

FOOT LOCKER INC  
Form 10-K  
March 30, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

# FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended January 31, 2015

OR

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

For the transition period from to

Commission File No. 1-10299

(Exact name of Registrant as specified in its charter)

New York 13-3513936  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

112 West 34<sup>th</sup> Street, New York, New York 10120  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code: (212) 720-3700

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$0.01	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The number of shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding at March 16, 2015: 139,649,989

The aggregate market value of voting stock held by non-affiliates of the Registrant computed by reference to the closing price as of the last business day of the Registrant's most recently completed second fiscal quarter, August 2, 2014, was approximately: \$5,363,852,719\*

For purposes of this calculation only (a) all directors plus three executive officers and owners of five percent or more of the Registrant are deemed to be affiliates of the Registrant and (b) shares deemed to be held by such persons include only outstanding shares of the Registrant's voting stock with respect to which such persons had, on such date, voting or investment power.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive Proxy Statement (the Proxy Statement) to be filed in connection with the Annual Meeting of Shareholders to be held on May 20, 2015: Parts III and IV.

---

TABLE OF CONTENTS

**TABLE OF CONTENTS**

PART I

Item 1.

1

Business

Item 1A.

2

Risk Factors

Item 1B.

9

Unresolved Staff Comments

Item 2.

9

Properties

Item 3.

9

Legal Proceedings

Item 4.

9

Mine Safety Disclosures

PART II

Item 5.

Market for the Company's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

11

Item 6.

13

Selected Financial Data

Item 7.

14

Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 7A.

33

Quantitative and Qualitative Disclosures About Market Risk

Item 8.

33

Consolidated Financial Statements and Supplementary Data

Item 9.

72

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Item 9A.

72

Controls and Procedures

Item 9B.

74

Other Information

PART III

Item 10.

74

Directors, Executive Officers and Corporate Governance

Item 11.

74

Executive Compensation

Item 12.

74

Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Item 13.

74

Certain Relationships and Related Transactions, and Director Independence

Item 14.

74

Principal Accounting Fees and Services

PART IV

Item 15.

75

Exhibits and Financial Statement Schedules

---

TABLE OF CONTENTS

**PART I**

**Item 1. Business**

**General**

Foot Locker, Inc., incorporated under the laws of the State of New York in 1989, is a leading global retailer of athletically inspired shoes and apparel, operating 3,423 primarily mall-based stores in the United States, Canada, Europe, Australia, and New Zealand as of January 31, 2015. Foot Locker, Inc. and its subsidiaries hereafter are referred to as the Registrant, Company, we, our, or us. Information regarding the business is contained under Business Overview section in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Company maintains a website on the Internet at [www.footlocker-inc.com](http://www.footlocker-inc.com). The Company's filings with the U.S. Securities and Exchange Commission (the SEC), including its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports are available free of charge through this website as soon as reasonably practicable after they are filed with or furnished to the SEC by clicking on the SEC Filings link. The Corporate Governance section of the Company's corporate website contains the Company's Corporate Governance Guidelines, Committee Charters, and the Company's Code of Business Conduct for directors, officers and employees, including the Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer. Copies of these documents may also be obtained free of charge upon written request to the Company's Corporate Secretary at 112 West 34<sup>th</sup> Street, New York, N.Y. 10120. The Company intends to promptly disclose amendments to the Code of Business Conduct and waivers of the Code for directors and executive officers on the Corporate Governance section of the Company's corporate website.

**Information Regarding Business Segments and Geographic Areas**

The financial information concerning business segments, divisions, and geographic areas is contained under the Business Overview and Segment Information sections in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Information regarding sales, operating results, and identifiable assets of the Company by business segment and by geographic area is contained under the *Segment Information* note in Item 8. Consolidated Financial Statements and Supplementary Data.

The service marks and trademarks appearing in this report (except for Nike, Inc.) are owned by Foot Locker, Inc. or its subsidiaries.

**Employees**

The Company and its consolidated subsidiaries had 14,567 full-time and 30,001 part-time employees at January 31, 2015. The Company considers employee relations to be satisfactory.

## Competition

Financial information concerning competition is contained under the **Business Risk** section in the *Financial Instruments and Risk Management* note in **Item 8. Consolidated Financial Statements and Supplementary Data.**

## Merchandise Purchases

Financial information concerning merchandise purchases is contained under the **Liquidity** section in **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations** and under the **Business Risk** section in the *Financial Instruments and Risk Management* note in **Item 8. Consolidated Financial Statements and Supplementary Data.**

TABLE OF CONTENTS

**Item 1A. Risk Factors**

The statements contained in this Annual Report on Form 10-K ( Annual Report ) that are not historical facts, including, but not limited to, statements regarding our expected financial position, business and financing plans found in Item 1.

Business and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Please also see Disclosure Regarding Forward-Looking Statements. Our actual results may differ materially due to the risks and uncertainties discussed in this Annual Report, including those discussed below. Additional risks and uncertainties that we do not presently know about or that we currently consider to be insignificant may also affect our business operations and financial performance.

**Our inability to implement our strategic long range plan may adversely affect our future results.**

Our ability to successfully implement and execute our long-range plan is dependent on many factors. Our strategies may require significant capital investment and management attention, which may result in the diversion of these resources from our core business and other business issues and opportunities. Additionally, any new initiative is subject to certain risks including customer acceptance of our products and renovated store designs, competition, product differentiation, and the ability to attract and retain qualified personnel. If we cannot successfully execute our strategic growth initiatives or if the long-range plan does not adequately address the challenges or opportunities we face, our financial condition and results of operations may be adversely affected. Additionally, failure to meet market expectations, particularly with respect to sales, operating margins, and earnings per share, would likely result in volatility in the market value of our stock.

**The retail athletic footwear and apparel business is highly competitive.**

Our athletic footwear and apparel operations compete primarily with athletic footwear specialty stores, sporting goods stores, department stores, discount stores, traditional shoe stores, mass merchandisers, and Internet retailers, many of which are units of national or regional chains that have significant financial and marketing resources. The principal competitive factors in our markets are selection of merchandise, reputation, store location, quality, advertising, price, and customer service. Our success also depends on our ability to differentiate ourselves from our competitors with respect to a quality merchandise assortment and superior customer service. We cannot assure that we will continue to be able to compete successfully against existing or future competitors. Our expansion into markets served by our competitors, and entry of new competitors or expansion of existing competitors, into our markets could have a material adverse effect on our business, financial condition, and results of operations.

Although we sell merchandise via the Internet, a significant shift in customer buying patterns to purchasing athletic footwear, athletic apparel, and sporting goods via the Internet could have a material adverse effect on our business results. In addition, all of our significant suppliers distribute products directly through the Internet and others may follow. Some of our suppliers currently operate retail stores and some have indicated that they intend to open additional retail stores. Should this continue to occur, and if our customers decide to purchase directly from our suppliers, it could have a material adverse effect on our business, financial condition, and results of operations.

**The industry in which we operate is dependent upon fashion trends, customer preferences, product innovations, and other fashion-related factors.**

The athletic footwear and apparel industry is subject to changing fashion trends and customer preferences. In addition, retailers in the athletic industry rely on their suppliers to maintain innovation in the products they develop. We cannot guarantee that our merchandise selection will accurately reflect customer preferences when it is offered for sale or that we will be able to identify and respond quickly to fashion changes, particularly given the long lead times for ordering much of our merchandise from suppliers. A substantial portion of our highest margin sales are to young males (ages 12 - 25), many of whom we believe purchase athletic footwear and athletic apparel as a fashion statement and are frequent purchasers. Our failure to anticipate, identify or react appropriately in a timely manner to changes in fashion trends that would make athletic footwear or athletic apparel less attractive to these customers could have a material adverse effect on our business, financial condition, and results of operations.



TABLE OF CONTENTS

**If we do not successfully manage our inventory levels, our operating results will be adversely affected.**

We must maintain sufficient inventory levels to operate our business successfully. However, we also must guard against accumulating excess inventory. For example, we order most of our athletic footwear four to six months prior to delivery to our stores. If we fail to anticipate accurately either the market for the merchandise in our stores or our customers' purchasing habits, we may be forced to rely on markdowns or promotional sales to dispose of excess or slow moving inventory, which could have a material adverse effect on our business, financial condition, and results of operations.

**A change in the relationship with any of our key suppliers or the unavailability of our key products at competitive prices could affect our financial health.**

Our business is dependent to a significant degree upon our ability to obtain exclusive product and the ability to purchase brand-name merchandise at competitive prices from a limited number of suppliers. In addition, our suppliers provide volume discounts, cooperative advertising, and markdown allowances, as well as the ability to negotiate returns of excess or unneeded merchandise. We cannot be certain that such terms with our suppliers will continue in the future.

The Company purchased approximately 89 percent of its merchandise in 2014 from its top five suppliers and expects to continue to obtain a significant percentage of its athletic product from these suppliers in future periods.

Approximately 73 percent was purchased from one supplier - Nike, Inc. ( Nike ). Each of our operating divisions is highly dependent on Nike; they individually purchased 47 to 84 percent of their merchandise from Nike. Merchandise that is high profile and in high demand is allocated by our suppliers based upon their internal criteria. Although we have generally been able to purchase sufficient quantities of this merchandise in the past, we cannot be certain that our suppliers will continue to allocate sufficient amounts of such merchandise to us in the future. Our inability to obtain merchandise in a timely manner from major suppliers (particularly Nike) as a result of business decisions by our suppliers or any disruption in the supply chain could have a material adverse effect on our business, financial condition, and results of operations. Because of our strong dependence on Nike, any adverse development in Nike's reputation, financial condition or results of operations or the inability of Nike to develop and manufacture products that appeal to our target customers could also have an adverse effect on our business, financial condition, and results of operations. We cannot be certain that we will be able to acquire merchandise at competitive prices or on competitive terms in the future. These risks could have a material adverse effect on our business, financial condition, and results of operations.

**We depend on mall traffic and our ability to secure suitable store locations.**

Our stores are located primarily in enclosed regional and neighborhood malls. Our sales are dependent, in part, on the volume of mall traffic. Mall traffic may be adversely affected by, among other factors, economic downturns, the closing of anchor department stores and/or specialty stores, and a decline in the popularity of mall shopping among our target customers. Further, any terrorist act, natural disaster, or public health or safety concern that decreases the level of mall traffic, or that affects our ability to open and operate stores in affected areas, could have a material

adverse effect on our business.

To take advantage of customer traffic and the shopping preferences of our customers, we need to maintain or acquire stores in desirable locations such as in regional and neighborhood malls anchored by major department stores. We cannot be certain that desirable mall locations will continue to be available at favorable rates. Some traditional enclosed malls are experiencing significantly lower levels of customer traffic, driven by economic conditions as well as the closure of certain mall anchor tenants.

Several large landlords dominate the ownership of prime malls, particularly in the United States, Canada, and Australia, and because of our dependence upon these landlords for a substantial number of our locations, any significant erosion of their financial condition or our relationships with these landlords would negatively affect our ability to obtain and retain store locations. Additionally, further landlord consolidation may negatively affect our ability to negotiate favorable lease terms.

3

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TABLE OF CONTENTS

**We may experience fluctuations in and cyclicalities of our comparable-store sales results.**

Our comparable-store sales have fluctuated significantly in the past, on both an annual and a quarterly basis, and we expect them to continue to fluctuate in the future. A variety of factors affect our comparable-store sales results, including, among others, fashion trends, product innovation, the highly competitive retail sales environment, economic conditions, timing of promotional events, changes in our merchandise mix, calendar shifts of holiday periods, supply chain disruptions, and weather conditions. Many of our products represent discretionary purchases. Accordingly, customer demand for these products could decline in a recession or if our customers develop other priorities for their discretionary spending. These risks could have a material adverse effect on our business, financial condition, and results of operations.

**Economic or political conditions in other countries, including fluctuations in foreign currency exchange rates and tax rates may adversely affect our operations.**

A significant portion of our sales and operating income for 2014 was attributable to our operations in Europe, Canada, Australia, and New Zealand. As a result, our business is subject to the risks associated with doing business outside of the United States such as foreign customer preferences, political unrest, disruptions or delays in shipments, changes in economic conditions in countries in which we operate, foreign currency fluctuations, real estate costs, and labor and employment practices in non-U.S. jurisdictions that may differ significantly from those that prevail in the United States. In addition, because we and our suppliers have a substantial amount of our products manufactured in foreign countries, our ability to obtain sufficient quantities of merchandise on favorable terms may be affected by governmental regulations, trade restrictions, and economic, labor, and other conditions in the countries from which our suppliers obtain their product.

Fluctuations in the value of the euro may affect the value of our European earnings when translated into U.S. dollars. Similarly our earnings in Canada, Australia, and New Zealand may be affected by the value of currencies when translated into U.S. dollars. Our operating results may be adversely affected by significant changes in these foreign currencies relative to the U.S. dollar. For the most part, our international subsidiaries transact in their functional currency, other than in the U.K., whose inventory purchases are denominated in euro, which could result in foreign currency transaction gains or losses.

Our products are subject to import and excise duties and/or sales or value-added taxes in many jurisdictions. Fluctuations in tax rates and duties and changes in tax legislation or regulation could have a material adverse effect on our results of operations and financial condition.

**Macroeconomic developments may adversely affect our business.**

Our performance is subject to global economic conditions and the related impact on consumer spending levels. Continued uncertainty about global economic conditions poses a risk as consumers and businesses postpone spending in response to tighter credit, unemployment, negative financial news, and/or declines in income or asset values, which could have a material negative effect on demand for our products.

As a retailer that is dependent upon consumer discretionary spending, our results of operations are sensitive to changes in macroeconomic conditions. Our customers may have less money for discretionary purchases as a result of job losses, foreclosures, bankruptcies, increased fuel and energy costs, higher interest rates, higher taxes, reduced access to credit, and lower home prices. There is also a risk that if negative economic conditions persist for a long period of time or worsen, consumers may make long-lasting reductions to their discretionary purchasing behavior. These and other economic factors could adversely affect demand for our products and our financial condition and operating results.

## **Instability in the financial markets may adversely affect our business.**

Any instability in the global financial markets could result in diminished credit availability. Although we currently have a revolving credit agreement in place until January 27, 2017, and other than amounts used for standby letters of credit, do not have any borrowings under it, tightening of credit markets could make it more difficult for us to access funds, refinance our existing indebtedness, enter into agreements for new indebtedness or obtain funding through the issuance of the Company's securities.

TABLE OF CONTENTS

We rely on a few key suppliers for a majority of our merchandise purchases (including a significant portion from one key supplier). The inability of key suppliers to access liquidity, or the insolvency of key suppliers, could lead to their failure to deliver merchandise to us. Our inability to obtain merchandise in a timely manner from major suppliers could have a material adverse effect on our business, financial condition, and results of operations.

**Material changes in the market value of the securities we hold may adversely affect our results of operations and financial condition.**

At January 31, 2015, our cash and cash equivalents totaled \$967 million. The majority of our investments were short-term deposits in highly-rated banking institutions. As of January 31, 2015, we had \$537 million of cash and cash equivalents held in foreign jurisdictions. We regularly monitor our counterparty credit risk and mitigate our exposure by making short-term investments only in highly-rated institutions and by limiting the amount we invest in any one institution. We continually monitor the creditworthiness of our counterparties. At January 31, 2015, almost all of the investments were in institutions rated A or better from a major credit rating agency. Despite those ratings, it is possible that the value or liquidity of our investments may decline due to any number of factors, including general market conditions and bank-specific credit issues.

Our U.S. pension plan trust holds assets totaling \$613 million at January 31, 2015. The fair values of these assets held in the trust are compared to the plan's projected benefit obligation to determine the pension funding liability. We attempt to mitigate funding risk through asset diversification, and we regularly monitor investment risk of our portfolio through quarterly investment portfolio reviews and periodic asset and liability studies. Despite these measures, it is possible that the value of our portfolio may decline in the future due to any number of factors, including general market conditions and credit issues. Such declines could have an impact on the funded status of our pension plan and future funding requirements.

**If our long-lived assets, goodwill or other intangible assets become impaired, we may need to record significant non-cash impairment charges.**

We review our long-lived assets, goodwill and other intangible assets when events indicate that the carrying value of such assets may be impaired. Goodwill and other indefinite lived intangible assets are reviewed for impairment if impairment indicators arise and, at a minimum, annually. As of January 31, 2015, we had \$157 million of goodwill; this asset is not amortized but is subject to an impairment test, which consists of either a qualitative assessment on a reporting unit level, or a two-step impairment test, if necessary. The determination of impairment losses are significantly affected by estimates of future operating cash flows and estimates of fair value. Our estimates of future operating cash flows are identified from our strategic long-range plans, which are based upon our experience, knowledge, and expectations; however, these estimates can be affected by such factors as our future operating results, future store profitability, and future economic conditions, all of which can be difficult to predict accurately. Any significant deterioration in macroeconomic conditions could affect the fair value of our long-lived assets, goodwill, and other intangible assets and could result in future impairment charges, which would adversely affect our results of operations.

## **Our financial results may be adversely affected by tax rates or exposure to additional tax liabilities.**

We are a U.S.-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. Our provision for income taxes is based on a jurisdictional mix of earnings, statutory rates, and enacted tax rules, including transfer pricing. Significant judgment is required in determining our provision for income taxes and in evaluating our tax positions on a worldwide basis. Our effective tax rate could be adversely affected by a number of factors, including shifts in the mix of pretax results by tax jurisdiction, changes in tax laws or related interpretations in the jurisdictions in which we operate, and tax assessments and related interest and penalties resulting from income tax audits.

A substantial portion of our cash and investments is invested outside of the United States. As we plan to permanently reinvest our foreign earnings outside the United States, in accordance with U.S. GAAP, we have not provided for U.S. federal and state income taxes or foreign withholding taxes that may result from future remittances of undistributed earnings of foreign subsidiaries. Recent proposals to reform U.S. tax rules may result in a reduction or elimination of the deferral of U.S. income tax on our foreign earnings, which could adversely affect our effective tax rate. Any of these changes could have an adverse effect on our results of operations and financial condition.

TABLE OF CONTENTS

**The effects of natural disasters, terrorism, acts of war, and public health issues may adversely affect our business.**

Natural disasters, including earthquakes, hurricanes, floods, and tornados may affect store and distribution center operations. In addition, acts of terrorism, acts of war, and military action both in the United States and abroad can have a significant effect on economic conditions and may negatively affect our ability to purchase merchandise from suppliers for sale to our customers. Public health issues, such as flu or other pandemics, whether occurring in the United States or abroad, could disrupt our operations and result in a significant part of our workforce being unable to operate or maintain our infrastructure or perform other tasks necessary to conduct our business. Additionally, public health issues may disrupt, or have an adverse effect on, our suppliers' operations, our operations, our customers, or customer demand. Our ability to mitigate the adverse impact of these events depends, in part, upon the effectiveness of our disaster preparedness and response planning as well as business continuity planning. However, we cannot be certain that our plans will be adequate or implemented properly in the event of an actual disaster. We may be required to suspend operations in some or all of our locations, which could have a material adverse effect on our business, financial condition, and results of operations. Any significant declines in public safety or uncertainties regarding future economic prospects that affect customer spending habits could have a material adverse effect on customer purchases of our products.

**Manufacturer compliance with our social compliance program requirements.**

We require our independent manufacturers to comply with our policies and procedures, which cover many areas including labor, health and safety, and environmental standards. We monitor compliance with our policies and procedures using internal resources, as well as third-party monitoring firms. Although we monitor their compliance with these policies and procedures, we do not control the manufacturers or their practices. Any failure of our independent manufacturers to comply with our policies and procedures or local laws in the country of manufacture could disrupt the shipment of merchandise to us, force us to locate alternate manufacturing sources, reduce demand for our merchandise, or damage our reputation.

**Complications in our distribution centers and other factors affecting the distribution of merchandise may affect our business.**

We operate multiple distribution centers worldwide to support our businesses. In addition to the distribution centers that we operate, we have third-party arrangements to support our operations in the United States, Canada, Australia, and New Zealand. If complications arise with any facility or if any facility is severely damaged or destroyed, our other distribution centers may be unable to support the resulting additional distribution demands. We may be affected by disruptions in the global transportation network such as a port strike, weather conditions, work stoppages or other labor unrest. These factors may adversely affect our ability to deliver inventory on a timely basis. We depend upon third-party carriers for shipment of a significant amount of merchandise. An interruption in service by these carriers for any reason could cause temporary disruptions in our business, a loss of sales and profits, and other material adverse effects.

Our freight cost is affected by changes in fuel prices through surcharges. Increases in fuel prices and surcharges, among and other factors, may increase freight costs and thereby increase our cost of sales. We enter into diesel fuel forward and option contracts to mitigate a portion of the risk associated with the variability caused by these surcharges.

**Disruptions, failures or security breaches of our information technology infrastructure or unauthorized disclosure of sensitive or confidential customer information could harm our business and standing with our customers.**

Information technology is a critically important part of our business operations. We depend on information systems to process transactions, manage inventory, operate our websites, purchase, sell and ship goods on a timely basis, and maintain cost-efficient operations. There is a risk that we could experience a business interruption, theft of information, or reputational damage as a result of a cyber-attack, such as an infiltration of a data center or data leakage of confidential information, either internally or at our third-party providers. We may experience operational problems with our information systems as a result of system failures, system implementation issues, viruses, malicious hackers, sabotage, or other causes.



## TABLE OF CONTENTS

Our business involves the storage and transmission of customers' personal information, such as consumer preferences and credit card information. We invest in security technology to protect the data stored by the Company, as well as our data and business processes, against the risk of data security breaches and cyber-attacks. Our data security management program includes enforcement of standard data protection policies such as Payment Card Industry compliance. Additionally, we certify our major technology suppliers and any outsourced services through accepted security certification measures. We maintain and routinely test backup systems and disaster recovery, along with external network security penetration testing by an independent third party as part of our business continuity preparedness.

While we believe that our security technology and processes follow leading practices in the prevention of security breaches and the mitigation of cyber security risks, given the ever-increasing abilities of those intent on breaching cyber security measures and given the necessity of our reliance on the security procedures of third-party vendors, the total security effort at any point in time may not be completely effective. Any such security breaches and cyber incidents could adversely affect our business. Failure of our systems, including failures due to cyber-attacks that would prevent the ability of systems to function as intended, could cause transaction errors, loss of customers and sales, and negative consequences to us, our employees, and those with whom we do business. Any security breach involving the misappropriation, loss, or other unauthorized disclosure of confidential information by us could also severely damage our reputation, expose us to the risks of litigation and liability, and harm our business. While we carry insurance that would mitigate the losses, such insurance may be insufficient to compensate us for potentially significant losses.

### **Risks associated with digital operations.**

Our digital operations are subject to numerous risks, including risks related to the failure of the computer systems that operate our websites and mobile sites and their related support systems, computer viruses, telecommunications failures, and similar disruptions. Also, we may require additional capital in the future to sustain or grow our digital commerce. Business risks related to digital commerce include risks associated with the need to keep pace with rapid technological change, Internet cyber security risks, risks of system failure or inadequacy, governmental regulation, legal uncertainties with respect to Internet regulatory compliance, and collection of sales or other taxes by additional states or foreign jurisdictions. If any of these risks materializes, it could have a material adverse effect on our business.

### **Our reliance on key management.**

Future performance will depend upon our ability to attract, retain, and motivate our executive and senior management team. Our executive and senior management team have substantial experience and expertise in our business and have made significant contributions to our recent growth and success. Our future performance depends to a significant extent both upon the continued services of our current executive and senior management team, as well as our ability to attract, hire, motivate, and retain additional qualified management in the future. While we feel that we have adequate succession planning and executive development programs, competition for key executives in the retail industry is intense, and our operations could be adversely affected if we cannot retain and attract qualified executives.

### **Risks associated with attracting and retaining store and field associates.**

Disruptions, failures or security breaches of our information technology infrastructure or unauthorized disclosure of

Many of the store and field associates are in entry level or part-time positions which, historically, have had high rates of turnover. If we are unable to attract and retain quality associates, our ability to meet our growth goals or to sustain expected levels of profitability may be compromised. Our ability to meet our labor needs while controlling costs is subject to external factors such as unemployment levels, prevailing wage rates, minimum wage legislation, overtime regulations, and changing demographics.

## **We face risks arising from activity by the National Labor Relations Board in the United States.**

The National Labor Relations Board continually considers changes to labor regulations, many of which could significantly affect the nature of labor relations in the United States and how union elections and contract negotiations are conducted. The National Labor Relations Board's current definition of a bargaining unit makes it possible for smaller groups of employees to organize labor unions.

7

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TABLE OF CONTENTS

Furthermore, recent regulations shorten the election process, significantly reducing the time between the filing of a petition and an election being held. These regulations and recent decisions could impose more labor relations requirements and union activity on our business conducted in the United States, thereby potentially increasing our costs, which could negatively affect our profitability.

## **Health care reform could adversely affect our business.**

In 2010, Congress enacted comprehensive health care reform legislation which, among other things, includes guaranteed coverage requirements, eliminates pre-existing condition exclusions and annual and lifetime maximum limits, restricts the extent to which policies can be rescinded, and imposes new and significant taxes on health insurers and health care benefits. Due to the breadth and complexity of the health care reform legislation and the large number of eligible employees who currently choose not to participate in our plans, it is difficult to predict the overall effect of the statute and related regulations on our business over the coming years. Due to the health care law changes, some eligible employees who had historically not chosen to participate in our health care plans have found it more advantageous to participate in our plans effective January 1, 2015. Such changes include tax penalties to persons for not obtaining health care coverage and being ineligible for certain health care subsidies if an employee is eligible for health care coverage under an employer's plan. If a larger number of eligible employees, who currently choose not to participate in our plans, choose to enroll over the next few years, it may significantly increase our health care coverage costs and negatively affect our financial results.

## **Legislative or regulatory initiatives related to global warming/climate change concerns may negatively affect our business.**

There has been an increasing focus and significant debate on global climate change, including increased attention from regulatory agencies and legislative bodies. This increased focus may lead to new initiatives directed at regulating an as-yet unspecified array of environmental matters. Legislative, regulatory, or other efforts in the United States to combat climate change could result in future increases in taxes or in the cost of transportation and utilities, which could decrease our operating profits and could necessitate future additional investments in facilities and equipment. We are unable to predict the potential effects that any such future environmental initiatives may have on our business.

## **We may be adversely affected by regulatory and litigation developments.**

We are exposed to the risk that federal or state legislation may negatively impact our operations. Changes in federal or state wage requirements, employee rights, health care, social welfare or entitlement programs, such as health insurance, paid leave programs, or other changes in workplace regulation could increase our cost of doing business or otherwise adversely affect our operations. Additionally, we are regularly involved in various litigation matters, including class actions and patent infringement claims, which arise in the ordinary course of our business. Litigation or regulatory developments could adversely affect our business operations and financial performance.

**We operate in many different jurisdictions and we could be adversely affected by violations of the U.S. Foreign Corrupt Practices Act and similar worldwide anti-corruption laws.**

The U.S. Foreign Corrupt Practices Act ( FCPA ) and similar worldwide anti-corruption laws, including the U.K. Bribery Act of 2010, which is broader in scope than the FCPA, generally prohibit companies and their intermediaries from making improper payments to non-U.S. officials for the purpose of obtaining or retaining business. Our internal policies mandate compliance with these anti-corruption laws. Despite our training and compliance programs, we cannot be assured that our internal control policies and procedures will always protect us from reckless or criminal acts committed by our employees or agents.

Our continued expansion outside the United States, including in developing countries, could increase the risk of FCPA violations in the future. Violations of these laws, or allegations of such violations, could disrupt our business and result in a material adverse effect on our results of operations or financial condition.

TABLE OF CONTENTS

**Failure to fully comply with Section 404 of the Sarbanes-Oxley Act of 2002 could negatively affect our business, market confidence in our reported financial information, and the price of our common stock.**

We continue to document, test, and monitor our internal controls over financial reporting in order to satisfy all of the requirements of Section 404 of the Sarbanes-Oxley Act of 2002; however, we cannot be assured that our disclosure controls and procedures and our internal controls over financial reporting will prove to be completely adequate in the future. Failure to fully comply with Section 404 of the Sarbanes-Oxley Act of 2002 could negatively affect our business, market confidence in our reported financial information, and the price of our common stock.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

The properties of the Company and its consolidated subsidiaries consist of land, leased stores, administrative facilities, and distribution centers. Gross square footage and total selling area for the Athletic Stores segment at the end of 2014 were approximately 12.73 and 7.48 million square feet, respectively. These properties, which are primarily leased, are located in the United States, Canada, various European countries, Australia, and New Zealand.

The Company currently operates seven distribution centers, of which three are owned and four are leased, occupying an aggregate of 2.9 million square feet. Three distribution centers are located in the United States, three in Germany, and one in the Netherlands. The three locations in Germany relate to the central warehouse distribution centers for the Runners Point Group store locations, as well as a distribution center for its direct-to-customer business. During 2014, we opened a new distribution center in Germany which provides us with increased capacity that will enable us to support the planned growth of both the store and direct-to-customer businesses. This larger distribution center will also allow us to consolidate the other two locations in Germany in 2015.

We also own a cross-dock and manufacturing facility and operate a leased warehouse in the United States, both of which support our Team Edition apparel business.

**Item 3. Legal Proceedings**

Information regarding the Company's legal proceedings is contained in the *Legal Proceedings* note under Item 8. Consolidated Financial Statements and Supplementary Data.

**Item 4. Mine Safety Disclosures**