveraging fixed costs. Buying, occupancy and warehousing costs improved by 30 basis points, which was driven by the 11% sales increase.

There was \$1.4 million of share-based payment expense, consisting of time-based awards, included in gross profit for the period compared to \$1.1 million last year.

Our gross profit may not be comparable to that of other retailers, as some retailers include all costs related to their distribution network as well as design costs in cost of sales and others may exclude a portion of these costs from cost of sales, including them in a line item such as selling, general and administrative expenses. Refer to Note 2 to the Consolidated Financial Statements for a description of our accounting policy regarding cost of sales, including certain buying, occupancy and warehousing expenses.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased to \$190.6 million from \$185.1 million last year and improved 170 basis points, as a rate to net sales, to 22.9% from 24.6% last year. The \$5.5 million increase was due to investments in new stores, higher sales levels and investments in advertising, offset by continued expense savings.

There was \$1.8 million of share-based payment expense, consisting of time-based awards, included in selling, general and administrative expenses compared to \$2.4 million last year.

### *Depreciation and Amortization Expense*

Depreciation and amortization expense as a rate to net sales decreased to 4.2% compared to 4.8% for the corresponding period last year as a result of the higher net sales for the period. Depreciation and amortization expense decreased to \$35.2 million, compared to \$35.8 million last year.

### *Realized Loss on Sale of Investment Securities*

There were no realized losses on the sale of investment securities recorded this year. The realized loss on investment securities was \$24.2 million, or \$0.12 per diluted share, last year due to the liquidation of 95% of our ARS investment portfolio.

### *Other (Expense) Income, Net*

Other expense was \$0.4 million compared to income of \$2.0 million last year. The change is primarily due to fluctuations in foreign currency transactions and a decrease in interest income.

### *Provision for Income Taxes*

The provision for income taxes from continuing operations is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for quarterly events. The effective income tax rate from continuing operations based on actual operating results this year was 36.7% compared to 52.1% last year. The higher effective income tax rate for the 13 weeks ended October 30, 2010 was primarily due to losses on the sale of certain ARS investments for which no income tax benefits were recognized.



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### *Income from Continuing Operations*

Income from continuing operations was \$52.4 million, or \$0.27 per diluted share, compared to income from continuing operations last year of \$33.2 million, or \$0.17 per diluted share, which includes a \$0.12 per diluted share realized loss from the sale of investment securities. The change in income from continuing operations is attributable to the factors noted above.

### *Loss from Discontinued Operations*

We completed the closure of M+O stores and related e-commerce operation during the second quarter of Fiscal 2010. Accordingly, the after-tax operating results appear in Loss from Discontinued Operations on the Consolidated Statements of Operations for all periods presented. Loss from Discontinued Operations, net of tax, was \$0.2 million for the 13 weeks ended October 30, 2010. There was no loss from Discontinued Operations for the 13 weeks ended October 29, 2011.

Refer to Note 13 to the Consolidated Financial Statements for additional information regarding the discontinued operations of M+O.

### *Net Income*

Net income increased to \$52.4 million, or 6.3% as a percent to net sales, from \$33.0 million, or 4.4% as a percent to net sales last year. Net income per diluted share increased to \$0.27 from \$0.17 in the prior year. The change in net income is attributable to the factors noted above including the impact of the liquidation of our ARS investment portfolio and the closure of M+O last year.

### **Comparison of the 39 weeks ended October 29, 2011 to the 39 weeks ended October 30, 2010**

#### *Net Sales*

Net sales increased 3% to \$2.117 billion compared to \$2.051 billion last year. The increase in net sales resulted primarily from a 13% increase in AEO Direct sales, partially offset by a 1% decrease in comparable store sales for the period.

For the 39 week period, AE men's comparable store sales increased in the low single-digits and women's comparable store sales declined in the low single-digits. Transactions declined in the low single-digits, driven by decreased traffic and a flat customer conversion rate. The impact to our net sales caused by the decrease in transactions was partially offset by an increase in average transaction value.

#### *Gross Profit*

Gross profit for the 39 weeks ended October 29, 2011 decreased 5% to \$772.8 million, or 36.5% as a rate to net sales, compared to \$809.7 million, or 39.5% as a rate to net sales, last year. Merchandise margin decreased by 230 basis points primarily due to higher product costs and markdowns. Buying, occupancy and warehousing costs increased by 70 basis points as a result of an increase in rent related to new store openings as well as the impact of negative comparable store sales for the 39 weeks ended October 29, 2011.

There was \$4.0 million of share-based payment expense, consisting of time-based awards, included in gross profit for the period compared to \$6.3 million last year.

Our gross profit may not be comparable to that of other retailers, as some retailers include all costs related to their distribution network as well as design costs in cost of sales and others may exclude a portion of these costs from cost of sales, including them in a line item such as selling, general and administrative expenses. Refer to Note 2 to the Consolidated Financial Statements for a description of our accounting policy regarding cost of sales, including certain buying, occupancy and warehousing expenses.



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### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses decreased to \$516.2 million from \$519.2 million last year and improved 90 basis points, as a rate to net sales, to 24.4% from 25.3% last year. The improvement in the rate reflects our expense saving efforts, offset by planned investments in advertising and costs associated with new store growth.

There was \$5.1 million of share-based payment expense, consisting of time-based awards, included in selling, general and administrative expenses this year compared to \$15.6 million last year.

### *Depreciation and Amortization Expense*

Depreciation and amortization expense decreased to \$105.8 million compared to \$107.4 million last year. As a rate to net sales, depreciation and amortization was 5.0% this year compared to 5.3% for the corresponding period last year due to the lower level of expense and an increase in total net sales for the period.

### *Realized Loss on Sale of Investment Securities*

There were no realized losses on the sale of investment securities recorded this year. The realized loss on investment securities was \$24.4 million last year due to the liquidation of 95% of our ARS investment portfolio.

### *Other Income, Net*

Other income was \$5.5 million this year compared to \$1.2 million last year, primarily as a result of additional proceeds received from the ARS Call Option this year.

### *Provision for Income Taxes*

The provision for income taxes from continuing operations is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for quarterly events. The effective income tax rate from continuing operations based on actual operating results this year was 35.8% compared to 40.7% last year. The higher effective income tax rate for the 39 weeks ended October 30, 2010 was primarily due to losses on the sale of certain ARS investments for which no income tax benefits were recognized.

### *Income from Continuing Operations*

Income from continuing operations was \$100.4 million, or \$0.51 per diluted share, compared to income from continuing operations last year of \$94.9 million, or \$0.46 per diluted share. The change in income from continuing operations is attributable to the factors noted above, including the realized loss on the sale of investment securities last year.

### *Loss from Discontinued Operations*

We completed the closure of M+O stores and related e-commerce operation during the second quarter of Fiscal 2010. Accordingly, the after-tax operating results appear in Loss from Discontinued Operations on the Consolidated Statements of Operations for all periods presented. Loss from Discontinued Operations, net of tax, was \$41.3 million for the 39 weeks ended October 30, 2010 and includes pre-tax closure charges of \$43.4 million. Included in the pre-tax charges were lease-related items of \$15.4 million and \$7.6 million for severance and other employee-related charges, \$2.4 million in inventory charges and a non-cash asset impairment charge of \$18.0 million. There was no loss from Discontinued Operations for the 39 weeks ended October 29, 2011.

Refer to Note 13 to the Consolidated Financial Statements for additional information regarding the discontinued operations of M+O.

### *Net Income*

Net income increased to \$100.4 million, or 4.7% as a rate to net sales, from \$53.6 million, or 2.6% as a rate to net sales last year. Net income per diluted share increased to \$0.51 from \$0.26 in the prior year. The increases are attributable to the factors noted above, including the impact of the realized loss on the sale of investment securities and the closure of M+O last year.







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### **International Expansion**

We have entered into franchise agreements with multiple partners to expand our brands internationally. Through these franchise agreements, we are opening a series of American Eagle and aerie stores in the Middle East, Northern Africa, Eastern Europe, Hong Kong, China, Japan and Israel. As of the October 29, 2011, we had 12 franchised stores operated by our franchise partners in seven countries. These franchise agreements do not involve a capital investment from AEO and require minimal operational involvement. We continue to evaluate additional opportunities to expand internationally.

### **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.

### ***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 October 29, 2011, we held certain assets that are required to be measured at fair value on a recurring basis. These include cash equivalents and short and long-term investments, including auction rate securities ( ARS ).



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In accordance with ASC 820, the following table represents the fair value hierarchy of our financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of October 29, 2011:

		Fair Value Measurements at October 29, 2011		
		Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(In thousands)	Carrying Amount			
<b>Cash and cash equivalents:</b>				
Cash	\$ 325,152	\$ 325,152	\$	\$
Money-market	32,214	32,214		
Treasury bills	22,918	22,918		
<b>Total cash and cash equivalents</b>	<b>\$ 380,284</b>	<b>\$ 380,284</b>	<b>\$</b>	<b>\$</b>
<b>Short-term investments:</b>				
Treasury bills	\$ 76,078	\$ 76,078	\$	\$
Term-deposits	10,082	10,082		
Corporate bonds	9,376	9,376		
State and local government ARS	5,500			5,500
<b>Total short-term investments</b>	<b>\$ 101,036</b>	<b>\$ 95,536</b>	<b>\$</b>	<b>\$ 5,500</b>
<b>Long-term investments:</b>				
ARS Call Option	\$ 648	\$	\$	\$ 648
<b>Total long-term investments</b>	<b>\$ 648</b>	<b>\$</b>	<b>\$</b>	<b>\$ 648</b>
<b>Total</b>	<b>\$ 481,968</b>	<b>\$ 475,820</b>	<b>\$</b>	<b>\$ 6,148</b>
Percent to Total	100.0%	98.7%	0.0%	1.3%

We use a discounted cash flow model to value our Level 3 investments. The assumptions in our model for Level 3 investments, excluding the ARS Call Option, included a recovery period of 8 months, a discount factor for yield of 0.1% and illiquidity of 0.5%. These assumptions are subjective. They are based on our current judgment and our view of current market conditions. The use of different assumptions (i.e., an increase in the recovery period by one year or an increase to the discount rate and illiquidity premium of 100 basis points) would not result in a material change to the valuation.

The fair value of the ARS Call Option described in Note 3 to the Consolidated Financial Statements was also estimated using a discounted cash flow model. The model considers potential changes in yields for securities with similar characteristics to the underlying ARS and evaluates possible future refinancing opportunities of the issuers of the ARS. The analysis then assesses the likelihood that the options would be exercisable as a result of the underlying ARS being redeemed or traded in a secondary market at an amount greater than the exercise price prior to the end of the option term. Future changes in the fair values of the ARS Call Option will be recorded within the Consolidated Statements of Operations.

Refer to Notes 3 and 4 to the Consolidated Financial Statements for additional information on our investment securities, including a description of the securities and a discussion of the uncertainties relating to their liquidity.

**Liquidity and Capital Resources**

Our uses of cash are generally for working capital, the construction of new stores and remodeling of existing stores, information technology upgrades, distribution center improvements and expansion, the purchase of both short and long-term investments, the repurchase of common stock and the payment of dividends. Historically, these uses of cash have been funded with cash flow from operations and existing cash on hand. Additionally, our current and future uses of cash include the development of aerie and 77kids. We expect to be able to fund our future cash



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requirements through current cash holdings as well as cash generated from operations.

Our growth strategy includes internally developing new brands and the possibility of further international expansion or acquisitions. We periodically consider and evaluate these options to support future growth. In the event we do pursue such options, we could require additional equity or debt financing. There can be no assurance that we would be successful in closing any potential transaction, or that any endeavor we undertake would increase our profitability.



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The following sets forth certain measures of our liquidity:

	October 29, 2011	January 29, 2011	October 30, 2010
Working Capital (in 000 s)	\$ 809,292	\$ 786,573	\$ 820,435
Current Ratio	3.04	3.03	3.23

The \$22.7 million increase in working capital as of October 29, 2011 compared to January 29, 2011, resulted primarily from net income, net of non-cash adjustments, offset by the use of cash for investing and financing activities. Investing and financing activities include capital expenditures, the purchase of intangible assets, the payment of dividends and the repurchase of common stock.

The \$11.1 million decrease in working capital as of October 29, 2011, compared to October 30, 2010, is primarily related to use of cash for financing and investing activities including capital expenditures and the purchase of intangible assets, as well as the distribution of cash to shareholders through the payment of dividends and the repurchase of common stock. This use of cash was almost entirely funded by net income, net of non-cash adjustments.

*Cash Flows from Operating Activities of Continuing Operations*

Net cash (used for) provided by operating activities totaled (\$48.1) million and \$146.4 million for the 39 weeks ended October 29, 2011 and October 30, 2010, respectively. For both periods, our major source of cash from operations was merchandise sales and our primary outflows of cash for operations were for the purchase of merchandise inventory and the payment of operational costs. For the 39 weeks ended October 29, 2011, the increase in merchandise inventory reflects our investment in a key item strategy to expand market share and underscore our strong value offering, as well as a low double-digit increase in the average unit cost.

*Cash Flows from Investing Activities of Continuing Operations*

Investing activities for the 39 weeks ended October 29, 2011 included \$96.7 million of capital expenditures for property and equipment, \$33.9 million for the acquisition of intangible assets primarily related to our international expansion strategy and \$186.3 million of investment purchases, partially offset by \$158.0 million of proceeds from the sale of investments classified as available-for-sale. Investing activities for the 39 weeks ended October 30, 2010 primarily included \$177.5 million of proceeds from the sale of investments classified as available-for-sale, partially offset by \$65.4 million used for capital expenditures.

*Cash Flows from Financing Activities of Continuing Operations*

Cash used for financing activities for the 39 weeks ended October 29, 2011 consisted primarily of \$64.3 million for the payment of dividends and \$15.2 million for the repurchase of 1.4 million shares as part of our publicly announced repurchase program. Cash used for financing activities for the 39 weeks ended October 30, 2010 consisted primarily of \$192.3 million for the repurchase of 14.0 million shares as part of our publicly announced repurchase program, \$64.7 million for the payment of dividends, \$30.0 million for the full repayment of our demand line borrowings and \$18.0 million for the repurchase of common stock from employees for the payment of taxes in conjunction with the vesting of share-based payments.

*Credit Facilities*

We have borrowing agreements with four separate financial institutions under which we may borrow an aggregate of \$295.0 million United States Dollars ( USD ) and \$25.0 million Canadian Dollars ( CAD ). Of this amount, \$185.0 million USD can be used for demand letter of credit issuances, \$50.0 million USD and \$25.0 million CAD can be used for demand line borrowings and the remaining \$60.0 million USD can be used for either letters of credit or demand line borrowings at our discretion. These lines are provided at the discretion of the respective financial institutions and are subject to their periodic review.



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As of October 29, 2011, we had outstanding demand letters of credit of \$43.7 million USD and no demand line borrowings. The availability of any future borrowings is subject to acceptance by the respective financial institutions.

### *Capital Expenditures for Property and Equipment*

Capital expenditures for the 39 weeks ended October 29, 2011 were \$96.7 million and included \$69.5 million related to investments in our stores, including 33 new AE, aerie and 77kids stores, and 59 remodels. Additionally, we continued to support our infrastructure growth by investing in information technology initiatives (\$12.2 million), the improvement and expansion of our distribution centers (\$9.5 million), and other home office projects (\$5.5 million).

For Fiscal 2011, we expect capital expenditures to be approximately \$100 million, which includes the holiday accessory expansion initiative.

### *Stock Repurchases*

During the 39 weeks ended October 29, 2011, we repurchased 1.4 million shares as part of our publicly announced share repurchase program for approximately \$15.2 million, at a weighted average price of \$11.10 per share. During the 39 weeks ended October 30, 2010, we repurchased 14.0 million shares as part of our publicly announced share repurchase program for approximately \$192.3 million, at a weighted average price of \$13.73 per share. As of October 29, 2011, we had 13.1 million shares remaining authorized for repurchase. These shares may be repurchased at our discretion. During Fiscal 2010, our Board of Directors (the "Board") extended the current remaining share repurchase authorization, originally authorized in Fiscal 2007, through February 2, 2013.

There were no share repurchases from employees during the 13 weeks ended October 29, 2011. During the 39 weeks ended October 29, 2011 and October 30, 2010, we repurchased approximately 0.1 million and 1.0 million shares, respectively, from certain employees at market prices totaling \$2.2 million and \$18.0 million, respectively. These shares were repurchased for the payment of taxes, not in excess of the minimum statutory withholding requirements, in connection with the vesting of share-based payments, as permitted under the 2005 Stock Award and Incentive Plan. The aforementioned shares repurchased have been recorded as treasury stock.

### *Dividends*

During the 13 weeks ended October 29, 2011, our Board declared a quarterly cash dividend of \$0.11 per share, which was paid on October 7, 2011.

Subsequent to the third quarter of Fiscal 2011, our Board declared a quarterly cash dividend of \$0.11 per share, payable on January 6, 2012 to stockholders of record at the close of business on December 21, 2011.

## **Critical Accounting Policies**

Our critical accounting policies are described in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and in the notes to our Consolidated Financial Statements for the year ended January 29, 2011 contained in our Fiscal 2010 Annual Report on Form 10-K. Any new accounting policies or updates to existing accounting policies as a result of new accounting pronouncements have been discussed in the notes to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q. The application of our critical accounting policies may require management to make judgments and estimates about the amounts reflected in the Consolidated Financial Statements. Management uses historical experience and all available information to make these estimates and judgments, and different amounts could be reported using different assumptions and estimates.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

There were no material changes in our exposure to market risk from January 29, 2011. Our market risk profile as of January 29, 2011 is disclosed in Item 7A, *Quantitative and Qualitative Disclosures About Market Risk*, of our Fiscal 2010 Annual Report on Form 10-K.



**Table of Contents****ITEM 4. CONTROLS AND PROCEDURES.***Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management including our Principal Executive Officer and our Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

In connection with the preparation of this Quarterly Report on Form 10-Q, as of October 29, 2011, an evaluation was performed under the supervision and with the participation of our management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon that evaluation, our Principal Executive Officer and our Principal Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this Quarterly Report on Form 10-Q.

*Changes in Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting that occurred during the 13 weeks ended October 29, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****ITEM 1A. RISK FACTORS.**

Risk factors that affect our business and financial results are discussed within Item 1A of our Fiscal 2010 Annual Report on Form 10-K. There have been no material changes to the disclosures relating to this item from those set forth in our Fiscal 2010 Annual Report on Form 10-K.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.****Issuer Purchases of Equity Securities**

The following table provides information regarding our repurchases of our common stock during the 13 weeks ended October 29, 2011.

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Program (1)(3)
Month #1 (July 31, 2011 through August 27, 2011)		\$		14,500,000
Month #2 (August 28, 2011 through October 1, 2011)	1,365,455	\$ 11.08	1,365,455	13,134,545
Month #3 (October 2, 2011 through October 29, 2011)		\$		13,134,545
Total	1,365,455	\$ 11.08	1,365,455	13,134,545

(1) Shares purchased during Month #2 were all repurchased as part of our publicly announced share repurchase program.



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- (2) Average price paid per share excludes any broker commissions paid.
- (3) In January 2008, our Board authorized the repurchase of 60.0 million shares of our common stock. The authorization of the remaining 13.1 million shares that may yet be purchased has been extended through the end of Fiscal 2012.



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**ITEM 6. EXHIBITS.**

- \* Exhibit 15 Acknowledgement of Independent Registered Public Accounting Firm
- \* Exhibit 31.1 Certification by James V. O'Donnell pursuant to Rule 13a-14(a) or Rule 15d-14(a)
- \* Exhibit 31.2 Certification by Joan Holstein Hilson pursuant to Rule 13a-14(a) or Rule 15d-14(a)
- \*\* Exhibit 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*\* Exhibit 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*\* Exhibit 101 Interactive Data File

- \* Filed with this report.
- \*\* Furnished with this report.



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**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.

Dated: November 30, 2011

American Eagle Outfitters, Inc.

(Registrant)

By: /s/ James V. O'Donnell  
James V. O'Donnell  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Joan Holstein Hilson  
Joan Holstein Hilson  
Executive Vice President and Chief Financial  
Officer  
(Principal Financial Officer and Principal  
Accounting Officer)