

AMERICAN EAGLE OUTFITTERS INC

Form 10-Q

December 12, 2018

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 November 3, 2018

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

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

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

N/A

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

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

|                         |                           |
|-------------------------|---------------------------|
| Large accelerated filer | Accelerated filer         |
| Non-accelerated filer   | Smaller reporting company |
|                         | Emerging growth company   |

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

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 176,432,192 Common Shares were outstanding at December 11, 2018.

AMERICAN EAGLE OUTFITTERS, INC.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED BALANCE SHEETS

| (In thousands, except per share amounts)                         | November<br>3,<br>2018<br>(Unaudited) | February 3,<br>2018 | October 28,<br>2017<br>(Unaudited) |
|------------------------------------------------------------------|---------------------------------------|---------------------|------------------------------------|
| <b>Assets</b>                                                    |                                       |                     |                                    |
| <b>Current assets:</b>                                           |                                       |                     |                                    |
| Cash and cash equivalents                                        | \$279,872                             | \$413,613           | \$257,527                          |
| Short-term investments                                           | 79,856                                | -                   | -                                  |
| Merchandise inventory                                            | 591,671                               | 398,213             | 534,019                            |
| Accounts receivable, net                                         | 84,074                                | 78,304              | 77,113                             |
| Prepaid expenses and other                                       | 87,995                                | 78,400              | 61,553                             |
| Total current assets                                             | 1,123,468                             | 968,530             | 930,212                            |
| Property and equipment, at cost, net of accumulated depreciation | 735,714                               | 724,239             | 726,168                            |
| Intangible assets, at cost, net of accumulated amortization      | 44,164                                | 46,666              | 46,979                             |
| Goodwill                                                         | 14,898                                | 15,070              | 14,972                             |
| Non-current deferred income taxes                                | 12,796                                | 9,344               | 29,025                             |
| Other assets                                                     | 50,442                                | 52,464              | 54,424                             |
| Total assets                                                     | \$1,981,482                           | \$1,816,313         | \$1,801,780                        |
| <b>Liabilities and Stockholders' Equity</b>                      |                                       |                     |                                    |
| <b>Current liabilities:</b>                                      |                                       |                     |                                    |
| Accounts payable                                                 | \$343,360                             | \$236,703           | \$330,716                          |
| Accrued compensation and payroll taxes                           | 56,991                                | 54,324              | 43,561                             |
| Accrued rent                                                     | 87,410                                | 83,312              | 80,580                             |
| Accrued income and other taxes                                   | 29,340                                | 12,781              | 17,262                             |
| Unredeemed gift cards and gift certificates                      | 30,392                                | 52,347              | 29,475                             |
| Current portion of deferred lease credits                        | 11,337                                | 11,203              | 12,887                             |
| Other liabilities and accrued expenses                           | 48,317                                | 34,551              | 38,359                             |
| Total current liabilities                                        | 607,147                               | 485,221             | 552,840                            |
| <b>Non-current liabilities:</b>                                  |                                       |                     |                                    |
| Deferred lease credits                                           | 48,220                                | 47,977              | 50,439                             |
| Non-current accrued income taxes                                 | 7,229                                 | 7,269               | 4,590                              |
| Other non-current liabilities                                    | 23,474                                | 29,055              | 30,712                             |
| Total non-current liabilities                                    | 78,923                                | 84,301              | 85,741                             |
| Commitments and contingencies                                    | —                                     | —                   | —                                  |
| <b>Stockholders' equity:</b>                                     |                                       |                     |                                    |
| Preferred stock, \$0.01 par value; 5,000 shares authorized; none | —                                     | —                   | —                                  |

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|                                                                         |             |             |             |
|-------------------------------------------------------------------------|-------------|-------------|-------------|
| issued and outstanding                                                  |             |             |             |
| Common stock, \$0.01 par value; 600,000 shares authorized;              |             |             |             |
| 249,566 shares issued; 176,407, 177,316 and 177,084 shares              |             |             |             |
| outstanding, respectively                                               | 2,496       | 2,496       | 2,496       |
| Contributed capital                                                     | 565,316     | 593,770     | 588,978     |
| Accumulated other comprehensive loss                                    | (39,138 )   | (30,795 )   | (34,798 )   |
| Retained earnings                                                       | 2,002,687   | 1,883,592   | 1,812,821   |
| Treasury stock, at cost, 73,159, 72,250 and 72,482 shares, respectively | (1,235,949) | (1,202,272) | (1,206,298) |
| Total stockholders' equity                                              | 1,295,412   | 1,246,791   | 1,163,199   |
| Total liabilities and stockholders' equity                              | \$1,981,482 | \$1,816,313 | \$1,801,780 |

Refer to Notes to Consolidated Financial Statements

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Unaudited)

|                                                                                | 13 Weeks Ended         |                        | 39 Weeks Ended         |                        |
|--------------------------------------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                                                | November<br>3,<br>2018 | October<br>28,<br>2017 | November<br>3,<br>2018 | October<br>28,<br>2017 |
| (In thousands, except per share amounts)                                       |                        |                        |                        |                        |
| Total net revenue                                                              | \$1,003,707            | \$960,433              | \$2,791,522            | \$2,566,826            |
| Cost of sales, including certain buying, occupancy and<br>warehousing expenses | 604,220                | 585,520                | 1,734,491              | 1,621,441              |
| Gross profit                                                                   | 399,487                | 374,913                | 1,057,031              | 945,385                |
| Selling, general and administrative expenses                                   | 248,438                | 217,146                | 692,644                | 615,842                |
| Restructuring charges                                                          | —                      | 3,695                  | 1,568                  | 18,888                 |
| Depreciation and amortization expense                                          | 42,416                 | 43,149                 | 127,090                | 123,878                |
| Operating income                                                               | 108,633                | 110,923                | 235,729                | 186,777                |
| Other income (expense), net                                                    | 4,330                  | (13,243 )              | 5,692                  | (19,574 )              |
| Income before income taxes                                                     | 112,963                | 97,680                 | 241,421                | 167,203                |
| Provision for income taxes                                                     | 27,491                 | 33,947                 | 55,687                 | 56,997                 |
| Net income                                                                     | \$85,472               | \$63,733               | \$185,734              | \$110,206              |
| Net income per basic share                                                     | \$0.48                 | \$0.36                 | \$1.05                 | \$0.62                 |
| Net income per diluted share                                                   | \$0.48                 | \$0.36                 | \$1.04                 | \$0.61                 |
| Cash dividends per common share                                                | \$0.1375               | \$0.125                | \$0.4125               | \$0.375                |
| Weighted average common shares outstanding - basic                             | 176,938                | 177,288                | 177,033                | 178,272                |
| Weighted average common shares outstanding - diluted                           | 178,122                | 179,132                | 178,278                | 180,260                |
| Retained earnings, beginning                                                   | \$1,941,536            | \$1,772,233            | \$1,883,592            | \$1,775,775            |
| Adoption of Accounting Standards Update 2014-09 (see Note<br>2)                | -                      | -                      | 152                    | -                      |
| Net income                                                                     | 85,472                 | 63,733                 | 185,734                | 110,206                |
| Cash dividends and dividend equivalents                                        | (24,251 )              | (22,733 )              | (73,831 )              | (68,119 )              |
| Reissuance of treasury stock                                                   | (70 )                  | (412 )                 | 7,040                  | (5,041 )               |
| Retained earnings, ending                                                      | \$2,002,687            | \$1,812,821            | \$2,002,687            | \$1,812,821            |

Refer to Notes to Consolidated Financial Statements

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

|                                               | 13 Weeks Ended |          | 39 Weeks Ended |           |
|-----------------------------------------------|----------------|----------|----------------|-----------|
|                                               | November       | October  | November       | October   |
|                                               | 3,             | 28,      | 3,             | 28,       |
| (In thousands)                                | 2018           | 2017     | 2018           | 2017      |
| Net income                                    | \$85,472       | \$63,733 | \$185,734      | \$110,206 |
| Other comprehensive income:                   |                |          |                |           |
| Foreign currency translation income (expense) | 6,492          | (4,677 ) | 8,343          | 1,504     |
| Other comprehensive income:                   | 6,492          | (4,677 ) | 8,343          | 1,504     |
| Comprehensive income                          | \$91,964       | \$59,056 | \$194,077      | \$111,710 |

Refer to Notes to Consolidated Financial Statements

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| (In thousands)                                                             | 39 Weeks Ended         |                        |
|----------------------------------------------------------------------------|------------------------|------------------------|
|                                                                            | November<br>3,<br>2018 | October<br>28,<br>2017 |
| Operating activities:                                                      |                        |                        |
| Net income                                                                 | \$ 185,734             | \$ 110,206             |
| Adjustments to reconcile net income to net cash from operating activities: |                        |                        |
| Depreciation and amortization                                              | 131,704                | 125,370                |
| Share-based compensation                                                   | 17,833                 | 12,056                 |
| Deferred income taxes                                                      | (3,955 )               | 19,846                 |
| Foreign currency transaction loss (gain)                                   | (1,426 )               | (5,002 )               |
| Changes in assets and liabilities:                                         |                        |                        |
| Merchandise inventory                                                      | (197,120)              | (173,020)              |
| Accounts receivable                                                        | (5,705 )               | 9,515                  |
| Prepaid expenses and other                                                 | (5,604 )               | 16,220                 |
| Other assets                                                               | (1,697 )               | 2,872                  |
| Accounts payable                                                           | 108,334                | 80,844                 |
| Unredeemed gift cards and gift certificates                                | (21,724 )              | (23,581 )              |
| Deferred lease credits                                                     | 374                    | 5,287                  |
| Accrued compensation and payroll taxes                                     | 2,929                  | (9,499 )               |
| Accrued income and other taxes                                             | 16,468                 | 5,519                  |
| Accrued liabilities                                                        | 17,444                 | 11,467                 |
| Total adjustments                                                          | 57,855                 | 77,894                 |
| Net cash provided by operating activities                                  | 243,589                | 188,100                |
| Investing activities:                                                      |                        |                        |
| Capital expenditures for property and equipment                            | (143,940)              | (134,920)              |
| Purchase of available-for-sale investments                                 | (124,829)              | -                      |
| Sale of available-for-sale investments                                     | 44,973                 | -                      |
| Acquisition of intangible assets                                           | (547 )                 | (645 )                 |
| Net cash used for investing activities                                     | (224,343)              | (135,565)              |
| Financing activities:                                                      |                        |                        |
| Payments on capital leases                                                 | (4,927 )               | (8,705 )               |
| Repurchase of common stock as part of publicly announced programs          | (70,332 )              | (87,682 )              |
| Repurchase of common stock from employees                                  | (19,060 )              | (12,300 )              |
| Net proceeds from stock options exercised                                  | 15,496                 | 225                    |
| Cash dividends paid                                                        | (71,312 )              | (66,385 )              |
| Net cash used for financing activities                                     | (150,135)              | (174,847)              |
| Effect of exchange rates changes on cash                                   | (2,852 )               | 1,226                  |
| Net change in cash and cash equivalents                                    | (133,741)              | (121,086)              |
| Cash and cash equivalents - beginning of period                            | 413,613                | 378,613                |
| Cash and cash equivalents - end of period                                  | \$ 279,872             | \$ 257,527             |
| Supplemental disclosure of cash flow information:                          |                        |                        |
| Cash paid during the period for income taxes                               | \$ 46,604              | \$ 36,822              |



|                                          |       |       |
|------------------------------------------|-------|-------|
| Cash paid during the period for interest | \$832 | \$818 |
|------------------------------------------|-------|-------|

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 November 3, 2018 and October 28, 2017 and for the 13 and 39 week periods ended November 3, 2018 and October 28, 2017 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 2017 Annual Report on Form 10-K filed on March 16, 2018 (the “Fiscal 2017 Form 10-K”). In the opinion of the Company’s management, all adjustments (consisting of normal recurring adjustments) that are considered necessary for a fair presentation have been included. The existence of subsequent events has been evaluated through the filing date of this Quarterly Report on Form 10-Q.

As used in this report, all references to “we,” “our” and the “Company” refer to American Eagle Outfitters, Inc. and its wholly owned subsidiaries. “American Eagle Outfitters,” “American Eagle,” “AEO” and the “AE Brand” refer to our American Eagle Outfitters stores. “Aerie” refers to our Aerie<sup>®</sup> by American Eagle<sup>®</sup> stores. “AEO Direct” refers to our e-commerce operations, [www.ae.com](http://www.ae.com) and [www.aerie.com](http://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 November 3, 2018, the Company operated in one reportable segment.

Fiscal Year

The Company’s financial year is a 52 or 53-week year that ends on the Saturday nearest to January 31 (each such period, a “Fiscal Year”). As used herein, “Fiscal 2018” refers to the 52-week period ending February 2, 2019. “Fiscal 2017” refers to the 53-week period ended February 3, 2018.

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.

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## Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, Leases (“ASU 2016-02”) which replaces the existing guidance in Accounting Standard Certification (“ASC”) 840, Leases. The new standard establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either financing or operating, with classification affecting the pattern of expense recognition in the Statement of Operations. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The guidance in ASU 2016-02 permits a Company to adopt using the modified retrospective approach for all leases existing as of the effective date and provides for certain practical expedients that the Company plans to elect. The Company will adopt the new standard in Fiscal 2019 and expects that it will result in a significant increase to its long-term assets and liabilities on the Consolidated Balance Sheets as the Company has a significant number of leases.

Additionally, in July 2018, the FASB issued ASU 2018-11, Targeted Improvements to Topic 842, Leases (“ASU 2018-11”) which provides an additional transition method to adopt ASU 2016-02. We expect to use this new transition approach which allows the comparative periods presented in our financial statements to continue to be reported in accordance with ASC 840, Leases. We anticipate that we will elect the package of practical expedients allowed in the standard, which among other things, allows us to carry forward our historical lease classification. We also anticipate that we will make an accounting policy election to use the practical expedient allowed in the standard to not separate lease and non-lease components when calculating the lease liability under ASU 2016-02.

As of November 3, 2018, the Company had undiscounted future minimum lease commitments under non-cancellable operating leases totaling approximately \$1.6 billion. The Company has formed an implementation team, is substantially complete in identifying its lease population and has begun to input the required information into its existing software used to manage its leases in accordance with this new accounting standard.

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income (“ASU 2018-02”). The new guidance permits companies to reclassify the stranded tax effects of the Tax Cuts and Jobs Act (the “Tax Act”) on items within accumulated other comprehensive income to retained earnings. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company will adopt ASU 2018-02 in Fiscal 2019 and does not expect a material impact from the adoption of this guidance to its Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment. 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. Under this ASU, the impairment charge to be recognized should be the amount by which the reporting unit's carrying value exceeds the reporting unit's fair value as calculated under Step 1 provided that the loss recognized should not exceed the total amount of goodwill allocated to the reporting unit. This ASU is effective beginning in 2019 and early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017. The adoption of this ASU may have a material effect on our consolidated financial statements in the event that we determine that goodwill for any of our reporting units is impaired.

## 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.

#### Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). ASU 2014-09 is a comprehensive new revenue recognition model that expands disclosure requirements and requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017.

The Company adopted ASU 2014-09 on February 4, 2018 using the modified retrospective method applied to all contracts as of February 4, 2018. Results for reporting periods beginning on or after February 4, 2018 are presented under ASU 2014-09, 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 vs. 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 ASU 2014-09. Refer to the Customer Loyalty Program caption below for additional information.

Additionally, ASU 2014-09 changes the balance sheet presentation of the Company's sales return reserve. Presentation on a gross basis is now required, consisting of a separate right of return asset and liability. These amounts are recorded within (i) Prepaid Expenses and Other and (ii) Other Liabilities and Accrued Expenses, respectively, on the Consolidated Balance Sheets. Historically, the Company presented the net sales return liability within Other Liabilities and Accrued Expenses on the Consolidated Balance Sheets. Refer to the Sales Return Reserve 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.

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<br>Ended |   |                  |   |
|---------------------------------------------------|-------------------|---|------------------|---|
|                                                   | November 3, 2018  |   | October 28, 2017 |   |
|                                                   |                   |   |                  |   |
| Men's apparel and accessories                     | 32                | % | 34               | % |
| Women's apparel and accessories (excluding Aerie) | 53                | % | 54               | % |
| Aerie                                             | 15                | % | 12               | % |

Total 100% 100 %

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

|                        | 13 Weeks Ended |           |
|------------------------|----------------|-----------|
|                        | November       | October   |
|                        | 3,             | 28,       |
| (In thousands)         | 2018           | 2017      |
| Total Net Revenue:     |                |           |
| United States          | \$873,840      | \$840,632 |
| Foreign <sup>(1)</sup> | 129,867        | 119,801   |
| Total Net Revenue      | \$1,003,707    | \$960,433 |

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

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

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

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 (Expense), Net

Other income, net consists primarily of allowances for uncollectible receivables, foreign currency transaction gain/loss and interest income/expense.

### Cash and Cash Equivalents and Short-term Investments

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

As of November 3, 2018, short-term investments classified as available-for-sale included certificates of deposit, corporate bonds, and commercial paper with a maturity of greater than three months, but less than one year.

As of October 28, 2017, the Company held no short or long-term investments.

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 net realizable value, 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.

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

## Property and Equipment

Property and equipment is recorded on the basis of cost, including costs to prepare the asset for use, with depreciation computed utilizing the straight-line method over the 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 November 3, 2018, the weighted average remaining useful life of our assets is 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 significant long-lived asset impairment charges were recorded during the 13 or 39 weeks ended November 3, 2018

or October 28, 2017.

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

#### Goodwill

The Company's goodwill is primarily related to the acquisition of its importing operations, Canada business 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 3, 2018. As a result of the Company's annual goodwill impairment test, the Company concluded that its goodwill was not impaired.

## Intangible Assets

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

The Company evaluates intangible assets for impairment in accordance with ASC 350 when events or circumstances indicate that the carrying value of the asset may not be recoverable. Such an evaluation includes the estimation of undiscounted future cash flows to be generated by those assets. If the sum of the estimated future undiscounted cash flows is less than the carrying amounts of the assets, then the assets are impaired and are adjusted to their estimated fair value. No intangible asset impairment charges were recorded during the 13 or 39 weeks ended November 3, 2018 or October 28, 2017.

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 adoption of ASU 2014-09 did not have an impact of the Company's accounting for gift card breakage.

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 \$1.6 million of revenue related to gift card breakage during both the 13 weeks ended November 3, 2018 and October 28, 2017. During the 39 weeks ended November 3, 2018 and October 28, 2017, the Company recorded \$6.2 million and \$6.1 million, respectively, of revenue related to gift card breakage.

## Deferred Lease Credits

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

## Co-branded Credit Card

The Company offers a co-branded credit card (the "AEO Visa Card") and a private label credit card (the "AEO Credit Card") under the AEO and Aerie brands. These credit cards are issued by a third-party bank (the "Bank") in accordance with a credit card agreement (the "Agreement"). The Company has no liability to the Bank for bad debt expense, provided that purchases are made in accordance with the Bank's procedures. We receive funding from the Bank based on the Agreement and card activity, which includes payments for new account activations and usage of the 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 ASU 2014-09 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

The Company recently 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 and, when reached, rewards are distributed. Customers earn rewards in the form of discount savings certificates. Rewards earned are valid through the stated expiration date, which is approximately 45 days from the

issuance date of the reward. Additional rewards are also given for key items such as jeans and bras. Rewards not redeemed during the 45-day redemption period are forfeited.

Points earned under the Program on purchases at American Eagle and Aerie are accounted for in accordance with ASU 2014-09. 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-AEO or Aerie purchases are accounted for in accordance with ASU 2014-09. As the points are earned, a current liability is recorded for the estimated cost of the award, and the impact of adjustments is recorded in cost of sales. The Company recorded a net increase to opening retained earnings of \$0.2 million as of February 4, 2018 due to the cumulative impact of adoption.

### 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 net Sales Return Reserve reflects an estimate of sales returns based on projected merchandise returns determined through the use of historical average return percentages.

As of November 3, 2018, the Company recorded a Right of Return Asset of \$3.9 million within Prepaid Expenses and Other on the Consolidated Balance Sheet, offset by a Sales Return Reserve Liability of \$11.1 million within Other Liabilities and Accrued Expenses on the Consolidated Balance Sheet. The net Sales Return Reserve Liability was \$5.2 million, recorded within Other Liabilities and Accrued Expenses, at October 28, 2017.

### 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. All 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 available-for-sale short-term investments, which are recorded on the Consolidated Balance Sheets:

|                            | November<br>3,<br>2018 | February<br>3,<br>2018 | October<br>28,<br>2017 |
|----------------------------|------------------------|------------------------|------------------------|
| (In thousands)             | 2018                   | 2018                   | 2017                   |
| Cash and cash equivalents: |                        |                        |                        |
| Cash                       | \$ 156,250             | \$ 184,107             | \$ 185,546             |
| Interest bearing deposits  | 93,733                 | 174,577                | 71,981                 |
| Commercial paper           | 29,889                 | 54,929                 | —                      |

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|                                       |            |            |            |
|---------------------------------------|------------|------------|------------|
| Total cash and cash equivalents       | \$ 279,872 | \$ 413,613 | \$ 257,527 |
| Short-term investments                |            |            |            |
| Certificates of deposit               | 55,000     | —          | —          |
| Corporate bonds                       | 9,997      | —          | —          |
| Commercial paper                      | 14,859     | —          | —          |
| Total short-term investments          | 79,856     | —          | —          |
| Total cash and short-term investments | \$ 359,728 | \$ 413,613 | \$ 257,527 |

For the 39 weeks ended November 3, 2018, purchases of investments were \$124.8 million, partially offset by sale of investments of \$45.0 million. There were no sales or purchases of investments for the 39 weeks ended October 28, 2017.

#### 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.

In accordance with ASC 820, the following table represents the Company's fair value hierarchy for its financial assets (cash equivalents and investments) measured at fair value on a recurring basis at November 3, 2018 and October 28, 2017:

|                                 | Fair Value Measurements at November 3, 2018 |                                                                         |                                                           |                                       |
|---------------------------------|---------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------------|---------------------------------------|
|                                 | Carrying Amount                             | Quoted Market<br>Prices in Active<br>Markets for<br>Identical<br>Assets | Significant<br>Other<br>Unobservable<br>Observable Inputs | Significant<br>Unobservable<br>Inputs |
| (In thousands)                  |                                             | (Level 1)                                                               | (Level 2)                                                 | (Level 3)                             |
| Cash and cash equivalents:      |                                             |                                                                         |                                                           |                                       |
| Cash                            | \$156,250                                   | \$ 156,250                                                              |                                                           |                                       |
| Interest bearing deposits       | 93,733                                      | 93,733                                                                  |                                                           |                                       |
| Commercial paper                | 29,889                                      | 29,889                                                                  |                                                           |                                       |
| Total cash and cash equivalents | 279,872                                     | 279,872                                                                 |                                                           |                                       |
| Short-term investments          |                                             |                                                                         |                                                           |                                       |
| Certificates of deposit         | 55,000                                      | 55,000                                                                  |                                                           |                                       |
| Corporate bonds                 | 9,997                                       | 9,997                                                                   |                                                           |                                       |
| Commercial paper                | 14,859                                      | 14,859                                                                  |                                                           |                                       |
| Total short-term investments    | 79,856                                      | 79,856                                                                  |                                                           |                                       |
| Total                           | \$359,728                                   | \$ 359,728                                                              |                                                           |                                       |

|                | Fair Value Measurements at October 28, 2017 |                                                  |                                                           |                                       |
|----------------|---------------------------------------------|--------------------------------------------------|-----------------------------------------------------------|---------------------------------------|
|                | Carrying Amount                             | Quoted Market<br>Prices in Active<br>Markets for | Significant<br>Other<br>Unobservable<br>Observable Inputs | Significant<br>Unobservable<br>Inputs |
| (In thousands) |                                             | (Level 2)                                        | (Level 2)                                                 | (Level 3)                             |
|                |                                             |                                                  |                                                           |                                       |



Identical (Level 3)

Assets

(Level 1)

|                                 |            |            |
|---------------------------------|------------|------------|
| Cash and cash equivalents:      |            |            |
| Cash                            | \$ 185,546 | \$ 185,546 |
| Interest bearing deposits       | 71,981     | 71,981     |
| Total cash and cash equivalents | \$ 257,527 | \$ 257,527 |

In the event the Company holds Level 3 investments, a discounted cash flow model is used to value those investments. There were no Level 3 investments at November 3, 2018 or October 28, 2017.

#### Non-Financial Assets

The Company's non-financial assets, which include goodwill, intangible assets and property and equipment, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur, or if an annual impairment test is required, and the Company is required to evaluate the non-financial asset for impairment, a resulting asset impairment would require that the non-financial asset be recorded at the estimated fair value. During the 13 and 39 weeks ended for November 3, 2018, no significant non-financial asset impairment charges were recorded.

## 5. Earnings per Share

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

| (In thousands)                                  | 13 Weeks Ended   |                  | 39 Weeks Ended   |                  |
|-------------------------------------------------|------------------|------------------|------------------|------------------|
|                                                 | November 3, 2018 | October 28, 2017 | November 3, 2018 | October 28, 2017 |
| Weighted average common shares outstanding:     |                  |                  |                  |                  |
| Basic number of common shares outstanding       | 176,938          | 177,288          | 177,033          | 178,272          |
| Dilutive effect of stock options and non-vested |                  |                  |                  |                  |
| restricted stock                                | 1,184            | 1,844            | 1,245            | 1,988            |
| Diluted number of common shares outstanding     | 178,122          | 179,132          | 178,278          | 180,260          |

Equity awards to purchase approximately 0.7 million and no shares of common stock during the 13 and 39 weeks ended November 3, 2018, respectively and approximately 2.5 million shares of common stock during both the 13 and 39 weeks ended October 28, 2017, respectively, were outstanding, but were not included in the computation of weighted average diluted common share amounts as the effect of doing so would be anti-dilutive.

Additionally, approximately 0.4 million shares of restricted stock units for the 13 and 39 weeks ended November 3, 2018, and 0.1 and 0.9 million shares of restricted stock units for the 13 and 39 weeks ended October 28, 2017, respectively, were outstanding, but not included in the computation of weighted average diluted common share amounts as the effect of doing so would be anti-dilutive. Furthermore, approximately 1.0 million and 1.3 million shares of restricted stock units for the 13 and 39 weeks ended November 3, 2018, respectively, and 0.1 million and 0.9 million shares of restricted stock units for the 13 and 39 weeks ended October 28, 2017, respectively, were not included in the computation of weighted average diluted common shares amounts because the number of shares ultimately issued is contingent on the Company's performance compared to pre-established annual performance goals.

Refer to Note 9 to the Consolidated Financial Statements for additional information regarding share-based compensation.

## 6. Property and Equipment

Property and equipment consists of the following:

| (In thousands) | November 3, 2018 | February 3, 2018 | October 28, 2017 |
|----------------|------------------|------------------|------------------|
|                |                  |                  |                  |

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|                                               |             |             |             |
|-----------------------------------------------|-------------|-------------|-------------|
| Property and equipment, at cost               | \$2,136,945 | \$2,023,875 | \$1,994,071 |
| Less: Accumulated depreciation and impairment | (1,401,231) | (1,299,636) | (1,267,903) |
| Property and equipment, net                   | \$735,714   | \$724,239   | \$726,168   |

7. Intangible Assets

Intangible assets consist of the following:

|                                | November<br>3,<br>2018 | February<br>3,<br>2018 | October<br>28,<br>2017 |
|--------------------------------|------------------------|------------------------|------------------------|
| (In thousands)                 |                        |                        |                        |
| Trademarks, at cost            | \$ 70,869              | \$ 70,322              | \$ 69,623              |
| Less: Accumulated amortization | (26,705 )              | (23,656)               | (22,644)               |
| Intangible assets, net         | \$ 44,164              | \$ 46,666              | \$ 46,979              |

8. Other Credit Arrangements

In Fiscal 2014, the Company 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 liens on certain real property.

As of November 3, 2018, the Company was 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 November 3, 2018.

## 9. 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. The Company adopted ASU 2016-09, Compensation—Stock Compensation (“ASU 2016-09”) prospectively at the beginning of Fiscal 2017 and now records excess tax benefits and deficiencies as a discrete adjustment to income tax expense when stock awards vest or are exercised, rather than in contributed capital where they have been historically recorded. ASU 2016-09 also requires cash flows related to excess tax benefits from share-based compensation to be presented in operating activities, rather than separately as a financing activity, in the Consolidated Statement of Cash Flows.

Total share-based compensation expense included in the Consolidated Statements of Operations and Retained Earnings for the 13 weeks and 39 weeks ended November 3, 2018 was \$6.2 million (\$4.7 million, net of tax) and \$17.8 million (\$13.7 million, net of tax), respectively, and for the 13 weeks and 39 weeks ended October 28, 2017 was \$2.3 million (\$1.5 million, net of tax) and \$12.1 million (\$7.9 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 13 weeks ended November 3, 2018 follows:

|                                                | Options<br>(In thousands) | Weighted-<br>Average<br>Exercise Price | Weighted-<br>Remaining<br>Contractual<br>Term<br>(In years) | Aggregate<br>Intrinsic Value<br>(In thousands) |
|------------------------------------------------|---------------------------|----------------------------------------|-------------------------------------------------------------|------------------------------------------------|
| Outstanding - February 3, 2018                 | 2,190                     | \$ 14.59                               |                                                             |                                                |
| Granted                                        | 715                       | \$ 19.60                               |                                                             |                                                |
| Exercised (1)                                  | (993)                     | \$ 15.60                               |                                                             |                                                |
| Cancelled                                      | —                         | \$ —                                   |                                                             |                                                |
| Outstanding - November 3, 2018                 | 1,912                     | \$ 16.75                               | 5.5                                                         | \$ 10,507                                      |
| Vested and expected to vest - November 3, 2018 | 1,777                     | \$ 16.69                               | 5.5                                                         | \$ 9,872                                       |
| Exercisable - November 3, 2018 (2)             | 171                       | \$ 14.92                               | 5.1                                                         | \$ 1,256                                       |

(1) Options exercised during the 39 weeks ended November 3, 2018 had exercise prices ranging from \$13.70 to \$19.89.

(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 November 3, 2018.

Cash received from the exercise of stock options was \$15.5 million for the 39 weeks ended November 3, 2018 and \$0.2 million for the 39 weeks ended October 28, 2017. The actual tax benefit realized from stock option exercises totaled \$0.9 million for the 39 weeks ended November 3, 2018 and \$0.7 million for the 39 weeks ended October 28, 2017.

As of November 3, 2018, there was \$5.7 million of unrecognized compensation expense for stock option awards that is expected to be recognized over a weighted average period of 1.9 years.

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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 | 39 Weeks Ended      | 39 Weeks Ended      |   |
|--------------------------------------------|---------------------|---------------------|---|
|                                            | November 3,<br>2018 | October 28,<br>2017 |   |
| Risk-free interest rate (1)                | 2.6                 | % 2.1               | % |
| Dividend yield                             | 2.5                 | % 3.1               | % |
| Volatility factor (2)                      | 39.5                | % 38.5              | % |
| Weighted-average expected term (3)         | 4.5 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 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 per share of the Company's common stock or certain market conditions on the date of grant.

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

| (Shares in thousands) | Time-Based Restricted Stock |                  | Performance and Market-Based Restricted Stock |                  |
|-----------------------|-----------------------------|------------------|-----------------------------------------------|------------------|
|                       | 39 Weeks Ended              | Weighted-Average | 39 Weeks Ended                                | Weighted-Average |
|                       | November 3, 2018            | Grant Date Fair  | November 3, 2018                              | Grant Date Fair  |
|                       | Shares                      |                  | Shares                                        |                  |

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|                              |         | Value    |        | Value    |
|------------------------------|---------|----------|--------|----------|
| Nonvested - February 3, 2018 | 2,189   | \$ 13.27 | 2,138  | \$ 15.16 |
| Granted                      | 930     | \$ 24.52 | 698    | \$ 21.74 |
| Vested                       | (1,033) | \$ 14.00 | (930 ) | \$ 14.87 |
| Cancelled                    | (104 )  | \$ 13.65 | (18 )  | \$ 15.42 |
| Nonvested - November 3, 2018 | 1,982   | \$ 17.95 | 1,888  | \$ 17.44 |

As of November 3, 2018, there was \$24.2 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 2.1 years. Based on current probable performance, there is \$6.2 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 November 3, 2018, the Company had 6.9 million shares available for all equity grants.

## 10. 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 November 3, 2018 was 24.3% compared to 34.8% for the 13 weeks ended October 28, 2017. The effective income tax rate for the 39 weeks ended November 3, 2018 was 23.1% compared to 34.1% for the 39 weeks ended October 28, 2017. The decrease in the effective income tax rate for the 13 weeks ended November 3, 2018 was primarily due to the reduction in the U.S. federal corporate tax rate from 35% to 21% as a result of the enactment of the Tax Act in December 2017. The decrease in the effective income tax rate for the 39 weeks ending November 3, 2018 was primarily due to the reduction in the U.S. federal corporate tax rate from 35% to 21% as a result of the Tax Act, and excess tax benefits from share-based payments in accordance with ASU 2016-09.

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 did not change significantly during the 13 weeks ended November 3, 2018. Over the next twelve months, the Company believes that it is reasonably possible that unrecognized tax benefits may decrease by approximately \$3.2 million due to settlements, expiration of statute of limitations or other changes in unrecognized tax benefits.

The Tax Act reduces the U.S. federal corporate income tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. The Company is applying the guidance in Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), when accounting for the enactment-date effects of the Tax Act. At November 3, 2018, the Company has not completed its accounting for the tax effects of the Tax Act; however, it has made reasonable estimates of the tax effects. During the three months ended November 3, 2018, the Company has not recorded any adjustments to the provisional amounts recorded at February 3, 2018 related to the remeasurement of its deferred balances and the one-time transition tax. In all cases, the Company is continuing to make and refine its calculations as additional analysis is completed. In addition, the Company’s estimates may also be affected as it gains a more thorough understanding of the tax law and certain aspects of the Tax Act are clarified by the taxing authorities. See Note 14 to the Consolidated Financial Statements in the Fiscal 2017 Form 10-K for further details on the Tax Act and SAB 118.

## 11. 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.

## 12. Restructuring Charges

During the 39 weeks ended November 3, 2018, the Company recorded pre-tax restructuring charges of \$1.6 million. This amount consists primarily of charges for corporate severance costs. The Company may incur additional charges for corporate and international restructuring in Fiscal 2018. The magnitude is dependent on a number of factors, including negotiating third-party agreements, adherence to notification requirements and local laws.

During the 13 and 39 weeks ended October 28, 2017, the Company recorded pre-tax restructuring related charges of \$3.7 million and \$29.9 million, respectively. These amounts consist of costs related to the planned exit of a joint business venture; charges for home office restructuring; and the previously announced initiative to explore the closure or conversion of Company owned and operated stores in Hong Kong, China, and the United Kingdom to licensed

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partnerships. The closure of the Company owned and operated United Kingdom stores was completed in the 39 weeks ended October 28, 2017.

| (In thousands)                            | 39<br>Weeks Ended<br>November 3,<br>2018 | 13 Weeks Ended<br>October 28,<br>2017 | 39<br>Weeks Ended<br>October 28,<br>2017 |
|-------------------------------------------|------------------------------------------|---------------------------------------|------------------------------------------|
| Severance and related employee costs      | \$ 1,568                                 | \$ 2,431                              | \$ 9,592                                 |
| Lease termination and store closure costs | —                                        | 1,264                                 | 9,296                                    |
| Total cash restructuring charges (1)      | 1,568                                    | 3,695                                 | 18,888                                   |
| Joint business venture charges (2)        | —                                        | —                                     | 9,311                                    |
| Inventory charges (3)                     | —                                        | —                                     | 1,669                                    |
| Total restructuring and related charges   | \$ 1,568                                 | \$ 3,695                              | \$ 29,868                                |

- (1) Cash charges of \$1.6 million for the 39 weeks ended November 3, 2018 consisted primarily of charges for corporate severance costs; and \$3.7 million and \$18.9 million for the 13 and 39 weeks ended October 28, 2017, respectively, for lease termination, store closures and severance were recorded within Restructuring Charges on the Consolidated Statements of Operations and Retained Earnings.
- (2) \$9.3 million (\$5.1 million cash and \$4.2 million non-cash) of charges related to the planned exit of a joint business venture were recorded within Other (Expense) Income, Net on the Consolidated Statements of Operations and Retained Earnings.
- (3) Non-cash inventory charges of \$1.7 million related to restructuring activities for our United Kingdom and Asia markets recorded as a reduction in Gross Profit on the Consolidated Statements of Operations and Retained Earnings.

A roll forward of the liabilities recognized in the Consolidated Balance Sheet is as follows. The accrued liability as of February 3, 2018 relates to previous restructuring activities disclosed in the Company's Fiscal 2017 Form 10-K, which remained unpaid at the beginning of Fiscal 2018.

| (In thousands)                                  | 39 Weeks Ended<br>November 3,<br>2018 |
|-------------------------------------------------|---------------------------------------|
| Accrued liability as of February 3, 2018        | \$ 7,650                              |
| Add: Costs incurred, excluding non-cash charges | 1,568                                 |
| Less: Cash payments and adjustments             | (5,284)                               |
| Accrued liability as of November 3, 2018        | \$ 3,934                              |



## 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 2017 Management's Discussion and Analysis of Financial Condition and Results of Operations which can be found in our Fiscal 2017 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 approximately 15 to 20 American Eagle Outfitters stores and 10 to 15 Aerie stores, and the addition of 20 to 25 Aerie side-by-side format stores to existing American Eagle Outfitters store locations in North America during Fiscal 2018;
  - 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 60 to 70 American Eagle Outfitters stores in the United States and Canada for remodeling and refurbishing during Fiscal 2018;
  - the potential closure of approximately 10 to 15 American Eagle Outfitters and 5 to 10 Aerie stores, primarily in North America during Fiscal 2018;
  - the planned opening of approximately 45 to 50 new international third-party operated American Eagle Outfitters stores during Fiscal 2018;
  - the success of our core American Eagle Outfitters and Aerie brands through our omni-channel and licensed outlets within North America and internationally;
  - the success of our business priorities and strategies;
  - our performance during the year-end holiday selling season;
  - our ability to predict inventory turnover;
  - 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 our product costs are adversely affected by foreign trade issues (including import tariffs and other trade restrictions with China), currency exchange rate fluctuations, increasing prices for raw materials, political instability or other reasons; 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 Item 1A of our Fiscal 2017 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, including Fiscal 2018, 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 Outfitters, 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 Outfitters and Aerie brand comparable sales disclosures represent sales from stores and AEO Direct.

AEO Direct sales are included in the individual American Eagle Outfitters 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, apps, 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 traffic. We also offer a 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.

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 (“SG&A”), 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: sales per square foot, comparable sales, average unit retail price (“AUR”), units per transaction (“UPT”), average transaction value, transactions, customer traffic, conversion rates, average unit cost (“AUC”), 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 third quarter produced the fifteenth consecutive quarter of positive comparable sales increase and our first-ever third quarter with revenue over \$1 billion. Total net revenue increased 5% to \$1.004 billion and consolidated comparable sales, including AEO Direct, increased 8%, following a 3% increase last year. By brand, American Eagle comparable sales increased 5%, building on a 1% increase last year. Aerie's comparable sales increased 32%, following a 19% increase last year, marking the 16<sup>th</sup> consecutive quarter of double-digit comp growth.

Gross profit increased 7% or \$24.6 million to \$399.5 million compared to \$374.9 million last year. The gross margin rate improved 80 basis points to a rate of 39.8% of revenue. The increase was a result of lower markdowns and lower rent as a percentage of sales, partially offset by higher delivery costs.

Selling, general and administrative ("SG&A") expenses increased 14% or \$31.3 million to \$248.4 million from \$217.1 million last year. As a percentage of total net revenue, SG&A expenses increased 220 basis points to 24.8%, compared to 22.6% last year. The increase was due to investments in customer experience, our brands, and our associates.

Net income for the quarter increased 34% to \$85.5 million, or \$0.48 per diluted share, compared to \$63.7 million, or \$0.36 per diluted share last year, which included \$0.01 per share of restructuring charges. Net income per diluted share this year increased 30% to \$0.48 per share, compared to adjusted net income per diluted share of \$0.37 last year (see the reconciliation to GAAP net income per diluted share below).

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.

During the third quarter of 2018, we returned \$50 million to shareholders through share repurchases of \$25.4 million, and cash dividends of \$24.3 million, bringing our year-to-date total return to shareholders to approximately \$142 million consisting of share repurchases of \$70.3 million and cash dividends of \$71.3 million. We had \$359.7 million in cash and short-term investments as of November 3, 2018 compared to \$257.5 million last year. Merchandise inventory at the end of the third quarter was \$591.7 million, compared to \$534.0 million last year, an 11% increase. This is primarily due to strong demand, our clearance store strategy and the timing of holiday receipts.

This results of operations section contains a non-GAAP financial measures ("non-GAAP" or "adjusted"), comprised of earnings per share information excluding 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. This amount is 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<br>Weeks<br>Ended<br>October<br>28,<br>2017 |
| Net income per diluted share - GAAP Basis                  | \$ 0.36                                        |
| Add: Restructuring charges <sup>(1)</sup>                  | 0.01                                           |
| Net income per diluted share - Adjusted or Non- GAAP Basis | \$ 0.37                                        |

(1) \$3.7 million pre-tax restructuring related charges, consisting of corporate severance related charges (\$2.4 million) and corporate lease buyouts of (\$1.3 million)

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

|                                                                             | 13 Weeks Ended |         | 39 Weeks Ended |         |
|-----------------------------------------------------------------------------|----------------|---------|----------------|---------|
|                                                                             | November       | October | November       | October |
|                                                                             | 3,             | 28,     | 3,             | 28,     |
|                                                                             | 2018           | 2017    | 2018           | 2017    |
| Total net revenue                                                           | 100.0 %        | 100.0 % | 100.0 %        | 100.0 % |
| Cost of sales, including certain buying, occupancy and warehousing expenses | 60.2           | 61.0    | 62.1           | 63.2    |
| Gross profit                                                                | 39.8           | 39.0    | 37.9           | 36.8    |
| Selling, general and administrative expenses                                | 24.8           | 22.6    | 24.8           | 24.0    |
| Restructuring charges                                                       | 0.0            | 0.4     | 0.1            | 0.8     |
| Depreciation and amortization expense                                       | 4.2            | 4.5     | 4.6            | 4.8     |
| Operating income                                                            | 10.8           | 11.5    | 8.5            | 7.2     |
| Other income (expense), net                                                 | 0.4            | (1.4 )  | 0.2            | (0.8 )  |
| Income before income taxes                                                  | 11.2           | 10.1    | 8.7            | 6.4     |
| Provision for income taxes                                                  | 2.7            | 3.5     | 2.0            | 2.2     |
| Net Income                                                                  | 8.5 %          | 6.6 %   | 6.7 %          | 4.2 %   |

The following table shows our consolidated store data:

|                                                              | 13 Weeks Ended |         | 39 Weeks Ended |         |
|--------------------------------------------------------------|----------------|---------|----------------|---------|
|                                                              | November       | October | November       | October |
|                                                              | 3,             | 28,     | 3,             | 28,     |
|                                                              | 2018           | 2017    | 2018           | 2017    |
| Number of stores:                                            |                |         |                |         |
| Beginning of period                                          | 1,054          | 1,057   | 1,047          | 1,050   |
| Opened                                                       | 7              | 5       | 18             | 26      |
| Closed                                                       | (4 )           | (4 )    | (8 )           | (18 )   |
| End of period                                                | 1,057          | 1,058   | 1,057          | 1,058   |
| Total gross square feet at end of period (in '000)           | 6,662          | 6,641   | 6,662          | 6,641   |
| International licensed/franchise stores at end of period (1) | 223            | 205     | 223            | 205     |

(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 941 American Eagle Outfitters retail stores (which include 142 Aerie side-by-side locations), 110 Aerie stand-alone locations and AEO Direct. Additionally, there were 5 Tailgate and 1 Todd Snyder stand-alone locations.

Comparison of the 13 weeks ended November 3, 2018 to the 13 weeks ended October 28, 2017

Total Net Revenue

Total net revenue increased 5%, or \$43.3 million, to \$1.004 billion compared to \$960.4 million last year. As a result of the shifted 2018 retail calendar, approximately \$40 million of total net revenue shifted out of the third quarter and was recorded in the second quarter.

Consolidated comparable sales increase of 8% for the period following a 3% increase last year. By brand, including the respective AEO Direct sales, American Eagle Outfitters brand comparable sales increased 5%, or \$38.9 million, and Aerie brand comparable sales increased 32%, or \$28.9 million. Third quarter 2018 comparable sales are compared to the 13 weeks ended November 4, 2017 due to the shifted retail calendar.

For the third quarter, consolidated comparable traffic increased in the high-single digits while transactions increased in the mid-single digits. UPT increased in the low-single digits and AUR increased slightly.

## Gross Profit

Gross profit increased 7% or \$24.6 million to \$399.5 million compared to \$374.9 million last year. The gross margin rate improved 80 basis points to a rate of 39.8% of revenue. The increase was a result of lower markdowns and lower rent as a percentage of sales, slightly offset by higher delivery costs from increased AEO Direct penetration and sales volume.

There was \$2.9 million and \$2.0 million of share-based payment expense included in gross profit for the periods ended November 3, 2018 and October 28, 2017 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 SG&A. 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 14% or \$31.3 million to \$248.4 million from \$217.1 million last year. As a percentage of total net revenue, SG&A expenses increased 220 basis points to 24.8%, compared to 22.6% last year. The dollar increase primarily supported key investments in our brands, the customer experience and our associates with increases in store payroll, higher wages, and incremental advertising and incentive expense.

There was \$3.3 million and \$0.3 million of share-based payment expense included in SG&A expenses for the periods ended November 3, 2018 and October 28, 2017, respectively, comprised of both time and performance-based awards.

## Restructuring Charges

There were no restructuring charges recorded for the 13 weeks ended November 3, 2018. For the 13 weeks ended October 28, 2017 restructuring charges were \$3.7 million, or 0.4% as a percentage of total net revenue. These charges were the result of corporate severance related charges of \$2.4 million and \$1.3 million of corporate lease buyout charges.

## Depreciation and Amortization Expense

Depreciation and amortization expense decreased 2% or \$0.7 million to \$42.4 million, compared to \$43.1 million last year. As a percentage of total net revenue, depreciation and amortization expense was 4.2% this year compared to 4.5% last year.

## Other Income (Expense), Net

Other income increased to \$4.3 million this year, compared to other expense of \$(13.2) million last year. The increase is primarily attributable to increased interest income and a benefit from a vendor settlement. Included in other expense last year was a \$13.9 million discrete charge, associated with a reserve against a receivable.

## 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 November 3, 2018 was 24.3% compared to 34.8% for the 13 weeks ended October 28, 2017. The decrease in the effective income tax rate for the 13

weeks ended November 3, 2018 is primarily due to the reduction in the U.S. federal corporate tax rate from 35% to 21% as a result of the enactment of the Tax Act in December 2017.

#### Net Income

Net income increased 34%, or \$21.7 million, to \$85.5 million, or 8.5% as a percent of total net revenue, from \$63.7 million, or 6.6% as a percent of total net revenue last year. Net income per share increased 33% to \$0.48 per diluted share, from \$0.36 per diluted share last year, which included \$0.01 of restructuring related charges and \$0.05 per share of a discrete charge associated with a reserve against a receivable. The change in net income is attributable to the factors noted above.

Comparison of the 39 weeks ended November 3, 2018 to the 39 weeks ended October 28, 2017

#### Total Net Revenue

Total net revenue increased 9%, or \$224.7 million, to \$2.792 billion compared to \$2.567 billion last year. The increase resulted from a consolidated comparable sales increase of 9% for the period following a 2% increase last year. Approximately \$15 million of the revenue increase was due to the shifted retail calendar.

By brand, including the respective AEO Direct sales, American Eagle Outfitters brand comparable sales increased 5%, or \$114.5 million, and Aerie brand comparable sales increased 32%, or \$86.2 million.

For the year to date period, consolidated comparable traffic increased in the high-single digits while transactions increased in the mid-single digits. UPT increased slightly and AUR increased in the low-single digits.

#### Gross Profit

Gross profit increased 12% or \$111.6 million to \$1.057 billion compared to \$945.4 million last year. Gross profit last year included \$1.7 million or 10 basis points of inventory charges related to restructuring activities in our United Kingdom and Asia markets. The gross margin rate improved 110 basis points to a rate of 37.9% of revenue. The increase in the gross margin rate is primarily the result of lower rent as a percentage of sales and lower markdowns.

There was \$8.5 million and \$7.2 million of share-based payment expense included in gross profit for the periods ended November 3, 2018 and October 28, 2017, 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 SG&A. 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

SG&A expenses increased 12% or \$76.8 million to \$692.6 million from \$615.8 million last year. As a percentage of total net revenue, SG&A expenses increased 80 basis points to 24.8%, compared to 24.0% last year. SG&A expense increased primarily as a result of investments in customer-facing store payroll, higher wages, increased incentive expense and advertising.

There was \$9.3 million and \$4.8 million of share-based payment expense included in SG&A expenses for the periods ended November 3, 2018 and October 28, 2017, respectively, comprised of both time and performance-based awards.

#### Restructuring Charges

Restructuring charges were \$1.6 million, or 0.1% as a percentage of total net revenue, for the 39 weeks ended November 3, 2018. These charges are primarily the result of corporate severance charges.

For the 39 weeks ended October 28, 2017 restructuring charges were \$18.9 million, or 0.8% as a percentage of total net revenue. These charges are the result of home office restructuring and the previously announced initiative to explore the closure or conversion of Company owned and operated stores in Hong Kong, China, and the United Kingdom to licensed partnerships. Recorded separately from Restructuring Charges on the Consolidated Statements of Operations and Retained Earnings is \$1.7 million, or 0.1% as percentage of total revenue, of inventory charges related to restructuring activities recorded as a reduction in Gross Profit in our United Kingdom and Asia

markets. Additionally, \$9.3 million, or 0.4% as a percentage of total revenue, for costs related to the planned exit of a joint business venture are recorded within Other Income (Expense), Net.

#### Depreciation and Amortization Expense

Depreciation and amortization expense increased 3% or \$3.2 million to \$127.1 million, compared to \$123.9 million last year. As a percentage of total net revenue, depreciation and amortization expense was 4.6% this year compared to 4.8% last year. The increase in expense was driven by omni-channel, stores and IT technology investments.

### Other Income (Expense), Net

Other income increased to \$5.7 million this year, compared to other expense of \$(19.6) million last year. Included in other expense last year was a \$16.0 million discrete charge associated with a reserve against a receivable, along with \$9.3 million of costs related to the planned exit of a joint business venture, partially offset by 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 39 weeks ended November 3, 2018 was 23.1% compared to 34.1% for the 39 weeks ended October 28, 2017. The decrease in the effective income tax rate for the 39 weeks ended November 3, 2018 is primarily due to the reduction in the U.S. federal corporate tax rate from 35% to 21% as a result of the enactment of the Tax Act in December 2017, and excess tax benefits from share-based payments in accordance with ASU 2016-09.

### Net Income

Net income increased 69%, or \$75.5 million, to \$185.7 million, or 6.7% as a percent to total net revenue, from \$110.2 million, or 4.2% as a percent to total net revenue last year. Net income per share increased 70% to \$1.04 per diluted share, including \$0.01 of restructuring charges, from \$0.61 per diluted share, including \$0.11 of restructuring charges and \$0.05 per share of a discrete charge associated with a reserve against a receivable last year. 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 Outfitters 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. As of November 3, 2018, we had 223 stores operated by our third party operators in 25 countries. International third party operated stores are not included in the consolidated store data or the total gross square feet calculation.

As of November 3, 2018, we had 104 Company-owned stores in Canada, 37 in Mexico, 6 in Hong Kong, 4 in China and 6 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 November 3, 2018, 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.

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In accordance with ASC 820, the following table represents the fair value hierarchy of our financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of November 3, 2018:

| Fair Value Measurements at November 3, 2018 |                 |             |              |
|---------------------------------------------|-----------------|-------------|--------------|
| Quoted Market                               |                 |             |              |
| Prices in Active                            |                 |             |              |
| Markets for                                 |                 | Significant |              |
| Identical                                   | Significant     | Other       | Unobservable |
| Assets                                      | Observable      | Inputs      | Inputs       |
| (In thousands)                              | Carrying Amount | (Level 2)   | (Level 3)    |
| Cash and cash equivalents:                  |                 |             |              |
| Cash                                        | \$ 156,250      | \$ 156,250  |              |
| Interest bearing deposits                   | 93,733          | 93,733      |              |
| Commercial paper                            | 29,889          | 29,889      |              |
| Total cash and cash equivalents             | 279,872         | 279,872     |              |
| Short-term investments                      |                 |             |              |
| Certificates of deposit                     | 55,000          | 55,000      |              |
| Corporate bonds                             | 9,997           | 9,997       |              |
| Commercial paper                            | 14,859          | 14,859      |              |
| Total short-term investments                | 79,856          | 79,856      |              |
| Total                                       | \$ 359,728      | \$ 359,728  |              |

### 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, AEO Direct enhancements, distribution center improvements and expansion and the return of value to shareholders through the repurchase of common stock and the payment of dividends. Additionally, our uses of cash include the development of the Aerie brand, investments in omni-channel capabilities, and our international expansion efforts. Historically, these uses of cash have been funded with cash flow from operations and existing cash on hand. Also, we hold a five-year asset-based revolving credit facility that allows us to borrow up to \$400 million, which will expire in December of 2019. 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:

|                                | November<br>3,<br>2018 | February<br>3,<br>2018 | October<br>28,<br>2017 |
|--------------------------------|------------------------|------------------------|------------------------|
| Working Capital (in thousands) | \$516,321              | \$483,309              | \$377,372              |
| Current Ratio                  | 1.85                   | 2.00                   | 1.68                   |

Working capital increased \$33.0 million compared to February 3, 2018 and increased \$138.9 million compared to last year. The \$33.0 million increase in our working capital as of November 3, 2018, is driven by \$243.6 million of cash inflow from operations, partially offset by capital expenditures of \$143.9 million and the payment of cash dividends of \$71.3 million. Additionally, we repurchased 3.3 million shares for \$70.3 million under our publicly announced program during the 39 weeks ended November 3, 2018.

#### Cash Flows from Operating Activities

Net cash provided by operating activities totaled \$243.6 million and \$188.1 million for the 39 weeks ended November 3, 2018 and October 28, 2017, 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 for Investing Activities

Investing activities for the 39 weeks ended November 3, 2018 primarily consisted of \$143.9 million of capital expenditures for property and equipment and \$79.9 million of net short-term investment purchases, classified as available-for-sale. Investing activities for the 39 weeks ended October 28, 2017 primarily included \$134.9 million of capital expenditures for property and equipment.

### Cash Flows for Financing Activities

Cash used for financing activities for the 39 weeks ended November 3, 2018 consisted primarily of \$70.3 million used for purchases of 3.3 million shares of common stock under publicly announced programs, \$71.3 million for cash dividends paid at a quarterly rate of \$0.1375 per share, \$19.1 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payments and \$4.9 million for the payments on capital leases, offset by net proceeds from stock options exercised of \$15.5 million.

Cash used for financing activities for the 39 weeks ended October 28, 2017 consisted primarily of \$87.7 million used for purchases of common stock under publicly announced programs, \$66.4 million for cash dividends paid at a quarterly rate of \$0.125 per share, \$12.3 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payments and \$8.7 million for the payments on capital leases.

### Credit Facilities

In Fiscal 2014, 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 \$400.0 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 liens on certain real property.

As of November 3, 2018, 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 on November 3, 2018.

### Capital Expenditures for Property and Equipment

Capital expenditures for the 39 weeks ended November 3, 2018 were \$143.9 million and included \$84.4 million related to investments in our stores. In the 13 weeks ended November 3, 2018, we opened 2 new Aerie locations. We opened 5 American Eagle stores; 2 in Mexico and 3 in the U.S. to better position ourselves in select markets. Additionally, we continued to support our infrastructure growth by investing in information technology initiatives (\$22.1 million), e-commerce (\$23.6 million), the improvement of our distribution centers (\$12.5 million), and other home office projects (\$1.3 million).

For Fiscal 2018, we expect total capital expenditures to be in the range of \$180 million to \$190 million in support of our expansion efforts, stores investments including selective remodels of high performing, long-term locations, information technology upgrades to support growth and investments in e-commerce.

### Stock Repurchases

During Fiscal 2016, our Board authorized the repurchase of 25.0 million shares under a new share repurchase program which expires on January 30, 2021. As of November 3, 2018, 15.7 million shares remain authorized under the current program.

During the 39 weeks ended November 3, 2018, as part of our publicly announced share repurchase program, we repurchased 3.3 million shares for \$70.3 million, at a weighted average price of \$21.31 per share. During the 39 weeks ended October 28, 2017, as part of our publicly announced share repurchase program, we repurchased 6.0 million shares for \$87.7 million, at a weighted average price of \$14.59 per share.

During the 39 weeks ended November 3, 2018 and October 28, 2017, we repurchased approximately 0.9 million and 0.8 million shares, respectively, from certain employees at market prices totaling \$19.1 million and \$12.3 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.

#### Dividends

During the 13 weeks ended November 3, 2018, our Board declared a quarterly cash dividend of \$0.1375 per share, which was paid on October 26, 2018. 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 3, 2018 contained in our Fiscal 2017 Form 10-K. Any new accounting policies or updates to existing accounting policies as a result of new accounting pronouncements have been discussed in the notes to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q. The application of our critical accounting policies may require 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 3, 2018. Our market risk profile as of February 3, 2018 is disclosed in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our Fiscal 2017 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 November 3, 2018, 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

There were no changes in our internal control over financial reporting that occurred during the 13 weeks ended November 3, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Off Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements.

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## 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 affect our business and financial results are discussed within Item 1A of our Fiscal 2017 Form 10-K. There have been no material changes to the disclosures relating to this item from those set forth in our Fiscal 2017 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 November 3, 2018.

| Period                                               | Total Number of Shares Purchased<br>(1) | Average Price Paid Per Share<br>(2) | Total Number of Shares Purchased as Part of Publicly Announced Programs<br>(1) | Maximum Number of Shares that May Yet Be Purchased Under the Program<br>(1) (3) |
|------------------------------------------------------|-----------------------------------------|-------------------------------------|--------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| Month #1 (August 5, 2018 through September 1, 2018)  | 1,000,787                               | \$ 25.42                            | 1,000,000                                                                      | 15,700,000                                                                      |
| Month #2 (September 2, 2018 through October 6, 2018) | —                                       | \$ -                                | —                                                                              | 15,700,000                                                                      |
| Month #3 (October 7, 2018 through November 3, 2018)  | 32,225                                  | \$ 22.95                            | —                                                                              | 15,700,000                                                                      |
| Total                                                | 1,033,012                               | \$ 25.34                            | 1,000,000                                                                      | 15,700,000                                                                      |

- (1) During the 13 weeks ended November 3, 2018, there were 1.0 million shares repurchased as part of our publicly announced share repurchase program. There were 33,012 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 25.0 million shares under a new share repurchase program which expires on January 30, 2021.

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ITEM 6. EXHIBITS.

- \* Exhibit 10.1 Notice of Long Term Incentive Grant of Special Engagement and Retention Restricted Stock Units
  
- \* Exhibit 10.2 Notice of Grant of Special Engagement and Retention Restricted Stock Units
  
- \* 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 Interactive Data File

\* 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: December 12, 2018

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)