

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

FORM 10-Q

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

For the quarterly period ended August 3, 2019

OR

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

Commission File Number: 1-33338

AMERICAN EAGLE OUTFITTERS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

77 Hot Metal Street, Pittsburgh, PA

(Address of principal executive offices)

13-2721761

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

15203-2329

(Zip Code)

(412) 432-3300

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.01 par value	AEO	New York Stock Exchange

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 every Interactive Data File required to be submitted 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 such files). YES NO

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 168,963,058 Common Shares were outstanding at September 3, 2019.

AMERICAN EAGLE OUTFITTERS, INC.
TABLE OF CONTENTS

	<u>Page Number</u>	
<u>PART I - FINANCIAL INFORMATION</u>		
Item 1.	Financial Statements	3
	Consolidated Balance Sheets: August 3, 2019, February 2, 2019 and August 4, 2018	3
	Consolidated Statements of Operations: 13 and 26 weeks ended August 3, 2019 and August 4, 2018	4
	Consolidated Statements of Comprehensive Income: 13 and 26 weeks ended August 3, 2019 and August 4, 2018	5
	Consolidated Statements of Stockholders' Equity: 13 and 26 weeks ended August 3, 2019 and August 4, 2018	6
	Consolidated Statements of Cash Flows: 26 weeks ended August 3, 2019 and August 4, 2018	7
	Notes to Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	29
Item 4.	Controls and Procedures	29
<u>PART II - OTHER INFORMATION</u>		
Item 1.	Legal Proceedings	30
Item 1A.	Risk Factors	30
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	30
Item 3.	Defaults Upon Senior Securities	N/A
Item 4.	Mine Safety Disclosures	N/A
Item 5.	Other Information	N/A
Item 6.	Exhibits	31

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

AMERICAN EAGLE OUTFITTERS, INC.
CONSOLIDATED BALANCE SHEETS

<i>(In thousands, except per share amounts)</i>	August 3, 2019 <i>(Unaudited)</i>	February 2, 2019	August 4, 2018 <i>(Unaudited)</i>
Assets			
Current assets:			
Cash and cash equivalents	\$ 267,166	\$ 333,330	\$ 323,322
Short-term investments	50,000	92,135	40,000
Merchandise inventory	534,762	424,404	466,112
Accounts receivable, net	98,604	93,477	74,153
Prepaid expenses and other	69,541	102,907	93,493
Total current assets	<u>1,020,073</u>	<u>1,046,253</u>	<u>997,080</u>
Property and equipment, at cost, net of accumulated depreciation	754,031	742,149	732,350
Operating lease right-of-use assets	1,462,544	—	—
Intangible assets net, including goodwill	56,326	58,167	59,990
Non-current deferred income taxes	16,759	14,062	8,558
Other assets	49,426	42,747	52,771
Total assets	<u>\$ 3,359,159</u>	<u>\$ 1,903,378</u>	<u>\$ 1,850,749</u>
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable	\$ 316,995	\$ 240,671	\$ 264,247
Current portion of operating lease liabilities	279,207	—	—
Accrued income and other taxes	17,754	20,064	18,332
Accrued compensation and payroll taxes	54,683	82,173	51,903
Unredeemed gift cards and gift certificates	34,742	53,997	33,185
Other current liabilities and accrued expenses	60,265	145,740	140,353
Total current liabilities	<u>763,646</u>	<u>542,645</u>	<u>508,020</u>
Non-current liabilities:			
Non-current operating lease liabilities	1,338,634	—	—
Other non-current liabilities	28,302	73,178	82,152
Total non-current liabilities	<u>1,366,936</u>	<u>73,178</u>	<u>82,152</u>
Commitments and contingencies	—	—	—
Stockholders' equity:			
Preferred stock, \$0.01 par value; 5,000 shares authorized; none issued and outstanding	—	—	—
Common stock, \$0.01 par value; 600,000 shares authorized; 249,566 shares issued; 168,962, 172,436 and 176,217 shares outstanding, respectively	2,496	2,496	2,496
Contributed capital	568,413	574,929	560,349
Accumulated other comprehensive loss	(36,630)	(34,832)	(32,646)
Retained earnings	2,070,077	2,054,654	1,941,536
Treasury stock, 80,604, 77,130 and 73,349 shares, respectively	(1,375,779)	(1,309,692)	(1,211,158)
Total stockholders' equity	<u>1,228,577</u>	<u>1,287,555</u>	<u>1,260,577</u>
Total liabilities and stockholders' equity	<u>\$ 3,359,159</u>	<u>\$ 1,903,378</u>	<u>\$ 1,850,749</u>

Refer to Notes to Consolidated Financial Statements

AMERICAN EAGLE OUTFITTERS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	13 Weeks Ended		26 Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
<i>(In thousands, except per share amounts)</i>				
Total net revenue	\$ 1,040,879	\$ 964,853	\$ 1,927,169	\$ 1,787,814
Cost of sales, including certain buying, occupancy and warehousing expenses	658,308	611,752	1,219,677	1,130,271
Gross profit	382,571	353,101	707,492	657,543
Selling, general and administrative expenses	253,051	233,971	483,791	444,205
Restructuring charges	2,728	—	4,272	1,568
Depreciation and amortization expense	44,870	42,739	89,661	84,674
Operating income	81,922	76,391	129,768	127,096
Other income, net	3,990	860	8,172	1,362
Income before income taxes	85,912	77,251	137,940	128,458
Provision for income taxes	20,931	16,918	32,206	28,196
Net income	\$ 64,981	\$ 60,333	\$ 105,734	\$ 100,262
Net income per basic share	\$ 0.38	\$ 0.34	\$ 0.61	\$ 0.57
Net income per diluted share	\$ 0.38	\$ 0.34	\$ 0.61	\$ 0.56
Weighted average common shares outstanding - basic	170,756	177,249	172,291	177,329
Weighted average common shares outstanding - diluted	171,781	178,505	173,701	178,730

Refer to Notes to Consolidated Financial Statements

AMERICAN EAGLE OUTFITTERS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

<i>(In thousands)</i>	13 Weeks Ended		26 Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Net income	\$ 64,981	\$ 60,333	\$ 105,734	\$ 100,262
Other comprehensive income:				
Foreign currency translation (loss) income	(1,276)	(2,290)	(1,798)	1,850
Other comprehensive (loss) income:	(1,276)	(2,290)	(1,798)	1,850
Comprehensive income	\$ 63,705	\$ 58,043	\$ 103,936	\$ 102,112

Refer to Notes to Consolidated Financial Statements

AMERICAN EAGLE OUTFITTERS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

13 Weeks Ended August 3, 2019 and August 4, 2018

<i>(In thousands, except per share amounts)</i>	Shares Outstanding	Common Stock	Contributed Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Stockholders' Equity
Balance at May 4, 2019	171,870	\$ 2,496	\$ 570,443	\$ 2,028,627	\$ (1,324,461)	\$ (35,354)	\$ 1,241,751
Stock awards	—	—	9,207	—	—	—	9,207
Repurchase of common stock as part of publicly announced programs	(3,425)	—	—	—	(60,000)	—	(60,000)
Repurchase of common stock from employees	(252)	—	—	—	(4,423)	—	(4,423)
Reissuance of treasury stock	769	—	(11,797)	261	13,105	—	1,569
Net income	—	—	—	64,981	—	—	64,981
Other comprehensive income, net of tax	—	—	—	—	—	(1,276)	(1,276)
Cash dividends and dividend equivalents (\$0.1375 per share)	—	—	560	(23,792)	—	—	(23,232)
Balance at August 3, 2019	168,962	\$ 2,496	\$ 568,413	\$ 2,070,077	\$ (1,375,779)	\$ (36,630)	\$ 1,228,577
Balance at May 5, 2018	176,216	\$ 2,496	\$ 565,033	\$ 1,904,190	\$ (1,229,402)	\$ (34,936)	\$ 1,207,381
Stock awards	—	—	5,826	—	—	—	5,826
Repurchase of common stock from employees	(180)	—	—	—	(4,086)	—	(4,086)
Reissuance of treasury stock	1,330	—	(11,042)	1,932	22,330	—	13,220
Net income	—	—	—	60,333	—	—	60,333
Other comprehensive income, net of tax	—	—	—	—	—	2,290	2,290
Cash dividends and dividend equivalents (\$0.1375 per share)	—	—	532	(24,919)	—	—	(24,387)
Balance at August 4, 2018	177,366	\$ 2,496	\$ 560,349	\$ 1,941,536	\$ (1,211,158)	\$ (32,646)	\$ 1,260,577

26 Weeks Ended August 3, 2019 and August 4, 2018

<i>(In thousands, except per share amounts)</i>	Shares Outstanding	Common Stock	Contributed Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Stockholders' Equity
Balance at February 2, 2019	172,436	\$ 2,496	\$ 574,929	\$ 2,054,654	\$ (1,309,692)	\$ (34,832)	\$ 1,287,555
Stock awards	—	—	14,166	—	—	—	14,166
Repurchase of common stock as part of publicly announced programs	(4,336)	—	—	—	(80,000)	—	(80,000)
Repurchase of common stock from employees	(421)	—	—	—	(7,921)	—	(7,921)
Adoption of ASC 842, net of tax	—	—	—	(44,435)	—	—	(44,435)
Reissuance of treasury stock	1,283	—	(21,672)	1,979	21,834	—	2,141
Net income	—	—	—	105,734	—	—	105,734
Other comprehensive income, net of tax	—	—	—	—	—	(1,798)	(1,798)
Cash dividends and dividend equivalents (\$0.275 per share)	—	—	990	(47,855)	—	—	(46,865)
Balance at August 3, 2019	168,962	\$ 2,496	\$ 568,413	\$ 2,070,077	\$ (1,375,779)	\$ (36,630)	\$ 1,228,577
Balance at February 3, 2018	177,316	\$ 2,496	\$ 593,770	\$ 1,883,592	\$ (1,202,272)	\$ (30,795)	\$ 1,246,791
Stock awards	—	—	11,379	—	—	—	11,379
Repurchase of common stock as part of publicly announced programs	(2,300)	—	—	—	(44,913)	—	(44,913)
Repurchase of common stock from employees	(903)	—	—	—	(18,299)	—	(18,299)
Adoption of ASC 606	—	—	—	152	—	—	152
Reissuance of treasury stock	3,253	—	(45,768)	7,110	54,326	—	15,668
Net income	—	—	—	100,262	—	—	100,262
Other comprehensive income, net of tax	—	—	—	—	—	(1,850)	(1,850)
Cash dividends and dividend equivalents (\$0.275 per share)	—	—	968	(49,580)	—	—	(48,612)
Balance at August 4, 2018	177,366	\$ 2,496	\$ 560,349	\$ 1,941,536	\$ (1,211,158)	\$ (32,646)	\$ 1,260,577

Refer to Notes to Consolidated Financial Statements

AMERICAN EAGLE OUTFITTERS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

<i>(In thousands)</i>	26 Weeks Ended	
	August 3, 2019	August 4, 2018
Operating activities:		
Net income	\$ 105,734	\$ 100,262
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	90,787	85,745
Share-based compensation	14,298	11,731
Deferred income taxes	11,823	(2,669)
Changes in assets and liabilities:		
Merchandise inventory	(110,768)	(69,570)
Operating lease assets and liabilities, net	(12,038)	—
Other assets	(27,368)	(11,312)
Accounts payable	76,326	22,992
Accrued compensation and payroll taxes	(27,436)	(2,946)
Accrued and other liabilities	(3,761)	18,164
Net cash provided by operating activities	117,597	152,397
Investing activities:		
Capital expenditures for property and equipment	(91,793)	(101,360)
Purchase of available-for-sale investments	(50,000)	(40,000)
Sale of available-for-sale investments	92,135	—
Other investing activities	(1,201)	(428)
Net cash used for investing activities	(50,859)	(141,788)
Financing activities:		
Repurchase of common stock as part of publicly announced programs	(80,000)	(44,913)
Repurchase of common stock from employees	(7,921)	(18,299)
Net proceeds from stock options exercised	2,119	15,496
Cash dividends paid	(46,865)	(48,612)
Other financing activities	(108)	(4,556)
Net cash used for financing activities	(132,775)	(100,884)
Effect of exchange rates changes on cash	(127)	(16)
Net change in cash and cash equivalents	(66,164)	(90,291)
Cash and cash equivalents - beginning of period	333,330	413,613
Cash and cash equivalents - end of period	<u>\$ 267,166</u>	<u>\$ 323,322</u>

Refer to Notes to Consolidated Financial Statements

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 August 3, 2019 and August 4, 2018 and for the 13 and 26 week periods ended August 3, 2019 and August 4, 2018 have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Certain notes and other information have been condensed or omitted from the interim Consolidated Financial Statements presented in this Quarterly Report on Form 10-Q. Therefore, these Consolidated Financial Statements should be read in conjunction with the Company’s Fiscal 2018 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 14, 2019 (the “Fiscal 2018 Form 10-K”). 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,” “AE” and the “AE Brand” refer to our American Eagle stores. “Aerie” refers to our Aerie® by American Eagle® stores. “AEO Direct” refers to our e-commerce operations, www.ae.com and www.aerie.com. “Tailgate” refers to our Tailgate brand of vintage, sports- inspired apparel. “Todd Snyder” refers to our Todd Snyder New York premium menswear brand.

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

2. Summary of Significant Accounting Policies

Principles of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. At August 3, 2019, and for all periods presented, the Company operated in one reportable segment.

Fiscal Year

Our fiscal year is a 52- or 53-week year that ends on the Saturday nearest to January 31. As used herein, “Fiscal 2019” refers to the 52-week period that will end on February 1, 2020. “Fiscal 2018” refers to the 52-week period ended February 2, 2019.

Estimates

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

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) established Accounting Standards Codification (“ASC”) Topic 842, *Leases* (“ASC 842”), by issuing Accounting Standards Update (“ASU”) No. 2016-02. ASC 842 was subsequently amended by ASU No. 2018-01, *Land Easement Practical Expedient for Transition to Topic 842*; ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*; and ASU No. 2018-11, *Targeted Improvements*.

The new standard establishes a right-of-use model (“ROU”) that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement.

The Company adopted ASU 2016-02 and its subsequent amendments effective February 3, 2019. Financial information has not been updated and the disclosures required under the new standard have not been provided for dates and periods before February 3, 2019. The Company elected the new standard’s package of practical expedients, which permits the Company to maintain prior conclusions about lease identification, lease classification, and initial direct costs. The Company elected to use the go-forward practical expedient to not separate lease and non-lease components for all of our leases. The Company also elected to use the short-term lease recognition exemption for all leases that qualify.

Upon adoption, the Company:

- Recognized lease liabilities and right-of-use assets of \$1.6 billion, for the present value of the remaining minimum rental payments on existing operating leases (including consideration related to non-lease components due to the related practical expedient).
- Recognized a transition adjustment of \$44.4 million (net of tax effects of \$15.0 million) to beginning retained earnings related to the impairment of newly recognized right-of-use assets related to store assets that were impaired prior to the date of adoption.
- Reclassified \$82.9 million of straight-line deferred rent, \$55.0 million of deferred lease credits, and \$40.4 million of prepaid rent to the ROU asset. Combined with the impairment discussed above, these reclassifications reduced the net ROU asset to \$1.4 billion. Corresponding amounts were not reclassified in prior periods as those prior periods are presented under ASC 840, *Leases*.

Refer to Note 9 to the Consolidated Financial Statements for information regarding leases.

In February 2018, the FASB issued ASU 2018-02, *Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income* (“ASU 2018-02”). This guidance permits companies to reclassify the stranded tax effects of the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) on items within accumulated other comprehensive income to retained earnings. The Company adopted ASU 2018-02 on February 3, 2019. The adoption did not have a material impact on our Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment* (“ASU 2017-04”). This ASU simplifies the accounting for goodwill impairments under Step 2 by eliminating the requirement to perform procedures to determine the fair value of the assets and liabilities of the reporting unit, including previously unrecognized assets and liabilities, in order to determine the fair value of the goodwill and any impairment charge to be recognized. The Company adopted ASU 2017-04 on February 3, 2019. The adoption did not have an impact on our Consolidated Financial Statements, as no goodwill was determined to be impaired during the 26 weeks ended August 3, 2019.

Foreign Currency Translation

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

Cash and Cash Equivalents and Short-term Investments

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

As of both August 3, 2019 and August 4, 2018, short-term investments classified as available-for-sale included certificates of deposit with a maturity of greater than three months, but less than one year.

Refer to Note 3 to the Consolidated Financial Statements for information regarding cash and cash equivalents and short-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 when control of the merchandise has transferred to the Company.

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

Revenue Recognition

In May 2014, the FASB issued ASC 606, *Revenue From Contracts With Customers* ("ASC 606"), a comprehensive new revenue recognition model that expands disclosure requirements and requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. ASC 606 is effective for annual reporting periods beginning after December 15, 2017. The Company adopted ASC 606 on February 4, 2018. Results for reporting periods beginning on or after February 4, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting. The Company recorded a net increase to opening retained earnings of \$0.2 million as of February 4, 2018 due to the cumulative impact of adoption. The impact was the result of accounting for customer loyalty programs using a relative stand-alone selling price method versus incremental cost method. The Company defers a portion of the sales revenue attributed to the loyalty points and recognizes revenue when the points are redeemed or expire, consistent with the requirements of ASC 606. Refer to the Customer Loyalty Program caption below for additional information.

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

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

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

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

The following table sets forth the approximate consolidated percentage of total net revenue attributable to each merchandise group for each of the periods indicated:

	13 Weeks Ended		26 Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Men's apparel and accessories	28%	30%	28%	30%
Women's apparel and accessories (excluding Aerie)	53%	54%	54%	54%
Aerie	19%	16%	18%	16%
Total	100%	100%	100%	100%

The following table disaggregates the Company's Total Net Revenue by geography:

<i>(In thousands)</i>	13 Weeks Ended		26 Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Total net revenue:				
United States	\$ 869,001	\$ 835,692	\$ 1,642,482	\$ 1,550,650
Foreign (1)	171,878	129,161	284,687	237,164
Total net revenue	\$ 1,040,879	\$ 964,853	\$ 1,927,169	\$ 1,787,814

- (1) Amounts represent sales from American Eagle and Aerie international retail stores, e-commerce sales that are billed and/or shipped to foreign countries, and international franchise royalty revenue.

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

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

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

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

Selling, General and Administrative Expenses

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

Other Income, Net

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

Property and Equipment

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

Buildings	25 years
Leasehold improvements	Lesser of 10 years or the term of the lease
Fixtures and equipment	5 years
Information technology	3-5 years

As of August 3, 2019, the weighted average remaining useful life of our assets was approximately 8 years.

In accordance with ASC 360, *Property, Plant, and Equipment* ("ASC 360"), the Company evaluates long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified, for stores that have been open for a period of time sufficient to reach maturity. Impairment losses are recorded on long-lived assets used in operations when events and circumstances indicate that the assets are impaired and the undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. When events such as these occur, the impaired assets are adjusted to their estimated fair value and an impairment loss is recorded. No long-lived asset impairment charges were recorded during the 13 or 26 weeks ended August 3, 2019 or August 4, 2018.

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

Intangible Assets including Goodwill

The Company's goodwill is primarily related to the acquisition of its importing operations, Canada business and Tailgate and Todd Snyder brands. 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 February 2, 2019. As a result of the Company's annual goodwill impairment test, the Company concluded that its goodwill was not impaired.

Definite-lived 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 definite-lived intangible assets, which consists primarily of trademark assets, are generally amortized over 15 to 25 years.

The Company evaluates definite-lived 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 is less than the carrying amounts of the assets, then the assets are impaired and are adjusted to their estimated fair value. No definite-lived intangible asset impairment charges were recorded during the 13 or 26 weeks ended August 3, 2019 or August 4, 2018.

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

Gift Cards

Revenue is not recorded on the issuance of gift cards. The value of a gift card is recorded as a current liability upon issuance, and revenue is recognized when the gift card is redeemed for merchandise. The Company estimates gift card breakage and recognizes revenue in proportion to actual gift card redemptions as a component of total net revenue.

The Company determines an estimated gift card breakage rate by continuously evaluating historical redemption data and the time when there is a remote likelihood that a gift card will be redeemed. The Company recorded \$1.8 million and \$2.1 million of revenue related to gift card breakage during the 13 weeks ended August 3, 2019 and August 4, 2018, respectively. During the 26 weeks ended August 3, 2019 and August 4, 2018, the Company recorded \$3.9 million and \$4.6 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 an adjustment to the operating lease ROU asset at the lease commencement date (date of initial possession of the store). The deferred lease credit is amortized as part of the single lease cost over the term of the original lease (including the pre-opening build-out period). The receivable is reduced as amounts are received from the landlord.

Co-branded Credit Card

The Company offers a co-branded credit card (the “AEO Visa Card”) and a private label credit card (the “AEO Credit Card”) under the AE and Aerie brands. These credit cards are issued by a third-party bank (the “Bank”) in accordance with a credit card agreement (“the Agreement”). The Company has no liability to the Bank for bad debt expense, provided that purchases are made in accordance with the Bank’s procedures. We receive funding from the Bank based on the Agreement and card activity, which includes payments for new account activations and usage of the credit cards. We recognize revenue for this funding when the amounts are fixed or determinable and collectability is reasonably assured. This revenue is recorded in other revenue, which is a component of total net revenue in our Consolidated Statements of Operations and Retained Earnings. The adoption of ASC 606 did not have an impact of the Company’s accounting for the co-branded credit card.

For further information on the Company’s loyalty program, refer to the Customer Loyalty Program caption below.

Customer Loyalty Program

In 2017, the Company launched a new, digitized loyalty program called AEO Connected™ (the “Program”). This Program integrates the credit card rewards program and the AEREWARDS loyalty program into one combined customer offering. Under the Program, customers accumulate points based on purchase activity and earn rewards by reaching certain point thresholds. Customers earn rewards in the form of discount savings certificates. Rewards earned are valid through the stated expiration date, which is 45 days from the issuance date of the reward. Rewards not redeemed during the 45-day redemption period are forfeited. Additional rewards are also given for key items such as jeans and bras.

Points earned under the Program on purchases at American Eagle and Aerie are accounted for in accordance with ASC 606. 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, using the relative stand-alone selling price method. Additionally, reward points earned using the co-branded credit card on non-AE or Aerie purchases are accounted for in accordance with ASC 606. 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.

Sales Return Reserve

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 total net revenue and cost of sales. The sales return reserve reflects an estimate of sales returns based on projected merchandise returns determined through the use of historical average return percentages.

The presentation on a gross basis consists of a separate right of return asset and liability. These amounts are recorded within (i) prepaid expenses and other and (ii) other current liabilities and accrued expenses, respectively, on the Consolidated Balance Sheets.

Income Taxes

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

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

The calculation of 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, requires management to make estimates and assumptions. The Company believes that its estimates and assumptions are reasonable, although actual results may have a positive or negative material impact on the balances of deferred tax assets and liabilities, valuation allowances or net income.

Refer to Note 11 to the Consolidated Financial Statements for additional information regarding income taxes.

Segment Information

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

3. Cash and Cash Equivalents and Short-term Investments

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

<i>(In thousands)</i>	August 3, 2019	February 2, 2019	August 4, 2018
Cash and cash equivalents:			
Cash	\$ 144,241	\$ 108,216	\$ 184,280
Interest bearing deposits	122,925	165,274	72,886
Commercial paper	—	59,840	66,156
Total cash and cash equivalents	\$ 267,166	\$ 333,330	\$ 323,322
Short-term investments			
Certificates of deposit	50,000	70,000	40,000
Commercial paper	—	22,135	—
Total short-term investments	50,000	92,135	40,000
Total	\$ 317,166	\$ 425,465	\$ 363,322

4. Fair Value Measurements

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

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.
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company's cash equivalents and short-term investments are Level 1 financial assets and are measured at fair value on a recurring basis, for all periods presented. Refer to Note 3 to the Consolidated Financial Statements for additional information regarding cash equivalents and short-term investments.

During the 13 and 26 weeks ended August 3, 2019 and August 4, 2018, we did not have any financial instruments that required other fair value measurements.

5. Earnings per Share

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

<i>(In thousands)</i>	13 Weeks Ended		26 Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Weighted average common shares outstanding:				
Basic number of common shares outstanding	170,756	177,249	172,291	177,329
Dilutive effect of stock options and non-vested restricted stock	1,025	1,256	1,410	1,401
Diluted number of common shares outstanding	171,781	178,505	173,701	178,730
Anti-dilutive shares	768	1,418	434	1,421

Dilutive and anti-dilutive shares relate to share-based compensation. 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:

<i>(In thousands)</i>	August 3, 2019	February 2, 2019	August 4, 2018
Property and equipment, at cost	\$ 2,271,371	\$ 2,180,850	\$ 2,096,940
Less: Accumulated depreciation and impairment	(1,517,340)	(1,438,701)	(1,364,590)
Property and equipment, net	\$ 754,031	\$ 742,149	\$ 732,350

7. Intangible Assets, including Goodwill

Intangible assets consist of the following:

<i>(In thousands)</i>	August 3, 2019	February 2, 2019	August 4, 2018
Goodwill	\$ 14,875	\$ 14,899	\$ 14,926
Trademarks, at cost	71,226	70,994	70,750
Less: Accumulated amortization	(29,775)	(27,726)	(25,686)
Intangible assets, net	\$ 56,326	\$ 58,167	\$ 59,990

8. Other Credit Arrangements

In January 2019, the Company entered into an amended and restated Credit Agreement (“Credit Agreement”) for five-year, syndicated, asset-based revolving credit facilities (the “Credit Facilities”). The Credit Agreement provides senior secured revolving credit for loans and letters of credit up to \$400 million, subject to customary borrowing base limitations. The Credit Facilities provide increased financial flexibility and take advantage of a favorable credit environment.

All obligations under the Credit Facilities are unconditionally guaranteed by certain subsidiaries. The obligations under the Credit Agreement are secured by a first-priority security interest in certain working capital assets of the borrowers and guarantors, consisting primarily of cash, receivables, inventory and certain other assets and have been further secured by first-priority mortgages on certain real property.

9. Leases

The Company leases all store premises, some of its office space and certain information technology and office equipment. These leases are generally classified as operating leases.

Store leases generally provide for a combination of base rentals and contingent rent based on store sales. Additionally, most leases include landlord incentives such as construction allowances and rent holidays. The Company is typically responsible for tenant occupancy costs including maintenance costs, common area charges, real estate taxes, and certain other expenses.

Most leases include one or more options to renew. The exercise of lease renewal options is at the Company's discretion and is not reasonably certain at lease commencement. When measuring ROU assets and lease liabilities after the date of adoption of ASC 842, the Company only includes cash flows related to options to extend or terminate leases once those options are executed.

Some leases have variable payments. However, because they are not based on an index or rate, they are not included in the measurement of ROU assets and lease liabilities.

The Company uses its incremental borrowing rate as a basis for the discount rates used in the measurement of ROU assets and lease liabilities.

For leases that qualify for the short-term lease exemption, the Company does not record a lease liability or ROU asset. Short-term lease payments are recognized on a straight-line basis over the lease term of 12 months or less.

<i>(In thousands)</i>	13 Weeks Ended Aug 3, 2019	26 Weeks Ended Aug 3, 2019
Lease costs		
Operating lease costs	\$ 85,519	\$ 168,081
Variable lease costs	24,899	48,455
Short-term leases and other lease costs	11,057	23,901
Total lease costs	\$ 121,475	\$ 240,437
Other information		
Operating cash flows for operating leases	\$ (80,397)	\$ (153,403)
New ROU asset for operating leases entered into during the period	\$ 99,830	\$ 155,927

Lease term and discount rate	Aug 3, 2019
Weighted-average remaining lease term - operating leases	6.4 years
Weighted-average discount rate - operating leases	5.1%

The table below is a maturity analysis of the operating leases in effect as of the end of the period. Undiscounted cash flows for finance leases and short-term leases are not material for the periods reported and are excluded from the table below:

<i>(In thousands)</i>	Undiscounted cash flows Aug 3, 2019
Fiscal years:	
2019 (remaining 26 weeks)	\$ 146,995
2020	353,668
2021	312,430
2022	261,947
2023	240,622
Thereafter	608,750
Total undiscounted cash flows	\$ 1,924,412
Less: discount on lease liability	(306,571)
Total lease liability	\$ 1,617,841

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 26 weeks ended August 3, 2019 and was \$9.3 million (\$7.0 million, net of tax) and \$14.3 million (\$10.9 million, net of tax), respectively, and for the 13 and 26 weeks ended August 4, 2018 was \$6.0 million (\$4.7 million, net of tax) and \$11.7 million (\$9.0 million, net of tax), respectively.

Stock Option Grants

The Company grants both time-based and performance-based stock options. A summary of the Company's stock option activity for the 26 weeks ended August 3, 2019 follows:

	Options <i>(In thousands)</i>	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term <i>(In years)</i>	Aggregate Intrinsic Value <i>(In thousands)</i>
Outstanding - February 2, 2019	1,912	\$ 16.75		
Granted	807	\$ 21.26		
Exercised (1)	(124)	\$ 16.06		
Cancelled	(11)	\$ 19.89		
Outstanding - August 3, 2019	2,584	\$ 18.18	5.4	\$ 1,446
Vested and expected to vest - August 3, 2019	2,279	\$ 18.25	5.4	\$ 510
Exercisable - August 3, 2019 (2)	997	\$ 16.10	4.5	\$ 910

- (1) Options exercised during the 26 weeks ended August 3, 2019 had exercise prices ranging from \$14.59 to \$23.53.
(2) Options exercisable represent "in-the-money" vested options based upon the weighted-average exercise price of vested options compared to the Company's stock price on August 3, 2019.

Cash received from the exercise of stock options was \$2.1 million and \$15.5 million for the 26 weeks ended August 3, 2019 and August 4, 2018, respectively. The actual tax benefit realized from stock option exercises totaled \$0.1 million for the 26 weeks ended August 3, 2019 and \$0.9 million for the 26 weeks ended August 4, 2018.

As of August 3, 2019, there was \$7.6 million of unrecognized compensation expense for stock option awards that is expected to be recognized over a weighted average period of 2.2 years.

The fair value of stock options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

Black-Scholes Option Valuation Assumptions	26 Weeks Ended August 3, 2019	26 Weeks Ended August 4, 2018
Risk-free interest rate (1)	2.2%	2.6%
Dividend yield	2.4%	2.5%
Volatility factor (2)	38.2%	39.5%
Weighted-average expected term (3)	4.4 years	4.5 years

- (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. The weighted average expected option terms were determined based on historical experience.

Restricted Stock Grants

Time-based restricted stock awards are comprised of time-based restricted stock units. These awards vest over three years. 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.

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 table:

	Time-Based Restricted Stock Units		Performance-Based Restricted Stock Units	
	26 Weeks Ended August 3, 2019		26 Weeks Ended August 3, 2019	
(Shares in thousands)	Shares	Weighted -Average Grant Date Fair Value	Shares	Weighted -Average Grant Date Fair Value
Nonvested - February 2, 2019	1,999	\$ 18.00	1,900	\$ 17.44
Granted	1,141	\$ 17.54	591	\$ 19.87
Vested	(906)	\$ 16.06	(245)	\$ 15.99
Cancelled	(47)	\$ 16.82	(346)	\$ 16.00
Nonvested - August 3, 2019	2,187	\$ 18.58	1,900	\$ 19.14

As of August 3, 2019, there was \$32.0 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 2.4 years. Based on current probable performance, there is \$7.3 million of unrecognized compensation expense related to performance-based restricted stock unit awards which will be recognized as achievement of performance goals is probable over a one to three year period.

As of August 3, 2019, the Company had 4.0 million shares available for all equity grants.

11. Income Taxes

The provision for income taxes is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for discrete quarterly events. The effective income tax rate for the 13 weeks ended August 3, 2019 was 24.4% compared to 21.9% for the 13 weeks ended August 4, 2018. The effective income tax rate for the 26 weeks ended August 3, 2019 was 23.3% compared to 21.9% for the 26 weeks ended August 4, 2018. The increase in the effective income tax rate this year is primarily due to changes in unrecognized tax benefits and less favorable excess tax benefits from share-based payments in accordance with ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*.

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 a result of the evaluation of new information not previously available. Unrecognized tax benefits decreased by approximately \$2.0 million during the 13 weeks ended August 3, 2019. Over the next twelve months, the Company believes that it is reasonably possible that unrecognized tax benefits may decrease by approximately \$2.5 million due to settlements, expiration of statute of limitations or other changes in unrecognized tax benefits.

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"), the Company 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, results of operations or consolidated cash flows of the Company. However, our assessment of any litigation or other legal claims could potentially change in light of the discovery of facts not presently known or determinations by judges, juries, or other finders of fact which are not in accord with management's evaluation of the possible liability or outcome of such litigation or claims.

13. Restructuring Charges

During the 13 and 26 weeks ended August 3, 2019, the Company recorded pre-tax restructuring charges of \$2.7 million and \$4.3 million, respectively. These amounts consist primarily of corporate severance charges and closure costs for our company-owned and operated stores in China.

During the 26 weeks ended August 4, 2018, the Company recorded pre-tax restructuring charges of \$1.6 million. These amounts consist primarily of charges for corporate severance costs.

The Company may incur additional charges for corporate and international restructuring in Fiscal 2019. The magnitude is dependent on a number of factors, including negotiating third-party agreements, adherence to notification requirements and local laws.

A rollforward of the liabilities recognized in the Consolidated Balance Sheet is in the table below. The accrued liability as of February 2, 2019 relates to previous restructuring activities disclosed in the Company's Fiscal 2018 Form 10-K, which remained unpaid at the beginning of Fiscal 2019. As of August 3, 2019, \$2.3 million of accrued liability is included in accrued compensation and \$1.8 million is included in other current liabilities on the consolidated balance sheet.

	<u>26 Weeks Ended</u>	
	August 3, 2019	
<i>(In thousands)</i>		
Accrued liability as of February 2, 2019	\$	6,629
Add: Costs incurred, excluding non-cash charges		4,272
Less: Cash payments and adjustments		(6,835)
Accrued liability as of August 3, 2019	\$	<u>4,066</u>

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 2018 Management's Discussion and Analysis of Financial Condition and Results of Operations, which can be found in our Fiscal 2018 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 15 to 20 American Eagle stores, 35 to 40 Aerie standalone stores, and the opening of 25 to 35 Aerie side-by-side format stores with new or existing American Eagle stores in North America during Fiscal 2019;
- the success of our efforts to expand internationally, engage in future franchise/license agreements, and/or growth through acquisitions or joint ventures;
- the selection of approximately 40 to 50 American Eagle stores in the United States and Canada for remodeling and refurbishing during Fiscal 2019;
- the potential closure of approximately 10 to 15 American Eagle and 5 to 10 Aerie stores, primarily in North America during Fiscal 2019;
- the planned opening of approximately 15 to 20 new international third-party operated American Eagle stores during Fiscal 2019;
- the success of our core American Eagle and Aerie brands through our omni-channel and licensed outlets within North America and internationally;
- the success of our business priorities and strategies;
- the continued validity of our trademarks;
- our performance during the year-end holiday selling season;
- our ability to predict inventory turnover;
- the accuracy of the estimates and assumptions we make pursuant to our critical accounting policies;
- the expected payment of a dividend in future periods;
- the possibility that our credit facilities may not be available for future borrowings;
- the availability of sufficient cash flow to fund anticipated capital expenditures, dividends, and working capital requirements;
- the possibility that product costs are adversely affected by foreign trade issues (including import tariffs and other trade restrictions with China and other countries), currency exchange rate fluctuations, increasing prices for raw materials, political instability or for other reasons
- the possibility that changes in global economic and financial conditions, and resulting impact on consumer confidence and consumer spending, as well as other changes in consumer discretionary spending habits; 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 herein and in Item 1A of our Fiscal 2018 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 sales — Comparable sales provide a measure of sales growth for stores and channels 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 sales in the thirteenth month of operation. However, stores that have a gross square footage change of 25% or greater due to a remodel are removed from the comparable sales base, but are included in total sales. These stores are returned to the comparable sales base in the thirteenth month following the remodel. Sales from American Eagle, Aerie, Tailgate and Todd Snyder stores, as well as sales from AEO Direct and other digital channels, are included in total comparable sales. Sales from licensed stores are not included in comparable sales. Individual American Eagle and Aerie brand comparable sales disclosures represent sales from stores and AEO Direct.

AEO Direct sales are included in the individual American Eagle and Aerie brand comparable sales metric for the following reasons:

- Our approach to customer engagement is “omni-channel,” which provides a seamless customer experience through both traditional and non-traditional channels, including four wall store locations, web, mobile/tablet devices, social networks, email, in-store displays and kiosks. Additionally, we fulfill online orders at stores through our buy online, ship from store capability, maximizing store inventory exposure to digital demand. We also offer reserve online, pickup in store service to our customers and give them the ability to look up store inventory from all digital channels; and
- Shopping behavior has continued to evolve across multiple channels that work in tandem to meet customer needs. Management believes that presenting a brand level performance metric that includes all channels (i.e., stores and AEO Direct) is the most appropriate, given customer behavior and our omni-channel model.

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

Gross profit — Gross profit measures whether we are optimizing profitability of our sales. Gross profit is the difference between total net revenue and cost of sales. Cost of sales consists of: merchandise costs, including design, sourcing, importing and inbound freight costs, as well as markdowns, shrinkage and certain promotional costs (collectively, “merchandise costs”) and buying, occupancy and warehousing costs. Design costs consist of: compensation, rent, depreciation, travel, supplies and samples.

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.

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 performance. The key drivers of operating income are comparable sales, gross profit, our ability to control selling, general and administrative expenses, and our level of capital expenditures.

Omni-channel sales performance — Our management utilizes the following quality of sales metrics in evaluating our omni-channel sales performance: comparable sales, average unit retail price (“AUR”), units per transaction, average transaction value, transactions, customer traffic, conversion rates, average unit cost, and comparable gross margin dollars.

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 cash position. Cash flow has historically been sufficient to cover our uses of cash. Our management believes that cash flow will be sufficient to fund anticipated capital expenditures, dividends and working capital requirements.

Results of Operations

Overview

Our second quarter produced record revenue and the eighteenth consecutive quarter of positive consolidated comparable sales increases. However, an unseasonably cool May suppressed demand for American Eagle spring apparel, which combined with a delayed start to back-to-school shopping in late July, adversely impacted second quarter sales and margins. Despite the challenges, we were encouraged to see many areas of the business perform well, including continued strong momentum in AE jeans, which achieved record sales and Aerie, which posted its 19th consecutive quarter of double digit sales growth. Additionally, our digital channel posted a double digit sales increase.

Total net revenue increased 8% for the second quarter of 2019 to \$1.041 billion and consolidated comparable sales, including AEO Direct, increased 2%, following a 9% increase last year. By brand, American Eagle brand comparable sales decreased 1% following a 7% increase last year. Aerie comparable sales increased 16% compared to a 27% increase last year. Additionally, included in total net revenue this year was \$40.0 million recognized for license royalties from a third-party operator of AE stores in Japan. Gross profit increased 8% or \$29.5 million to \$382.6 million compared to \$353.1 million last year and improved 10 basis points to 36.7% as a rate to total net revenue. Selling, general and administrative expenses increased 8%, or \$19.1 million, to \$253.1 million compared to \$210.2 million last year and remained flat as a rate to total revenue of 24.3%.

Net income for the quarter increased 8% to \$65.0 million, or \$0.38 per diluted share, compared to \$60.3 million, or \$0.34 per diluted share, last year. On an adjusted basis, net income per diluted share this quarter increased 12% to \$0.39 per share, which excludes \$0.01 per share of restructuring charges compared to \$0.34 per diluted share last year.

During the 26 weeks ended August 3, 2019, we returned \$126.9 million to shareholders through share repurchases of \$80.0 million and cash dividends of \$46.9 million. We had \$317.2 million in cash and short-term investments as of August 3, 2019 compared to \$363.3 million last year. Merchandise inventory at the end of the second quarter was \$534.8 million, compared to \$466.1 million last year, a 15% increase.

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.

This results of operations section contains a non-GAAP financial measure (“non-GAAP” or “adjusted”), adjusted net income per diluted share, which excludes non-GAAP items. This financial measure is not based on any standardized methodology prescribed by U.S. generally accepted accounting principles (“GAAP”) and is not necessarily comparable to similar measures presented by other companies. We believe that this non-GAAP information is useful as an additional means for investors to evaluate our operating performance, when reviewed in conjunction with our GAAP financial statements. These amounts are not determined in accordance with GAAP and, therefore, should not be used exclusively in evaluating our business and operations. The table below reconciles the GAAP financial measure to the non-GAAP financial measure discussed above.

	13 Weeks Ended	
	August 3, 2019	
Net income per diluted share - GAAP Basis	\$	0.38
Add: Restructuring charges (1)		0.01
Net income per diluted share - Adjusted or Non-GAAP Basis	\$	0.39

(1) \$2.7 million of pre-tax restructuring charges, primarily consisting of corporate severance.

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

	13 Weeks Ended		26 Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Total net revenue	100.0 %	100.0 %	100.0 %	100.0
Cost of sales, including certain buying, occupancy and warehousing expenses	63.3	63.4	63.3	63.2
Gross profit	36.7	36.6	36.7	36.8
Selling, general and administrative expenses	24.3	24.3	25.1	24.9
Restructuring charges	0.3	—	0.2	0.1
Depreciation and amortization expense	4.3	4.4	4.7	4.7
Operating income	7.8	7.9	6.7	7.1
Other income, net	0.4	0.1	0.4	0.1
Income before income taxes	8.2	8.0	7.1	7.2
Provision for income taxes	2.0	1.8	1.7	1.6
Net Income	6.2 %	6.2 %	5.4 %	5.6 %

The following table shows our consolidated store data:

	13 Weeks Ended		26 Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Number of stores:				
Beginning of period	1,061	1,049	1,055	1,047
Opened	19	6	30	11
Closed	(5)	(1)	(10)	(4)
End of period	1,075	1,054	1,075	1,054
Total gross square feet at end of period (in '000)	6,740	6,641	6,740	6,641
International licensed/franchise stores at end of period (1)	236	223	236	223

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

Our operations are conducted in one reportable segment, consisting of 939 American Eagle retail stores, which include 158 Aerie side-by-side locations, 131 Aerie stand-alone locations and AEO Direct. Additionally, there were 4 Tailgate and 1 Todd Snyder stand-alone locations.

Comparison of the 13 weeks ended August 3, 2019 to the 13 weeks ended August 4, 2018

Total net revenue

Total net revenue increased 8%, or \$76.0 million, to \$1.041 billion compared to \$964.9 million last year. Total comparable sales increased 2% for the period compared to a 9% increase last year. Additionally, included in total net revenue this year was \$40.0 million recognized for license royalties from a third-party operator of AE stores in Japan.

By brand, including the respective AEO Direct sales, American Eagle brand comparable sales decreased 1%, or (\$9.2) million, and Aerie brand comparable sales increased 16%, or \$20.5 million. Total comparable sales for AE women's increased 4% and men's decreased 5%.

For the 13 weeks ended August 3, 2019, consolidated comparable traffic increased in the high-single digits. Transactions increased in the mid-single digits and units per transaction increased in the low-single digits, partially offset by an AUR decrease in the mid-single digits.

Gross Profit

Gross profit increased 8%, or \$29.5 million, to \$382.6 million compared to \$353.1 million last year. The gross margin rate improved 10 basis points to a rate of 36.7% of revenue. Flow through from the \$40 million of Japan license royalties was the primary driver of the increase, which was offset by increased markdowns and delivery expense.

There was \$3.9 million and \$2.9 million of share-based payment expense included in gross profit for the periods ended August 3, 2019 and August 4, 2018, respectively, comprised of both time- and performance-based awards.

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 (“SG&A”) expenses increased 8%, or \$19.1 million, to \$253.1 million from \$234.0 million last year. As a rate to total net revenue, SG&A expenses remained flat as a rate to total net revenue of 24.3%. Strategic investments in the stores organization, which began midway through 2018, led to increased compensation expense. Professional services also contributed to the increase from last year.

There was \$5.4 million and \$3.1 million of share-based payment expense included in SG&A expenses for the periods ended August 3, 2019 and August 4, 2018, respectively, comprised of both time- and performance-based awards.

Restructuring Charges

Restructuring charges were \$2.7 million, or 0.3% as a rate to total net revenue, for the 13 weeks ended August 3, 2019. These charges are primarily the result of corporate severance. There were no restructuring charges recorded for the 13 weeks ended August 4, 2018.

Depreciation and Amortization Expense

Depreciation and amortization expense increased 5%, or \$2.1 million, to \$44.9 million, compared to \$42.7 million last year. As a rate to total net revenue, depreciation and amortization expense was 4.3% this year compared to 4.4% last year. The increase in expense was driven by omnichannel, stores and IT technology investments.

Other Income, Net

Other income increased to \$4.0 million this year, compared to other income of \$0.9 million last year. The increase is primarily attributable to increased interest income and foreign currency fluctuations.

Provision for Income Taxes

The provision for income taxes 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 for the 13 weeks ended August 3, 2019 was 24.4% compared to 21.9% for the 13 weeks ended August 4, 2018. The increase in the effective income tax rate this year was primarily due to changes in unrecognized tax benefits and less favorable excess tax benefits from share-based payments in accordance with ASU 2016-09.

Net Income

Net income increased 8%, or \$4.7 million, to \$65.0 million, or 6.2% as a percent to total net revenue, from \$60.3 million, or 6.2% as a percent to total net revenue last year. Net income per share increased 12% to \$0.38 per diluted share, including \$0.01 of restructuring charges per diluted share, from \$0.34 per diluted share last year. The change in net income is attributable to the factors noted above.

Comparison of the 26 weeks ended August 3, 2019 to the 26 weeks ended August 4, 2018

Total net revenue

Total net revenue increased 8%, or \$139.4 million, to \$1.927 billion compared to \$1.788 billion last year. Total comparable sales increased 3% for the period compared to a 9% increase last year. Additionally, included in total net revenue this year was \$40.0 million recognized for license royalties from a third-party operator of AE stores in Japan.

By brand, including the respective AEO Direct sales, American Eagle brand comparable sales increased 1%, or \$14.6 million, and Aerie brand comparable sales increased 15%, or \$37.4 million. Total comparable sales for AE women's increased 6% and men's decreased 4%.

For the year to date period, consolidated comparable traffic increased in the high-single digits and transactions increased in the mid-single digits. Units per transaction increased in the low-single digits, partially offset by an AUR decrease in the low-single digits.

Gross Profit

Gross profit increased 8%, or \$49.9 million, to \$707.5 million compared to \$657.5 million last year. The gross margin rate declined 10 basis points to a rate of 36.7% of revenue. Flow through from the \$40 million of Japan license royalties was the primary driver of the increase, which was offset by increased markdowns and delivery expense.

There was \$6.3 million and \$5.7 million of share-based payment expense included in gross profit for the periods ended August 3, 2019 and August 4, 2018, respectively, comprised of both time- and performance-based awards.

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 ("SG&A") expenses increased 9%, or \$39.6 million, to \$483.8 million from \$444.2 million last year. As a rate to total net revenue, SG&A expenses increased 20 basis points to 25.1%, compared to 24.9% last year. Strategic investments in the stores organization, which began midway through 2018, led to increased compensation expense. Advertising and professional services also contributed to the increase from last year.

There was \$8.0 million and \$6.0 million of share-based payment expense included in SG&A expenses for the periods ended August 3, 2019 and August 4, 2018, respectively, comprised of both time- and performance-based awards.

Restructuring Charges

Restructuring charges were \$4.3 million, or 0.2% as a rate to total net revenue, for the 26 weeks ended August 3, 2019. These charges are primarily the result of corporate severance charges and closure costs for our company-owned and operated stores in China. Restructuring charges were \$1.6 million, or 0.1% as a rate to total net revenue for the 26 weeks ended August 4, 2018. These charges were primarily the result of corporate severance charges.

Depreciation and Amortization Expense

Depreciation and amortization expense increased 6%, or \$5.0 million, to \$89.7 million, compared to \$84.7 million last year. As a rate to total net revenue, depreciation and amortization expense was 4.7% this year compared to 4.7% last year. The increase in expense was driven by omnichannel, stores and IT technology investments.

Other Income, Net

Other income increased to \$8.2 million this year, compared to other income of \$1.4 million last year. The increase is primarily attributable to increased interest income and foreign currency fluctuations.

Provision for Income Taxes

The provision for income taxes 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 for the 26 weeks ended August 3, 2019 was 23.3% compared to 21.9% for the 26 weeks ended August 4, 2018. The increase in the effective income tax rate this year is primarily due to changes in unrecognized tax benefits and less favorable excess tax benefits from share-based payments in accordance with ASU 2016-09.

Net Income

Net income increased 5%, or \$5.5 million, to \$105.7 million, or 5.4% as a percent to total net revenue, from \$100.3 million, or 5.6% as a percent to total net revenue last year. Net income per diluted share increased 9% to \$0.61, including \$0.02 of restructuring charges. Last year net income per diluted share was \$0.56, including \$0.01 of restructuring charges. The change in net income is attributable to the factors noted above.

International Operations

We have agreements with multiple third party operators to expand our brands internationally. Through these agreements, a series of franchised, licensed or other brand-dedicated American Eagle stores have opened and will continue to open in areas including Eastern Europe, the Middle East, Central and South America, Northern Africa and parts of Asia. These agreements do not involve a significant capital investment or operational involvement from us. We continue to increase the number of countries in which we enter into these types of arrangements as part of our strategy to expand internationally. We plan to terminate the agreement with our Japan license partner and are currently exploring options for our future business model to best serve customers and continue AEO's growth in Japan.

As of August 3, 2019, we had 236 stores operated by our third party operators in 24 countries. International third party operated stores are not included in the consolidated store data or the total gross square feet calculation.

As of August 3, 2019, we had 104 company-owned stores in Canada, 39 in Mexico, seven in Hong Kong and six in Puerto Rico.

Fair Value Measurements

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.
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of August 3, 2019, we held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents and short-term investments.

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 August 3, 2019:

(In thousands)	Fair Value Measurements at August 3, 2019			
	Carrying Amount	Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents:				
Cash	\$ 144,241	\$ 144,241	—	—
Interest bearing deposits	122,925	122,925	—	—
Total cash and cash equivalents	\$ 267,166	\$ 267,166	\$ —	\$ —
Short-term investments				
Certificates of Deposit	50,000	50,000	—	—
Total short-term investments	50,000	50,000	—	—
Total	\$ 317,166	\$ 317,166	—	—

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 and the return of value to shareholders through 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. Also, we maintain an asset-based revolving credit facility that allows us to borrow up to \$400 million, which will expire in January 2024. Additionally, our uses of cash include the development of the Aerie brand, investments in technology and omni-channel capabilities, and our international expansion efforts. We also made key investments in the customer experience and our associates, including store payroll and higher wages, as well as incremental advertising expenses. We expect to be able to fund our future cash requirements through current cash holdings as well as cash generated from operations.

Our growth strategy includes fortifying our brands and further e-commerce and store 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.

The following sets forth certain measures of our liquidity:

	August 3, 2019	February 2, 2019	August 4, 2018
Working Capital (in thousands)	\$ 256,427	\$ 503,608	\$ 489,060
Current Ratio	1.33	1.93	1.96

Working capital decreased \$247.2 million compared to February 2, 2019 and decreased \$232.6 million compared to last year. The adoption of ASC 842 decreased working capital by \$226.5 million, due to the addition of \$279.2 million of operating lease liabilities (current portion), offset by \$52.7 million of current deferred rent balances. Compared to last year, the remaining \$6.2 million decrease in working capital was primarily driven by a \$52.7 million increase in accounts payable, a \$46.2 million decrease in cash and short-term investments, offset by a \$68.7 million increase in inventory and a \$24.5 million increase in accounts receivable.

Cash Flows from Operating Activities

Net cash provided by operating activities totaled \$117.6 million and \$152.4 million for the 26 weeks ended August 3, 2019 and August 4, 2018, respectively. For both periods, our major source of cash from operations was merchandise sales and our primary outflow of cash for operations was for the payment of operational costs.

Cash Flows from Investing Activities

Investing activities for the 26 weeks ended August 3, 2019 primarily consisted of \$91.8 million of capital expenditures for property and equipment, partially offset by \$42.1 million of net short-term investment sales. Investing activities for the 26 weeks ended August 4, 2018 primarily included \$101.4 million of capital expenditures for property and equipment and \$40.0 million of short-term investment purchases.

Cash Flows from Financing Activities

Cash used for financing activities for the 26 weeks ended August 3, 2019 consisted primarily of \$80.0 million used for repurchases of 4.3 million shares of common stock under publicly announced programs, \$46.9 million for cash dividends paid at a quarterly rate of \$0.1375 per share, and \$7.9 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payments.

Cash used for financing activities for the 26 weeks ended August 4, 2018 consisted primarily of \$48.6 million for cash dividends paid at a quarterly rate of \$0.1375 per share, \$44.9 million used for purchases of 2.3 million shares of common stock under publicly announced programs and \$18.3 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payments, partially offset by net proceeds from stock options exercised of \$15.5 million.

Credit Facilities

In Fiscal 2018, we entered into a credit agreement (“Credit Agreement”) for five-year, syndicated, asset-based revolving credit facilities (the “Credit Facilities”). The Credit Agreement provides senior secured revolving credit for loans and letters of credit up to \$400 million, subject to customary borrowing base limitations. The Credit Facilities provide increased financial flexibility and take advantage of a favorable credit environment.

All obligations under the Credit Facilities are unconditionally guaranteed by certain subsidiaries. The obligations under the Credit Agreement are secured by a first-priority security interest in certain working capital assets of the borrowers and guarantors, consisting primarily of cash, receivables, inventory and certain other assets and have been further secured by first-priority mortgages on certain real property.

As of August 3, 2019, we were in compliance with the terms of the Credit Agreement and had \$8.1 million outstanding in stand-by letters of credit. No loans were outstanding under the Credit Agreement as of August 3, 2019.

Capital Expenditures for Property and Equipment

Capital expenditures for the 26 weeks ended August 3, 2019 were \$91.8 million and included \$60.6 million related to investments in our stores, including 19 new AEO stores, 24 remodeled and refurbished stores, and fixtures and visual investments. Additionally, we continued to support our infrastructure growth by investing in information technology initiatives (\$12.4 million), e-commerce (\$15.4 million) and other home office projects (\$3.4 million).

For Fiscal 2019, we expect capital expenditures to be in the range of \$200 million to \$215 million in support of our expansion efforts, store investments, including selective remodels of high performing, long-term locations, information technology upgrades to support growth and investments in e-commerce.

Stock Repurchases

During the 26 weeks ended August 3, 2019, as part of our publicly announced share repurchase program, we repurchased 4.3 million shares for \$80 million, at a weighted average price of \$18.96 per share. During the 26 weeks ended August 4, 2018, as part of our publicly announced share repurchase program, we repurchased 2.3 million shares for \$44.9 million, at a weighted average price of \$19.51 per share.

As of August 3, 2019, 7.4 million shares remain available under the program authorized by our Board in April 2016 that expires on January 30, 2021. During the 13 weeks ended August 3, 2019, our Board authorized the repurchase of 30.0 million shares under a new share repurchase program which expires on Feb 3, 2024, bringing our total share repurchase authorization to 37.4 million shares.

During the 26 weeks ended August 3, 2019 and August 4, 2018, we repurchased approximately 0.4 million and 0.9 million shares, respectively, from certain employees at market prices totaling \$7.9 million and \$18.3 million, respectively. These shares were repurchased for the payment of taxes, in connection with the vesting of share-based payments, as permitted under our equity incentive plans. The aforementioned shares repurchased have been recorded as treasury stock.

Dividends

During the 13 weeks ended August 3, 2019, our Board declared a quarterly cash dividend of \$0.1375 per share, which was paid on July 26, 2019. The payment of future dividends is at the discretion of our Board and is based on future earnings, cash flow, financial condition, capital requirements, changes in U.S. taxation and other relevant factors. It is anticipated that any future dividends paid will be declared on a quarterly basis.

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 February 2, 2019 contained in our Fiscal 2018 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. Our critical accounting policies and estimates did not change materially during the 26 week period ended August 3, 2019, except for the adoption of ASU 2016-02, "Leases (Topic 842)", on February 3, 2019. The application of our critical accounting policies may require our management to make judgments and estimates about the amounts reflected in the Consolidated Financial Statements. Our 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 February 2, 2019. Our market risk profile as of February 2, 2019 is disclosed in Item 7A, *Quantitative and Qualitative Disclosures About Market Risk*, of our Fiscal 2018 Form 10-K.

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 the management of American Eagle Outfitters, Inc. (the "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 August 3, 2019, the Company performed an evaluation 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 Rules 13a-15(e) or 15d-15(e) under the Exchange Act). Based upon that evaluation, our principal executive officer and our principal financial officer have concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective in the timely and accurate recording, processing, summarizing and reporting of material financial and non-financial information within the time periods specified within the Securities and Exchange Commission's rules and forms. Our principal executive officer and principal financial officer also concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our Management, including our principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new accounting standard related to leases on our financial statements to facilitate its adoption on February 3, 2019. We implemented a new software solution to support our accounting for leases and have implemented new internal controls in response. There has been no other change in our internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Off Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are involved, from time to time, in actions associated with or incidental to our business, including, among other things, matters involving credit card fraud, trademark and other intellectual property, licensing, importation of products, taxation, and employee relations. We believe at present that the resolution of currently pending matters will not individually or in the aggregate have a material adverse effect on our financial position or results of operations. However, our assessment of any litigation or other legal claims could potentially change in light of the discovery of facts not presently known or determinations by judges, juries, or other finders of fact which are not in accord with management's evaluation of the possible liability or outcome of such litigation or claims.

ITEM 1A. RISK FACTORS.

Risk factors that may affect our business and financial results are discussed within Item 1A of our Fiscal 2018 Form 10-K. There have been no material changes to the disclosures relating to this item from those set forth in our Fiscal 2018 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 August 3, 2019.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares that May Yet Be Purchased Under the Program
	(1)	(2)	(1)	(1) (3)
Month #1 (May 5, 2019 through June 1, 2019)	160,628	\$ 17.46	—	10,789,133
Month #2 (June 2, 2019 through July 6, 2019)	3,516,400	\$ 17.64	3,424,873	7,364,260
Month #3 (July 7, 2019 through August 3, 2019)	—	\$ —	—	37,364,260
Total	<u>3,677,028</u>	<u>\$ 17.63</u>	<u>3,424,873</u>	<u>37,364,260</u>

(1) During the 13 weeks ended August 3, 2019 there were 3.4 million shares repurchased as part of our publicly announced share repurchase program and there were 0.2 million shares repurchased for the payment of taxes in connection with the vesting of share-based payments.

(2) Average price paid per share excludes any broker commissions paid.

(3) During Fiscal 2016, our Board authorized the public repurchase of 25.0 million shares of our common stock. The authorization of the remaining 7.4 million shares that may yet be repurchased expires on January 30, 2021. During the 13 weeks ended August 3, 2019, our Board authorized 30.0 million shares under a new share repurchase program which expires on February 3, 2024, bringing our total repurchase authorization to 37.4 million.

ITEM 6. EXHIBITS.

- * Exhibit 31.1 [Certification by Jay L. Schottenstein pursuant to Rule 13a-14\(a\) or Rule 15d-14\(a\)](#)
- * Exhibit 31.2 [Certification by Robert L. Madore 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 Inline Data File
- * Exhibit 104 The cover page from the Company's Quarterly Report on Form 10-Q for the quarter ended August 3, 2019, formatted, in inline XBRL

* Filed with this report.

** Furnished with this report.

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: September 5, 2019

American Eagle Outfitters, Inc.
(Registrant)

By: /s/ Jay L. Schottenstein
Jay L. Schottenstein
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Robert L. Madore
Robert L. Madore
Executive Vice President, Chief Financial Officer
(Principal Financial Officer)

CERTIFICATIONS

I, Jay L. Schottenstein, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of American Eagle Outfitters, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: September 5, 2019

/s/ Jay L. Schottenstein

Jay L. Schottenstein
Chief Executive Officer

(Principal Executive Officer)

CERTIFICATIONS

I, Robert L. Madore, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of American Eagle Outfitters, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: September 5, 2019

/s/ Robert L. Madore

Robert L. Madore
Executive Vice President, Chief Financial Officer
(Principal Financial Officer)

**Certification Pursuant to 18 U.S.C. Section 1350,
as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of American Eagle Outfitters, Inc. (the "Company") on Form 10-Q for the period ended August 3, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jay L. Schottenstein, Principal Executive Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Dated: September 5, 2019

/s/ Jay L. Schottenstein

Jay L. Schottenstein

Chief Executive Officer

(Principal Executive Officer)

**Certification Pursuant to 18 U.S.C. Section 1350,
as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of American Eagle Outfitters, Inc. (the "Company") on Form 10-Q for the period ended August 3, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert L. Madore, Principal Financial Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Dated: September 5, 2019

/s/ Robert L. Madore

Robert L. Madore

Executive Vice President, Chief Financial Officer

(Principal Financial Officer)