



# CFA Institute

## **CFA Institute Research Challenge**

hosted by

**CFA Society Seattle**

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January 2, 2014

Current Price: \$26.21 (02JAN2014)

Price Target: \$36.12 (31DEC2014)

Upside: 37.94%

Recommendation: BUY

Sector: Services

Industry: Specialty Retailer

USD/Euro Exchange rate:  
\$1.36733

Fig 1: May 2005 to present  
Compounded Annual Revenue  
Growth

ZUMZ	18.97%
ANF	10.18%
AEO	8.64%
ARO	12.52%
PSUN	-2.55%
DKS	14.79%

Source: Team's estimates

Fig 2: MAY 2005 to present Stock  
Appreciation

ZUMZ	110.68%
ANF	-40.67%
AEO	-15.76%
ARO	-26.82%
PSUN	-84.79%
DKS	275.02%

Source: Google Finance

### Market Profile

52 Week Range	\$17.93 – 33.50
P/E ratio	18.98
Dividend yield	N/A
Avg Vol, 3 month	249,077
Beta	1.15
Shares Outstanding	30.28M
Float	56%
Market Capitalization	\$840.01M
Institutional Holdings	80.31%
Insider Holdings	26.81%
Price to Book Value	2.44
Debt to Equity ratio	0.02
Return on Equity	13.90%

Source: MSN Money

	2013	2014 E	2015 E	2016 E	2017 E	2018 E
(In thousands of USD)						
Net Revenue	\$669,393	\$738,828	\$814,603	\$897,201	\$987,129	\$1,084,919
EBIT	\$70,279	\$81,224	\$87,676	\$92,006	\$105,173	\$114,342
Net Income	\$42,164	\$50,383	\$54,876	\$57,586	\$65,828	\$71,567
(In USD)						
Earnings Per Share	\$1.37	\$1.71	\$1.91	\$2.02	\$2.19	\$2.24
Return on Assets (%)	10.31%	10.82%	11.15%	11.02%	11.26%	10.95%
Return on Equity (%)	13.90%	14.31%	14.65%	14.42%	14.53%	13.90%

Source: Team's Estimates

## Highlights

**The valuation and fundamentals are indicative of a BUY:** With a price target of \$36.12 at the end of 2014, ZUMZ has an upside potential of 37.94% from its current price of \$26.21. The price target is based on a combination of the DCF analysis and the relative valuation analysis, which are the most appropriate methods as they capture the requirements of both institutional and individual investors.

### A solid revenue stream from a niche market segment will ensure stable future earnings

As a leading action sports lifestyle retailer, ZUMZ has carved out a niche customer segment of 15-18 year olds. ZUMZ differentiates itself with its focus on the latest trends in apparel and hard goods segments. Its customer loyalty program is unique in the fact that it rewards customers for embracing an action sports lifestyle. The STASH program not only allows ZUMZ to collect data on changing market trends, but also serves as a cost effective venue for advertising its product line. Going into the future, ZUMZ is focusing on expanding revenue primarily via e-commerce in the US and in Europe (through Blue Tomato) while containing its overhead costs by limiting retail store growth.

### Consistent operating efficiency and financial discipline permits internally financed projects

ZUMZ has been profitable in every fiscal year of its 34-year history, which has resulted in strong operating margins with the exception of 2009 and 2010. Since the Great Recession ZUMZ has quickly reestablished double-digit operating margins, which are projected to be, on average, 10.9% through 2018. With a strong balance sheet free of substantial debt obligations and 94 million in cash (20.2% of their assets), ZUMZ is well-positioned to take advantage of any opportunities the market presents.

### The acquisition of Blue Tomato allows ZUMZ to pursue expansion in the Eurozone

ZUMZ has made a strategic move with the acquisition of Blue Tomato. Blue Tomato is a well-established online retailer with presence in Austria and Germany, the two countries with the lowest unemployment in the European Union. At the time of acquisition, Blue Tomato generated about 75% of its revenue from online sales. This not only provides an opportunity for growth outside the US, but also helps ZUMZ take advantage of Blue Tomato's e-commerce expertise.

### In a highly competitive retail industry, ZUMZ has outpaced its competitors

Since its IPO in May 2005, ZUMZ has had a compounded annual revenue growth rate of 18.97%, surpassing the majority of its peers (Figure 1). During the same period ZUMZ achieved an impressive stock appreciation of 117%, in a market that has been inconsistent in value generation (Figure 2).



Source: Yahoo Finance

## Business Description

ZUMZ is an action sports lifestyle retailer that offers over 400 brands in 537 stores across the U.S., Canada, and Europe. Their target customer is the 'rebellious' teenager (aged 15-18 years) who wishes to differentiate himself from the rest of his peer group. Though ZUMZ has been primarily a mall-based retailer, the management has been concentrating on expanding sales through an integrated omni-channel marketing platform while limiting store expansion to 700 stores worldwide. As a specialty retailer of action sports related apparel, footwear, equipment and accessories, ZUMZ operates a website that sells merchandise online and its stores average approximately 2,900 square feet. Its (softline) apparel offerings include tops, bottoms, outerwear and accessories, such as caps, bags and backpacks, belts, jewelry and sunglasses. Additionally, its footwear offerings primarily consist of action sports related athletic shoes and sandals. Its (hardline) equipment offerings include skateboards, snowboards and ancillary gear, such as boots and bindings. Finally, ZUMZ also offers a selection of other items, such as miscellaneous novelties.

As an action sports lifestyle retailer offering unique products from some of the industry's top brands, such as Obey, Vans, Diamond Supply, and Primitive; which places ZUMZ in a unique position to resonate on a personal level with their customer base. The company does not utilize price promotions to attract customers; instead it positions itself as a premium reseller of top brands. The recent acquisition of Blue Tomato is a strategic move to expand into the European action sports lifestyle market within the next 5 to 10 years.

## Industry Overview and Competitive Positioning

### Macro-economic analysis: Conditions Point to an Aggressive Play

#### Tapering of Quantitative Easing and a sluggish Eurozone Economy

The 'new normal' in the U.S. has been driven the Federal Reserve's \$85 billion a month bond buying program, which has resulted in extremely low interest rates that have fuelled a revival across all the major stock exchanges, pushing benchmark indices to record levels. Additionally, the situation in the Eurozone represents a significant challenge as the lack of a coherent banking policy has made the threat of deflation a real prospect. Coupled with austerity measures and sovereign debt downgrades of Eurozone nations, credit remains tight as banks are not lending and business investment is weak. With a lack of investment alternatives, the equity market uptrend in the U.S. is the result of a massive inflow of funds from both domestic and European sources. As the Federal Reserve and ECB begin to taper off their respective QE programs, this will be positive for ZUMZ as the equity markets shift their investment priorities to aggressive stocks as the risk-free rate increases. ZUMZ is currently expanding stores in the U.S. and in the stronger economies of the European Union: Austria and Germany. With an upside of 37.94%, ZUMZ is an aggressive security that will provide impressive returns.

### Industry Analysis:

The growth in the U.S. apparel and footwear sectors is expected to be 3% to 4% in 2013 (according to S&P's Industry survey, May 2013). However, recently the retail industry has been experiencing significant changes. The introduction of international brands such as H&M, Zara, and the UK's Topshop and Uniqlo has placed additional pressure on domestic retailers as they try to maintain their share of the market. Though ZUMZ differentiates itself from its competition, it will face pressure as more businesses compete for consumer spending.

#### Teen apparel market

The teen apparel market in the U.S. is fragmented and teens aged 15-19 represent 7.1% of the population (according to S&P's Industry survey, May 2013). ZUMZ faces competition from Abercrombie & Fitch (ANF), AEO, ARO, Pacific Sunwear (PSUN), and Tilly's (TLYS), in the teen apparel segment. ZUMZ has been successful in differentiating itself by building a 'cool' brand image amongst its customer base by establishing a loyal fan base amongst those who aspire to have an action sports oriented lifestyle. For example, they offer over 1400 unique t-shirt designs, which is approximately 10 times more than their competitors. Store sales associates are highly knowledgeable and exemplify the action sports lifestyle. Their unique customer loyalty program, STASH, rewards customers for participating in action sports and also helps advertise their product line.

#### E-commerce integration

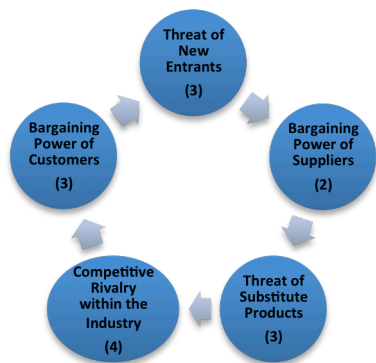
There has been a huge push within the apparel and footwear sector to generate sales through e-commerce. According to eMarketer, apparel and accessories are emerging as the fastest growing categories of the U.S. e-commerce retail sector. This category grew over 21% to \$45.6 billion in 2012 from 2011, and is projected to grow another 19% in 2013. In order to maximize its sales growth

opportunities in this space, ZUMZ strategic acquisition of the Blue Tomato brand in Europe enabled it to develop an integrated omni-channel marketing platform. At the time of acquisition, Blue Tomato generated nearly 75% of its \$39.5 million income through online sales, had only 5 retail stores, and its net profit margin was 11.9%. This acquisition clearly demonstrates ZUMZ's focus on increasing sales through online channels and using their stores to fortify the brand image. Finally, in 2012 ZUMZ's e-commerce sales represented 11.2% of revenue, up from 7.3% in 2010.

### Porter's Five Forces Model:

Porter's five forces analysis provides a framework for assessing an industry or market. We have applied this model to the apparel and footwear retail industry to better understand the competitive intensity and attractiveness of the market. The analysis that follows is rated on a scale of 1 to 5, where 5 is the most favorable for ZUMZ and 1 is the least favorable to ZUMZ (Figure 3).

Figure 3: Five Forces



Source: Team's Analysis

#### Threat of New Entrants (3)

The threat of new entrants to the apparel and footwear market is moderate. There are no major regulatory or licensing requirements to enter this industry. However, the U.S. retail market is saturated with several major players comprising 50.2% of the industry's revenue in 2012. In order to compete, new entrants will have to establish themselves in under-served, niche markets. ZUMZ has an established presence as a full-price retailer of the hottest brands and latest trends in teenage apparel and action sports, and is not under threat from new entrants.

#### Bargaining Power of Suppliers - Large Supplier Base and Vendor Service Agreements (2)

The U.S. apparel and footwear retail industry contains a large supplier base, which inherently results in high bargaining power for ZUMZ. However, when supplying to retailers that are heavily concentrated in niche markets, suppliers have the ability to look for more cost-effective contracts with large retailers, such as Amazon. ZUMZ mitigates this by requiring many of their brand suppliers to sign vendor service agreements (VSAs) to establish loyalty with their respective suppliers. This allows ZUMZ to have more bargaining power over their suppliers in comparison to other retailers.

#### Bargaining Power of Customers - High, but not in ZUMZ's primary market (3)

Customers in the apparel and footwear retail market have considerable power to switch to discounted products, which forces many retailers to engage in costly price wars. However, ZUMZ has been targeting customers from affluent households whose primary focus is on the quality of the brands and the overall experience at their stores. They have not engaged in price wars as they are focused on selling premium products for the action sports lifestyle niche.

#### Threat of Substitute Products - High threat of substitutes is mitigated by STASH (3)

The threat of substitutes in the apparel and footwear retail market is moderate. The market is highly saturated with competing products particularly in the lower end of the market. ZUMZ has created a niche in the teenage action lifestyle sector where they have little direct competition. The only direct competition that they face is in the form of popular garage retailers whose cool image and social media awareness may help them capture considerable market share from ZUMZ in limited geographic areas. To separate themselves from substitutes they have focused on building customer loyalty through their STASH program, which rewards customers for participating in events offered by ZUMZ. STASH has not only helped them decrease the threat of substitute products, but it serves as an advertising campaign and a significant data collection point. The increased customer loyalty obtained through STASH separates ZUMZ from substitute retailers.

#### Competitive Rivalry within the Industry - ZUMZ niche is expected to remain steady (4)

There is considerable rivalry in the U.S. retail industry. There are many players and many substitutes available, and ZUMZ will have continued pressure to sustain and grow revenues and market share. Examples of strong rivalry include International brands trying to penetrate the market; retailers offering heavily discounted products to capture market share; as well as the increasing aggressiveness of Amazon. The niche that ZUMZ has created through their unique offerings, superior customer service, and their STASH program has allowed them to have considerable success within the industry. As baby boomers reach retirement age, and Generation Y consumers flock into the retail markets, we can expect a decline in suits and an increase in the demand for trendy casual wear. This could potentially benefit ZUMZ as the landscape of the entire retail industry changes.

### Competitive Analysis:

There are not many competitors that exist in the action sports lifestyle market. With the exception of TLYS, ZUMZ's competitors are mostly focused on the apparel and footwear sector. Since the apparel and footwear segment represents 75% of their revenue, it is reasonable to compare them with ANF, AEO, ARO, and PSUN. Finally, ZUMZ's hardline sales also place them in competition with big-box retailers like Dick's Sporting Goods (DKS) and Sports Authority, as well as locally owned stores.

### Business Model Comparison

ZUMZ differentiates itself by having a niche focus within the action sports lifestyle market. They are the industry leader offering a variety of premium brands as well as the latest fashions to their customers. Their 'one-stop shop' mantra for all the latest apparel and hardline action sports goods has helped them establish a loyal customer base. The management has made a firm commitment to not compete on the basis of price. ZUMZ balanced product mix is centered on their private label brand, which accounted for over 20% of their revenues in 2013. Furthermore, their customer loyalty program, STASH, reinforces their brand image by rewarding their patrons for living an action sports oriented lifestyle. Conversely, AEO, ANF, and ARO have suffered from low priced substitutes being offered by off-price retailers, as well as international brands that are gaining market share.

**TLYS:** TLYS is ZUMZ closest competitor in the apparel and hardline business. It primarily operates in California, with over 189 stores in U.S. With no plans to expand into Canada or Europe, TLYS is primarily focused on increasing its market share through an aggressive store expansion of 15% per year for the next several years. This differs from ZUMZ's strategy of limiting store growth and expanding ecommerce revenue by focusing on an integrated omni-channel marketing platform.

**PSUN:** PSUN is ZUMZ's next closest competitor operating over 650 stores in the U.S. and Puerto Rico. However, PSUN has been unable to generate a profit over the past 6 years, and they lack an international presence. Given the saturation of the U.S. apparel market, it is unlikely that PSUN will return to profitability in the near term, or pose a continuing threat to ZUMZ.

**ANF, ARO and AEO:** ZUMZ competes with these retailers in the apparel and accessories market. Though they compete for the same market share, ZUMZ's commands a high degree of customer loyalty, and it will be hard for ANF, ARO and AEO to steal customers from this core segment.

**Amazon Inc. (AMZN):** Although Amazon is quickly becoming a growing threat to all brick and mortar retail store operators, they have a fundamentally different business model from ZUMZ. Where Amazon is focused on speed, price, and efficiency, ZUMZ caters to the latest fashion trends.

Finally, one area of concern for ZUMZ is the risk of overcapacity in the apparel and footwear sectors, which could result in a price war—a war that could have detrimental long-term effects on growth in these segments. With the increasing number of players in the apparel market, the oversupply can potentially overwhelm the market and drive down prices across the board. In that case, ZUMZ will have a tough time selling their goods at full price.

## Investment Summary

### The valuation and fundamentals are indicative of a BUY

The analysis of the company's operations, its valuation using multiple metrics, and the current macroeconomic environment make ZUMZ an attractive security. With a target price of \$36.12 at the end of 2014, there is an impressive gain of nearly 38%. This return is based entirely on its capital gains potential, which is derived from the growth opportunities the company has in the U.S. The high liquidity that ZUMZ has been able to maintain in an industry plagued by debt has allowed them to finance all of their expansion, including the acquisition of Blue Tomato, with cash.

### A solid revenue stream from a niche market segment will ensure stable future earnings

ZUMZ is the largest corporation in the action sports lifestyle industry in terms of market capitalization. As the company hits its maximum growth potential in brick and mortar stores by 2018, the integration of Blue Tomato's expertise in e-commerce and a new inventory control system will allow ZUMZ to begin transitioning its operations towards online retail sales. The new omni-channel marketing strategy being implemented will allow the company to remain relevant and competitive while limiting the growth in cost of goods sold and operating expenses. Additionally, the company's loyal customer base makes ZUMZ more tolerant to economic downturns because their product line represents a lifestyle, which makes household expenditures in this space less volatile than regular clothing. This is evidenced by the financial crisis where ZUMZ only experienced one year of negative growth, as well as its ability to generate wealth relative to its competitors (Appendices 2 & 5).

### In a highly competitive retail industry, ZUMZ has outpaced its peers

The retail industry has seen considerable consolidation since the recent financial crisis. During this period, however, ZUMZ has expanded its retail storefront locations in the U.S., Canada, and the European Union. As of August 2013 the company now operates some 537 stores, including 501 in the U.S., 28 in Canada, and 8 in the EU under the Zumiez and Blue Tomato brands. In order to ensure that its transition into e-commerce does not alienate its current customer base, the company has maintained both the zumiez.com and blue-tomato.com domain names with an integrated inventory control system. This integration will result in an estimated average operating margin of 10.9% through 2018.



Furthermore, with a consolidated inventory control procedure, we estimate that ZUMZ will be able to increase its inventory turnover rate from an average of 8.70 to 12.88 by 2018. Finally, ZUMZ generated \$332 million of Market Value Added value in 2013, even after paying cash for Blue Tomato the previous year (Appendix 5).

### Corporate Governance is highly rated

ZUMZ is a well-run company with an excellent corporate governance structure that boasts an effective board of directors and management team. The board of directors was analyzed using the criteria outlined in Appendix 14. Some important highlights of these criteria include the independence of the board (75%), separating the positions of Chairman and CEO, and establishing qualified personnel for the board as well as for each established committee. ZUMZ has three permanent committees, which include the audit committee, compensation committee and the governance and nominating committee. Currently, the board consists of 8 members, 6 of which are independent directors. Thomas Campion and Richard Brooks are the only directors that are current employees of the company, and they do not sit on any committee. Each independent director is qualified and has relevant financial experience to meet the needs of each committee. Please refer to Appendix 12 for a summary list of each board member as well as the management team.

### Strategic Acquisition

The cash purchase of Blue Tomato for \$75 million in 2012 represents a strategic step for ZUMZ's plan to build the leading global action sports retail business. Given the economic uncertainty in the Eurozone, the decision to buy a local company with an established brand and management team provides them the ability to selectively expand the company's European footprint. While Blue Tomato operates five stores in Austria (with plans for a flagship store in Germany), its real talent lies in its e-commerce experience. As the companies integrate their operations, ZUMZ's plans for expanding its own e-commerce footprint in the U.S. will benefit greatly from Blue Tomato's intellectual property, inventory control, and trans-national shipping experience. Finally, with ZUMZ pursuing expansion in both Austria and Germany, countries that have the lowest rates of unemployment in the Eurozone (4.8% and 5.2%, respectively), it is likely that Blue Tomato will add real value to ZUMZ as its operations are centered on the Eurozone's strongest economies.

### Economic Value Added

The economic value added (EVA) measure determines the amount of value ZUMZ is creating after accounting for the cost of both debt and equity. These figures are significantly lower than net income, because they show the value created after taking into consideration the cost of equity. As shown in Appendix 5, ZUMZ has successfully created value over the last three years. In 2013, their EVA was \$18M, and in 2012 their EVA was \$25M; with the decline stemming from the cash acquisition of Blue Tomato. EVA analysis for PSUN and TYLS provided varying results. PSUN showed significant wealth destruction while TYLS created an EVA equal to ZUMZ with less net income (Appendix 5).

Figure 4: Sharpe Ratios

<b>ZUMZ</b>	0.46
<b>ANF</b>	0.13
<b>AEO</b>	0.24
<b>ARO</b>	-0.08
<b>PSUN</b>	0.42
<b>DKS</b>	0.62

Source: Team's calculations

### Reward to Risk beats all direct competitors

By comparing the Sharpe Ratios of the dominant sports and lifestyle retailers in the U.S., we can see that ZUMZ provides a higher reward per unit of risk relative to its peer group (Figure 4). While DKS outperforms all other retailers, they are not in direct competition with ZUMZ for retail market share.

### Aggressive Price-maintenance

ZUMZ's market size and purchasing power in the wholesale softline industry cannot be understated, which is significant considering their high diversity of brands. Through the use of vendor service agreements (VSAs), they have been able to ensure that the products they source from the largest suppliers in the market are exclusive to their company. Additionally, the real depreciation of the USD over the last five years has decreased their reliance on foreign produced apparel, and has opened up access to a growing number of domestic garage suppliers. These VSAs virtually guarantee that these small-scale suppliers are prohibited from offering their products to discount resellers. Finally, the company's STASH loyalty program ensures that their diverse offering of private label and brands can be sold at full price. When combined, these strategies ensure that ZUMZ will be able to avoid a costly and potentially wealth destroying price war with other retailers.

## Valuation

### Valuation Models – DCF and Relative Valuation

ZUMZ was valued using a discounted cash flow (DCF) analysis of its free cash flow to equity (FCFE) and a relative valuation analysis of tradable comparable companies. The DCF model uses ZUMZ specific data and provides the best estimate of the company's intrinsic value. However, the DCF model is based upon assumptions of expected future performance, not market data. The relative valuation approach is market based, as ZUMZ is compared to its market peers, and less dependent

Fig 5: Target Price

	Weight	Price	P X W
FCFE	50%	36.00	18.00
Relative	50%	36.23	18.12
<b>Target Price</b>			<b>\$36.12</b>

upon assumptions. The average of these valuation models provides a robust estimate of \$36.12 (Figure 5) for ZUMZ's target price.

#### Discounting FCFE to Reach a Target Price

FCFE was determined as the best estimate of cash flow due to ZUMZ's minimal debt and stable capital structure. Furthermore, FCFE provides the best analysis for firm growth as ZUMZ is not expected to pay a dividend over the next five years and is expected to maintain its use of retained earnings to fund future growth. FCFE was discounted at the cost of equity to provide an estimated price target of \$36.98 (Figure 6).

Fig 6: Cost of Equity

<b>10-Yr Risk Free Rate</b>	<b>3.00%</b>
<b>Expected Market Return</b>	<b>10.00%</b>
<b>Estimated MRP</b>	<b>7.00%</b>
<b>Beta</b>	<b>1.15</b>
<b>Beta (Adj.)</b>	<b>1.15</b>
<b>Equity Risk Premium</b>	<b>8.04%</b>
<b>Cost of Equity</b>	<b>11.04%</b>

#### Five-Year Projected Cash Flow Assumptions

ZUMZ is expected to slow down its domestic brick and mortar expansion as it has nearly reached its target growth goal of 600 to 700 stores. While the company is expanding its operations in Europe, the domestic market is expected to persist as the primary revenue driver going forward. Therefore, a five year projected cash flow analysis was determined to be appropriate since ZUMZ is a relatively mature company.

#### Sales Forecast for 2014 through 2018

The projected five year revenue cash flows took into consideration ZUMZ expected performance in the domestic market. In the domestic market, ZUMZ revenue growth rate is expected to decline as opportunities for physical market space dwindle. However, ZUMZ is expected to improve same store sales through enhanced efficiencies and marketing. The company's website is also expected to contribute to revenue growth. ZUMZ expansion into Europe will help drive revenue growth over the next five years. However, given the persistent economic downturn in Europe, and Eurozone market fragmentation, we do not see a significant opportunity for rapid growth in the Eurozone. Given our assumptions, we see revenue growth proportionately declining from its current five-year growth rate of 10.4% to the current industry average of 9.79% (Figure 8) by the terminal year.

Fig 7: Absolute Return

<b>Target Price</b>	<b>\$36.12</b>
<b>Current Price</b>	<b>\$26.21</b>
<b>Upside</b>	<b>37.94%</b>

#### SG&A Growth will stabilize

As ZUMZ begins to integrate its management and operations with Blue Tomato, SG&A to Sales will decline. This is partially a result from stabilizing utility and insurance expenses from the building of a corporate headquarters and distribution facility. Since leasing is the primary method of securing retail space in the clothing industry, these costs will stabilize as ZUMZ reaches its maximum storefront growth potential by 2018. Finally, through the use of an improved inventory control system, ZUMZ will be able to exercise a higher degree of control over its cost of goods sold and operating expenses.

Fig 8: Retail Industry

<b>Annual Revenue Growth L5Y</b>	<b>9.79%</b>
<b>Cost of Equity</b>	<b>10.05%</b>

Source: Aswath Damodaran

#### Cost of Equity

The cost of equity was determined using the CAPM model, as is appropriate when discounting FCFE. The market value of debt was assumed to be the same as the book value based on the most recent SEC filing. While this value might not accurately reflect true market value, given the minimal amount of debt held by ZUMZ, any difference between book and market value would have negligible effect on the final valuation. ZUMZ has a levered beta of 1.15. However, given the firm's low level of debt, the unlevered beta is 1.148 and was rounded to 1.15. Using an estimate of the expected market return of 10%, the cost of equity for ZUMZ was determined to be 11.04% (Figure 6). Since expansion is projected to decline, ZUMZ's cost of equity is expected to proportionally decline over the next five years until it reaches the current industry average of 10.05% at the terminal year (Figure 8).

#### Terminal Value Component Assumptions

The terminal revenue growth rate is expected to be similar to the current growth rate for the retail (softlines) industry average of 9.79%. Terminal EBIT is expected to equal the company's average over the previous five years and the terminal cost of equity is expected to equal the current industry average. Given ZUMZ status as a maturing company in the retail market, we do not expect its revenue growth or cost of equity to differ significantly from the industry average.

#### Sensitivity Analysis

To test the sensitivity of our DCF estimates, we conducted a Monte Carlo simulation. The ranges of inputs were determined using a triangle distribution with the maximum and minimum figures determined to be plus or minus 10% of our expected value. Given ZUMZ stabilizing growth, we felt this range of sensitivity would best estimate ZUMZ expected performance. Using our sensitivity estimates, the projected price for ZUMZ is \$36.00, which was used as our final FCFE price target. The sensitivity analysis produced a minimum value of \$32.27 and a maximum value of \$40.79, with a standard deviation of \$1.55. The median is \$35.92. See Appendix 10 for further details.

#### Relative Valuation Using Market Data

A shortcoming of discounting FCFE is the lack of objective market data in the analysis. To counter this, we used relative valuation to compare ZUMZ with the performance of 16 peer companies.

### Determining Peer Companies

Given ZUMZ unique brand positioning, peer companies were determined based upon four categories: private label retailers, resellers clothing retailers, off-price clothing retailers, and sports retailers (softline and hardline). Private label retailers contain teen apparel competitors such as ANF, AEO, and ARO. American Apparel, Gap, and L Brands also compete for equity in this space. Resellers clothing retailers contains ZUMZ closest competitors, TLYS and PSUN, as well as Buckle and Urban Outfitters. ZUMZ also faces minor competition from off-price clothing retailers when the market is facing a downturn. Therefore, TJX Companies, Ross, and Burlington Coat Factory were included. Finally, ZUMZ faces competition from sports retailers (softline and hardline), which includes DKS, Big 5 Sporting Goods, and Hibbett Sports.

### Metrics Assessed and Time Frames Used

Three metrics were used in our relative valuation analysis. The first was price to adjusted earnings per share, which allowed us to compare the price per share relative to the earnings each share has generated. The second metric used was enterprise value to revenue, which allowed us to compare how much value is generated per dollar of revenue. The final metric analyzed was enterprise value to EBITDA, which compares company value to EBITDA (as a proxy for cash). These metrics were applied to the preceding twelve months; the forward twelve months (using pro forma values); as well as estimates for the fiscal year ending in 2015. The price estimates for each metric and time frame were averaged, which resulted in a final price target of \$36.23.

### Conclusion

Discounting FCFE and measuring market sentiment through relative valuation produced similar price targets, which average to \$36.12 (Figure 5). As of January 2, 2014 ZUMZ was trading at \$26.21, which provides a potential upside of 37.94% (Figure: 5), which reinforces ZUMZ as a BUY.

### Risks Associated with the Target Price

The DCF model's target price is sensitive to all its estimates. Appendix 10 ranks inputs based upon their impact on the final target price. The terminal cost of equity has the largest impact on the target price. If a different estimate was used for the terminal cost of equity, the estimated price could vary significantly. Relative valuation analysis is also subject to risk regarding market conditions and sentiment, which can affect its results (Appendix 11).

## Financial Analysis

With a solid revenue base relative to the industry since 2008, ZUMZ will be able to internally finance expansion in the U.S. and EU.

### Earnings

ZUMZ has benefited from solid earnings and its EPS growth is projected to maintain a steady average pace of 12.7% through 2018.

### Comparable Store Sales ensures successful storefront placement

The use of Comparable Store Sales metrics allows ZUMZ to not only assess how they are performing in the retail industry, but allows them to quickly identify storefront locations that are not adding value to the company. By engaging in base plus percentage of sales leases in high foot traffic shopping centers, ZUMZ is able to mitigate its rent exposure to the seasonal volatility of the market by subleasing underutilized space. This approach also allows them to sublease underutilized retail space for secondary, albeit small, income.

### Stable Operating Margins

ZUMZ is primarily a softline retailer catering to a consistent 'lifestyle' market of youth apparel. This has enabled post Great Recession operating margins to rebound to an average 10.5%. As synergies are created from the integration of Blue Tomato's retail operations—specifically its e-commerce expertise—SG&A expenses will stabilize, allowing them to achieve an average operating margin of 10.9% through 2018 (Appendices 2,3, & 4). Furthermore, with the introduction of improved inventory control procedures, ZUMZ will be able to increase its inventory turnover rate from an average 8.70 to 12.88 by 2018, as well as controlling their COGS expenses (Appendix 4).

### Cash Flow

ZUMZ is a publicly traded corporation that is able to behave like a private entity. As a cash-based company, they have been able to internally finance their North American store expansion, corporate headquarters and distribution center, as well as the acquisition of Blue Tomato without the issuance of debt. The company also aggressively manages its trade credit and accounts receivable programs alongside its inventory, which will enable them to bring their Cash Conversion Cycle down from 65 days in 2013 to 45 days by 2018 (Appendix 4).



**Balance Sheet & Financing**

ZUMZ maintains rotating credit facilities commensurate with a company of its size. ZUMZ's internally financed capital investment projects have allowed it to maintain a balance sheet that is virtually free of interest-bearing debt, with the exception of \$2 million inherited from Blue Tomato, and makes it a prime candidate for a takeover (Appendix 1). However, ZUMZ desire to maintain significant cash reserves, its projected growth of investment in marketable securities, as well as achieving its stated goals of expansion in the next five years implies that the company will be in a position to begin paying dividends after February 2018.

**Investment Risks****Operational Risks:****EURO/USD Exchange Rate**

Operational growth over the next five years will be reliant on the successful integration of Blue Tomato. The expansionary monetary policy by the European Central Bank, an extremely low Eurozone inflation rate, as well as the recent downgrade of France from AA+ to AA, may lead to a depreciation of the EURO. While this could negatively impact ZUMZ's ability to repatriate profits, it may also benefit their capitalization plans for expansion in the European market.

**Garage Suppliers**

ZUMZ maintains a strong reliance on minor suppliers in order to maintain their status as a lifestyle retailer. The use of garage suppliers—residential-based low-volume, low-capital suppliers—requires a substantial investment of time and energy from ZUMZ to develop these small businesses. While the use of these suppliers allows them to offer substantial product diversity in their softlines, large fluctuations in the commodity markets (e.g., oil and cotton), the loss of creativity, or even the loss of motivation on the part of the owner could cause significant supply chain disruptions.

**E-commerce and Omni-Channel Marketing**

The future success of ZUMZ will come from the synergies created with Blue Tomato, a company that has substantial experience in online retail sales. With ZUMZ approaching the point of saturation for brick and mortar store locations, any future growth in the U.S. market will be heavily contingent on creating a solid online sales presence. Additionally, the STASH program, which allows customers to earn points that can be applied to various lifestyle experiences, is heavily focused on a niche area of the teenage market. While this program has been successful in the U.S., it is not clear if a similar rewards/loyalty program would work in the EU.

**Competition Risks:****Low-cost Imports**

ZUMZ has been able to maximize returns on their private label softline goods by sourcing low-cost inputs such as raw materials, labor, and production services in China, where many of their featured brands and competitors do as well. Recognizing that international trade balances are recorded at the manufacturing level versus the retail level, overall imports in clothing and apparel have decreased over the past five years as a result of a depreciating USD. While this has made garage suppliers an attractive choice for ZUMZ, recent announcements by the U.S. Federal Reserve have indicated a continuous tapering off of expansionary monetary policy in the coming months. This could result in a real appreciation of the USD, which will make the domestic market more attractive to foreign brands that seek to mimic ZUMZ's product line. These brands will be able to offer significant discounts that could potentially inhibit the company's operating margin, as well as undermining the effectiveness of the STASH program to maintain a loyal customer base.

**Amazon and the EU**

The proposed Trans-Atlantic Trade and Investment Partnership will allow for greater competition in the European market for American labeled goods. The footprint that Amazon already possesses on the European continent is considerable, and their ability to offer similar products at lower prices may prevent Blue Tomato from maximizing its potential market share. Additionally, while ZUMZ is able to use vendor service agreements with its suppliers in the U.S. to prevent them from selling to third-party discount resellers, this contractual arrangement may no longer be tenable given the growth prospects for these suppliers in the EU by selling through Amazon.

## Regulatory Risks:

### Trans-Atlantic Trade and Investment Partnership (TTIP)

The U.S. – EU Free Trade Agreement will remove many of the barriers to trade in the clothing market. However, the retail clothing industry lacks a cohesive and effective lobby with the U.S. Office of Trade Representative, and this will prevent companies in this industry, such as ZUMZ, from securing any preferential trade concessions or protections. The TTIP will also make ZUMZ (through its ownership of Blue Tomato) a domestic EU business, as opposed to an American company conducting business in the EU. Given the strong preference of the EU Commission and European Parliament to regulate labor sourcing standards, competition, and pricing, ZUMZ operations in both the EU and the U.S. could be negatively impacted. As an example, recent rulings by the European Court of Justice (ECJ) have made price-maintenance contractual arrangements, such as vendor service agreements, illegal. As European businesses begin to expand their operations in the U.S., they will be able to utilize the ECJ to impose fines on the EU operations of U.S. firms that engage in otherwise legal price-maintenance activities in the U.S.

## Systemic Risks:

### Youth Unemployment

As compared to past economic downturns, there has been a slow improvement in the U.S. unemployment rate. In the past, recovery in the housing market was the major source of employment turnaround, but with the housing sector in shambles, the economy has struggled to add new jobs to the economy. The unemployment rate has dropped from a high of 10% in October 2009 to 7.0% in November 2013. However, the unemployment rate for teens (age 16-19 years) stands at 22.2%, and the number of fresh college graduates who are unemployed is at the highest level ever seen. Additionally, average unemployment in the European Union was 10.9% in November 2013, with Spain and Greece experiencing unemployment above 25%. With a bleak employment landscape, most young American and European men and women are holding off on starting families; this potentially long-term detrimental effect on the economy will impede ZUMZ's ability to maintain its long-run storefront expansion and sales growth.

### Minimum Wage Law Reform

The current U.S. federal minimum wage for non-tipped employees is \$7.25 an hour. The current administration announced in November 2013 its support for the Harkin-Miller bill currently before the U.S. Congress, which proposes raising this threshold to \$10.10 an hour over a two-year period where it will then be indexed to inflation. This proposal would provide a 39.3% wage increase to approximately 30 million working Americans. While economists remain divided over what impact this proposal will have on overall unemployment, there is consensus that if the economy maintains a 2% growth rate during the two-year period, youth unemployment could climb from 22.2% to 27.9%. Additionally, the recent CDU/CSU – SPD coalition agreement in Germany requires the introduction of a first ever national minimum wage of €8.50 an hour. This policy change will provide a wage increase to approximately 5.6 million working Germans. However, while youth unemployment in Germany is the lowest in the EU at 8.1% (as of November 2013), the coalition government predicts that this rate will increase to 10.3% in the absence of any tax cuts or abatements to firms. In conclusion, these potential increases to youth unemployment in the U.S. and Germany pose a significant threat to ZUMZ's retail operations.

## Valuation Risks:

The Terminal Value accounts for the largest portion of the DCF model, which is largely determined by the perpetual growth rate (which is assumed to equal the industry average after 2018). The Monte Carlo Simulation was used to test the sensitivity of the perpetual growth rate, and the probability that the recommendation would change from BUY to HOLD is minimal. At the minimum and maximum DCF price targets, after weighting with the multiples analysis, absolute upside gains are 19.77% and 42.78%, respectively (Appendix 10).

## Additional Upside Potential

### Acquisition of Blue Tomato

While the cash purchase and integration of Blue Tomato will provide ZUMZ with an expanded online presence and enhanced inventory control procedures, we have not factored in any future cash flows from this subsidiary in our valuation models. The 37.9% upside potential is based on domestic growth over the next five years, and any realized gains from ZUMZ's European operations is above and beyond our pricing model. Conversely, considering the nominal fee paid for this acquisition, the

intellectual property and e-commerce expertise gained will far outweigh any losses that would be incurred if Blue Tomato were to fail.

**Additional Overseas Expansion**

While Australia, China, and Latin America remain attractive markets for U.S. retailers, the lifestyle market that ZUMZ serves does not exist in these regions. However, the senior management of ZUMZ maintains a vigilant watch over these markets as growing income levels creates an ever-expanding middle class. As an example, market research conducted by ZUMZ found that only 50,000 teenagers actively engage in skateboarding as a lifestyle in China, and that the lifestyle market in Australia is saturated with domestic companies. With that being said, by pursuing a forward looking position on international expansion, ZUMZ will be able to enter these markets when the opportunity for a successful placement of their product line presents itself.

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The author(s), or a member of their household, of this report does not hold a financial interest in the securities of this company.

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## Appendix 1: Balance Sheet

	2009(A)	2010(A)	2011(A)	2012(A)	2013(A)	2014(F)	2015(F)	2016(F)	2017(F)	2018(F)
<b>Assets</b>										
<b>Current Assets</b>										
Cash and cash equivalents	\$33,057	\$1,568	\$11,357	\$14,779	\$17,579	\$58,035	\$77,872	\$57,556	\$65,521	\$35,574
Marketable securities	45,525	106,483	117,444	158,019	85,593	65,573	62,314	91,758	147,158	245,040
Receivables	4,555	5,600	6,129	6,284	9,467	12,592	15,913	18,763	20,219	21,454
Inventories	51,974	50,916	56,303	65,037	77,598	82,889	85,467	86,454	84,470	85,948
Prepaid expense and other	5,614	6,102	7,210	7,907	9,192	14,483	17,061	18,048	16,064	17,542
Deferred tax assets	2,588	3,045	2,418	1,477	3,885	6,030	7,578	6,330	5,174	3,192
<b>Total current assets</b>	<b>143,313</b>	<b>173,714</b>	<b>200,861</b>	<b>253,503</b>	<b>203,314</b>	<b>208,662</b>	<b>266,205</b>	<b>278,909</b>	<b>338,606</b>	<b>408,750</b>
Fixed assets, net	73,932	66,008	78,248	89,478	115,474	135,795	158,846	184,879	214,168	247,008
Goodwill	13,236	18,723	18,857	13,154	64,576	64,576	65,800	68,588	68,588	68,588
Intangible assets, net	-	-	-	-	20,480	-	3,250	6,822	-	-
Long-term other assets	2,868	1,820	3,665	6,022	5,254	5,158	4,952	3,226	3,507	3,128
<b>Total Long-term assets</b>	<b>90,036</b>	<b>86,551</b>	<b>100,770</b>	<b>108,654</b>	<b>205,784</b>	<b>262,251</b>	<b>232,847</b>	<b>263,515</b>	<b>286,263</b>	<b>318,724</b>
<b>Total assets</b>	<b>\$233,349</b>	<b>\$260,265</b>	<b>\$301,631</b>	<b>\$362,157</b>	<b>\$409,098</b>	<b>\$470,913</b>	<b>\$499,052</b>	<b>\$542,424</b>	<b>\$624,870</b>	<b>\$727,474</b>
<b>Liabilities and Shareholders' Equity</b>										
<b>Current liabilities</b>										
Trade accounts payable	\$15,909	\$16,817	\$16,371	\$21,743	\$16,052	\$19,842	\$23,427	\$26,337	\$28,520	\$31,520
Accrued payroll and payroll taxes	4,739	6,593	7,580	9,062	11,057	9,952	8,944	7,668	6,816	5,790
Income taxes payable	238	4,006	4,108	5,835	6,957	8,540	10,324	12,355	17,118	22,537
Deferred rent and tenant allowance	2,735	3,248	3,719	4,230	4,901	5,578	6,079	6,147	6,873	7,008
Other liabilities	7,600	9,123	13,683	14,706	18,232	18,687	19,055	19,309	19,687	19,999
<b>Total current liabilities</b>	<b>31,221</b>	<b>39,787</b>	<b>45,461</b>	<b>55,576</b>	<b>57,199</b>	<b>62,599</b>	<b>67,829</b>	<b>71,816</b>	<b>79,014</b>	<b>86,854</b>
Long-term deferred rent and tenant allowances	24,177	26,375	27,629	32,321	36,928	41,090	45,721	50,873	56,607	62,986
Long-term deferred tax liabilities	-	-	-	-	5,544	5,460	-	-	-	-
Long-term debt and other liabilities	-	1,427	1,806	1,983	6,006	5,748	5,475	5,187	4,883	4,562
<b>Total long-term liabilities</b>	<b>24,177</b>	<b>27,802</b>	<b>29,435</b>	<b>34,304</b>	<b>48,478</b>	<b>52,298</b>	<b>51,196</b>	<b>56,061</b>	<b>61,490</b>	<b>67,548</b>
<b>Total liabilities</b>	<b>55,398</b>	<b>67,589</b>	<b>74,896</b>	<b>89,880</b>	<b>105,677</b>	<b>114,897</b>	<b>119,025</b>	<b>127,877</b>	<b>140,504</b>	<b>154,402</b>
<b>Shareholders' equity</b>										
Preferred stock	-	-	-	-	-	-	-	-	-	-
Common stock	75,789	81,399	91,373	99,412	108,360	110,869	81,132	54,976	53,534	61,488
Accumulated other comprehensive income	117	101	(17)	135	6,010	5,144	3,225	4,114	5,001	6,119
Retained earnings	102,045	111,176	135,379	172,730	189,051	240,003	295,670	355,457	425,831	505,465
<b>Total shareholders' equity</b>	<b>177,951</b>	<b>192,676</b>	<b>226,735</b>	<b>272,277</b>	<b>303,421</b>	<b>356,016</b>	<b>380,027</b>	<b>414,547</b>	<b>484,366</b>	<b>573,072</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$233,349</b>	<b>\$260,265</b>	<b>\$301,631</b>	<b>\$362,157</b>	<b>\$409,098</b>	<b>\$470,913</b>	<b>\$499,052</b>	<b>\$542,424</b>	<b>\$624,870</b>	<b>\$727,474</b>

Source: Zumiez Annual Reports &amp; Team's estimates



## Appendix 2: Income Statement

	2009(A)	2010(A)	2011(A)	2012(A)	2013(A)	2014(F)	2015(F)	2016(F)	2017(F)	2018(F)
Net sales	\$408,669	\$407,603	\$478,849	\$555,874	\$669,393	\$738,828	\$814,603	\$897,201	\$987,129	\$1,084,919
Cost of goods sold	274,134	272,865	311,028	354,198	428,109	496,136	574,971	644,830	723,177	811,043
<b>Gross profit</b>	134,535	134,738	167,821	201,676	241,284	242,692	239,632	252,371	263,951	273,875
SG&A	109,927	122,003	130,454	141,444	172,742	162,857	153,601	161,661	160,270	161,099
<b>Operating profit</b>	24,608	12,735	37,367	60,232	68,542	79,835	86,031	90,710	103,681	112,776
Interest income, net	2,059	1,176	1,496	1,836	1,410	1,265	1,358	1,392	1,427	1,462
Other income (expense), net	36	96	(8)	(379)	327	124	287	(96)	65	103
<b>Earnings before income taxes</b>	26,703	14,007	38,855	61,689	70,279	81,224	87,676	92,006	105,173	114,342
Provision for income taxes	9,499	4,876	14,652	24,338	28,115	30,386	32,799	34,419	39,345	42,775
<b>Net income</b>	\$17,204	\$9,131	\$24,203	\$37,351	\$42,164	\$50,838	\$54,876	\$57,586	\$65,828	\$71,567
Shares outstanding	29,127	29,499	29,971	30,527	30,739	29,714	28,742	28,484	30,100	32,000
Basic earnings per share	\$0.59	\$0.31	\$0.81	\$1.22	\$1.37	\$1.71	\$1.91	\$2.02	\$2.19	\$2.24

Source: Zumiez Annual Reports &amp; Team's estimates

## Appendix 3: Statement of Cash Flows

	2009(A)	2010(A)	2011(A)	2012(A)	2013(A)	2014(F)	2015(F)	2016(F)	2017(F)	2018(F)
<b>Cash flows from operating activities</b>										
Net income	\$17,204	\$9,131	\$24,203	\$37,351	\$42,164	\$50,952	\$55,667	\$59,787	\$70,374	\$79,634
<b>Adjustments to reconcile net income to net cash:</b>										
Depreciation, amortization and accretion	19,470	22,092	17,923	19,744	22,957	23,994	24,764	25,559	26,380	27,226
Deferred taxes	(1,221)	(4,886)	537	3,441	(1,630)	(2,145)	(1,548)	1,248	1,156	1,982
Stock-based compensation expense	4,390	4,149	4,866	5,303	5,996	6,300	6,217	6,587	5,871	5,419
Excess tax benefit from stock-based compensation	(1,173)	(707)	(3,248)	(1,826)	(2,094)	(2,148)	(1,759)	(1,964)	(2,781)	(3,008)
Lease termination costs	-	-	-	-	1,397	1,526	907	785	655	512
Other	1,047	2,643	458	608	389	455	368	254	378	312
<b>Changes in operating assets and liabilities:</b>										
Receivables	220	(319)	(998)	(671)	(2,568)	(3,125)	(3,321)	(2,850)	(1,456)	(1,235)
Inventories	(3,253)	1,058	(5,387)	(8,833)	(2,987)	(5,291)	(2,578)	(987)	1,984	(1,478)
Prepaid expenses and other	(1,174)	(656)	(1,137)	(607)	(1,125)	(1,458)	(1,896)	(2,547)	(846)	(725)
Trade accounts payable	(3,763)	908	(52)	4,295	(5,626)	(3,790)	(3,585)	(2,910)	(2,183)	(3,000)
Accrued payroll and payroll taxes	(358)	1,854	987	1,485	1,207	1,105	1,008	1,276	852	1,026
Income taxes payable	1,364	4,475	3,350	2,868	1,843	1,583	1,784	2,031	4,763	5,419
Deferred rent and tenant allowance	7,044	3,917	1,838	5,334	5,469	5,578	6,079	6,147	6,873	7,008
Other liabilities	(1,460)	1,457	5,115	(427)	833	1,295	(987)	118	3,674	5,981
<b>Net cash provided by operating activities</b>	<b>38,337</b>	<b>45,116</b>	<b>48,455</b>	<b>68,065</b>	<b>66,225</b>	<b>74,831</b>	<b>81,120</b>	<b>92,534</b>	<b>115,693</b>	<b>125,073</b>
<b>Cash flows from investing activities:</b>										
Additions to fixed assets	(28,349)	(16,548)	(29,124)	(25,508)	(41,070)	(44,315)	(47,815)	(51,593)	(55,669)	(60,066)
Acquisitions, net of cash acquired	-	-	-	0	(70,711)	0	(15,294)	(34,855)	0	0
Purchases of marketable securities and other investments	(82,607)	(90,841)	(179,611)	(194,531)	(121,003)	(145,221)	(132,554)	(150,298)	(155,668)	(185,297)
Sales and maturities of marketable securities and investments	99,013	50,706	164,961	151,965	191,705	165,241	135,813	120,854	100,268	87,415
<b>Net cash used in investing activities</b>	<b>(11,943)</b>	<b>(56,683)</b>	<b>(43,774)</b>	<b>(68,074)</b>	<b>(41,079)</b>	<b>(24,295)</b>	<b>(59,850)</b>	<b>(115,892)</b>	<b>(111,069)</b>	<b>(157,948)</b>
<b>Cash flows from financing activities:</b>										
Payments on long-term debt (including change in book overdraft)	(7,384)	-	-	-	(258)	(273)	(288)	(304)	(321)	(340)
Repurchase of common stock	-	-	-	-	(25,213)	(12,589)	(4,198)	-	-	-
Proceeds from exercise of stock-based compensation	929	753	1,860	1,589	858	1,001	983	1,237	1,820	1,623
Excess tax benefit from stock-based compensation	1,173	707	3,248	1,826	2,094	1,568	1,870	1,964	1,674	1,492
<b>Net cash (used in) provided by financing activities:</b>	<b>(5,282)</b>	<b>1,460</b>	<b>5,108</b>	<b>3,415</b>	<b>(22,519)</b>	<b>(10,293)</b>	<b>(1,633)</b>	<b>2,897</b>	<b>3,173</b>	<b>2,775</b>
<b>Effect of exchange rate changes on cash &amp; cash equivalents</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>16</b>	<b>173</b>	<b>212</b>	<b>200</b>	<b>145</b>	<b>168</b>	<b>152</b>
<b>Net increase in cash and cash equivalents</b>	<b>21,112</b>	<b>(10,107)</b>	<b>9,789</b>	<b>3,422</b>	<b>2,800</b>	<b>40,456</b>	<b>19,837</b>	<b>(20,316)</b>	<b>7,965</b>	<b>(29,948)</b>
<b>Cash and equivalents, beginning of period</b>	<b>11,945</b>	<b>33,057</b>	<b>1,568</b>	<b>11,357</b>	<b>14,779</b>	<b>17,579</b>	<b>58,035</b>	<b>77,872</b>	<b>57,556</b>	<b>65,521</b>
<b>Cash and equivalents, end of period</b>	<b>\$33,057</b>	<b>\$22,950</b>	<b>\$11,357</b>	<b>\$14,779</b>	<b>\$17,579</b>	<b>\$58,035</b>	<b>\$77,872</b>	<b>\$57,556</b>	<b>\$65,521</b>	<b>\$35,574</b>

Source: Zumiez Annual Reports &amp; Team's estimates

## Appendix 4: Financial Ratios

	2009(A)	2010(A)	2011(A)	2012(A)	2013(A)	2014(F)	2015(F)	2016(F)	2017(F)	2018(F)
<b>Liquidity Ratios</b>										
Current Ratio	4.59	4.37	4.42	4.56	3.55	3.33	3.92	3.88	4.29	4.71
Quick Ratio	2.93	3.09	3.18	3.39	2.20	2.01	2.66	2.68	3.22	3.72
Cash Ratio	2.52	2.72	2.83	3.11	1.80	1.97	2.07	2.08	2.69	3.23
<b>Efficiency Ratio</b>										
Total Asset Turnover	1.82	1.65	1.70	1.67	1.74	1.68	1.68	1.73	1.70	1.62
Fixed Asset Turnover	5.84	5.83	6.64	6.63	6.53	5.88	5.54	5.24	4.98	4.76
Accts Receivable Turnover	63.70	80.28	81.65	89.56	85.00	67.00	57.24	51.95	51.02	52.69
Inventory Turnover	8.12	7.92	8.93	9.16	9.39	9.21	9.69	10.48	11.64	12.88
Days in Inventory (days)	44.97	46.07	40.86	39.84	38.89	39.63	37.66	34.83	31.37	28.33
Operating Cycle (days)	55.31	58.71	54.73	54.08	54.79	55.62	50.13	45.60	40.22	35.29
Cash Cycle (days)	55.44	73.32	67.35	66.56	65.07	64.46	59.79	55.66	50.26	45.25
<b>Profitability Ratio</b>										
Gross Margin	32.92%	33.06%	35.05%	36.28%	36.05%	32.86%	29.53%	28.41%	27.27%	26.12%
Operating Margin	6.02%	3.12%	7.80%	10.84%	10.24%	10.83%	10.70%	10.46%	11.16%	11.45%
EBIT Margin	6.53%	3.44%	8.11%	11.10%	10.50%	11.02%	10.90%	10.61%	11.31%	11.59%
EBITDA Margin	11.30%	8.86%	11.86%	14.65%	13.93%	14.26%	13.94%	13.44%	13.96%	14.07%
Net Profit Margin	4.21%	2.24%	5.05%	6.72%	6.30%	6.89%	6.82%	6.64%	7.08%	7.25%
ROA	7.37%	3.51%	8.02%	10.31%	10.31%	10.82%	11.15%	11.02%	11.26%	10.95%
ROE	9.67%	4.74%	10.67%	13.72%	13.90%	14.31%	14.65%	14.42%	14.53%	13.90%
SG&A/ Sales	26.90%	29.93%	27.24%	25.45%	25.81%	22.04%	18.83%	17.95%	16.12%	14.67%
<b>Solvency Ratio</b>										
Debt Ratio	23.74%	25.97%	24.83%	24.82%	25.83%	24.40%	23.85%	23.58%	22.49%	21.22%
Debt-to-Equity Ratio	31.13%	35.08%	33.03%	33.01%	34.83%	32.27%	31.32%	30.85%	29.01%	26.94%
Equity Multiple	1.31	1.35	1.33	1.33	1.35	1.32	1.31	1.31	1.29	1.27
Long-Term Debt Ratio	0.24	0.25	0.24	0.26	0.28	0.30	0.39	0.50	0.53	0.52
Interest Coverage Ratio	3.62	0.00	0.00	0.00	272.40	298.65	308.84	313.96	349.79	374.65

Source: Zumiez Annual Reports & Team's estimates

## Appendix 5: Estimation of EVA (in millions)

	ZUMZ				PAC SUN	TLYS
	2013	2012	2011	2010	2013	2013
NOPAT <sup>1</sup>	\$42	\$37	\$24	\$9	-\$52	23.9
Operating Assets <sup>2</sup>	\$324	\$204	\$184	\$154	\$336	205.8
Non-Int. Bearing Liab. <sup>3</sup>	\$95	\$84	\$71	\$64	\$230	149.9
INVESTED CAPITAL	\$229	\$121	\$113	\$90	\$106	\$56
\$ Cost of Capital <sup>4</sup>	\$24	\$13	\$12	\$9	\$11	\$5.89
EVA <sup>5</sup>	\$18	\$25	\$12	\$0	-\$63	\$18
ROIC <sup>6</sup>	18.45%	31.01%	21.42%	10.17%	-49.15%	42.75%
RADR	10.53%	10.53%	10.53%	10.53%	10.53%	10.53%
Spread	7.92%	20.48%	10.89%	-0.36%	-59.68%	32.22%
Zumiez Wholesale Corporation						
MVA (as of 1/31/2013) <sup>8</sup>	\$	332				
MVA (as of 1/31/2012) <sup>8</sup>	\$	618				
Percentage change from 2012		-46.28%				
Notes:						
<sup>1</sup> NOPAT equals operating income times 1 minus the tax rate						
<sup>2</sup> Operating assets equal total assets less any excess cash at the beginning of the fiscal year (excess cash was determined by the firm's level of short term investments at the beginning of the year).						
<sup>3</sup> Non-interest liabilities include accounts payable, payable/accrued, accrued expenses, other current liabilities, deferred income taxes, minority interest, and other LT liabilities all measured at the beginning of the year.						
<sup>4</sup> The \$ costs of capital equals the level of invested capital times the WACC.						
<sup>5</sup> EVA equals NOPAT minus the \$ cost of capital.						
<sup>6</sup> ROIC equals NOPAT divided by Invested Capital.						
<sup>8</sup> MVA equals MV(equity) minus BV(equity) at the end of the FY.						

Source: Zumiez Annual Reports &amp; Team's estimates

## Appendix 6: FCFE Inputs

<b>Date of valuation</b>	<b>1/3/2014</b>
<b>Company name</b>	<b>Zumiez, Inc.</b>
Country of incorporation	United States of America
Industry (US)	Retail (Softlines)
Industry (Global)	Retail (Softlines)
Revenues	\$669,393
Operating income or EBIT	\$68,542
Book value of equity	\$303,421
Book value of debt <sup>1</sup>	\$1,948
Number of shares outstanding <sup>2</sup>	30742
Current stock price <sup>3</sup>	\$26.21
Effective tax rate <sup>4</sup>	37.4%

### Value drivers:

First year growth rate <sup>5</sup>	10.37%
Change in growth rate per year	-0.12%
Terminal year growth rate <sup>6</sup>	9.79%
Target pre-tax operating margin (EBIT as % of sales in year 5)	10.39%

### Market numbers:

Riskfree rate <sup>7</sup>	3.00%
Initial cost of equity	11.04%
Change in cost of equity per year	-0.20%
Terminal cost of equity <sup>8</sup>	10.05%

### Other Inputs

Number of options outstanding <sup>9</sup>	820.15
Average strike price <sup>10</sup>	\$17.62
Average maturity <sup>11</sup>	6.25
Standard deviation on stock price <sup>12</sup>	66.70%

### Sources:

1. ZUMZ 2013 10K page 65. Assumes market value equals book value since Blue Tomato was recently acquired
2. Basic shares
3. Closing price 1/2/2013
4. The Marginal Tax rate is based on the weighted average of all corporate income tax rates paid by ZUMZ.
5. Last five years' compound annual growth rate
6. Aswath Damodaran's Industry Averages, Retail (Softlines), <http://pages.stern.nyu.edu/~adamodar/>
7. Ten year Treasury Yield. Closing price 1/2/2013. <http://www.treasury.gov/>
8. Aswath Damodaran's Industry Averages, Retail (Softlines), <http://pages.stern.nyu.edu/~adamodar/>
9. ZUMZ 2013 10K pages 69-70
10. ZUMZ 2013 10K pages 69-70
11. ZUMZ 2013 10K pages 69-70
12. ZUMZ 2013 10K pages 69-70



**Appendix 7: Estimation of Value of Options**

<b>Inputs</b>	
Current stock price <sup>1</sup> =	\$26.21
Average exercise price <sup>2</sup> =	\$17.62
Average time to maturity <sup>3</sup> =	6.25
Average standard deviation <sup>4</sup> =	66.70%
Dividend yield <sup>5</sup> =	0.00%
Risk-free rate <sup>6</sup> =	3.00%
Options Outstanding (thousands) <sup>7</sup> =	820
Shares outstanding (thousands) <sup>8</sup> =	30,742

<b>Black-Scholes Output</b>	
stock	26.21
strike	17.62
time	6.25
risk free	3.00%
st. dev.	66.70%
div	0.00%
Call	18.52

Value of Options Outstanding	\$ 15,189
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1. Closing price 1/2/2013
2. ZUMZ 2013 10K pages 69-70
3. ZUMZ 2013 10K pages 69-70
4. ZUMZ 2013 10K pages 69-70
5. ZUMZ 2013 10K pages 69-70
6. Ten year Treasury Yield. Closing price 1/2/2013. <http://www.treasury.gov/>
7. ZUMZ 2013 10K pages 69-70
8. Basic shares ZUMZ 2013 10K

### Appendix 8: Estimation of Current Cost of Equity

<i>Inputs</i>	
<b>Equity</b>	
Number of Shares outstanding <sup>1</sup>	30742
Current Market Price per share <sup>2</sup>	\$26.21
<b>Debt</b>	
Market Value of Debt <sup>4</sup>	\$1,948.00
Tax Rate <sup>5</sup>	37%
Levered beta <sup>5</sup>	1.15
Unlevered beta =	1.15
Risk free Rate <sup>6</sup>	3.00%
Expected Market Return <sup>7</sup>	10.00%
Expected Market Risk Premium	7.00%
Equity Risk Premium	8.04%
Cost of Equity	11.04%

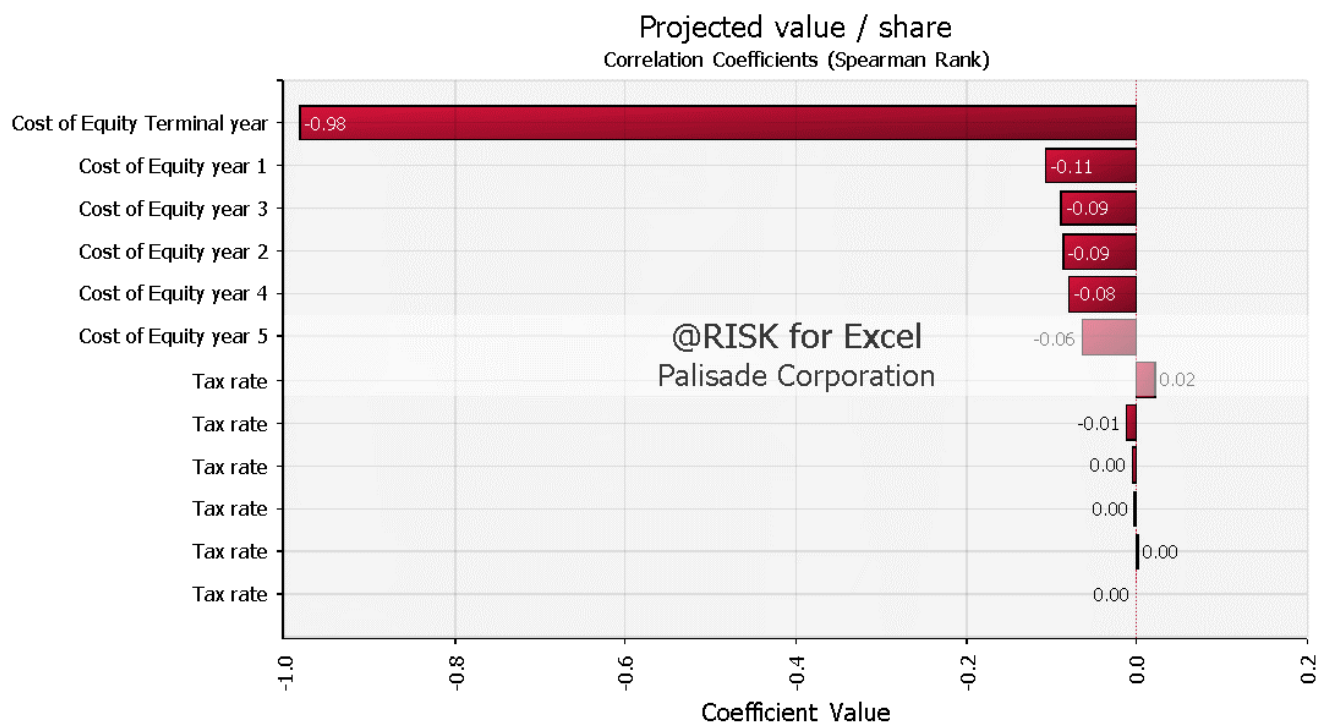
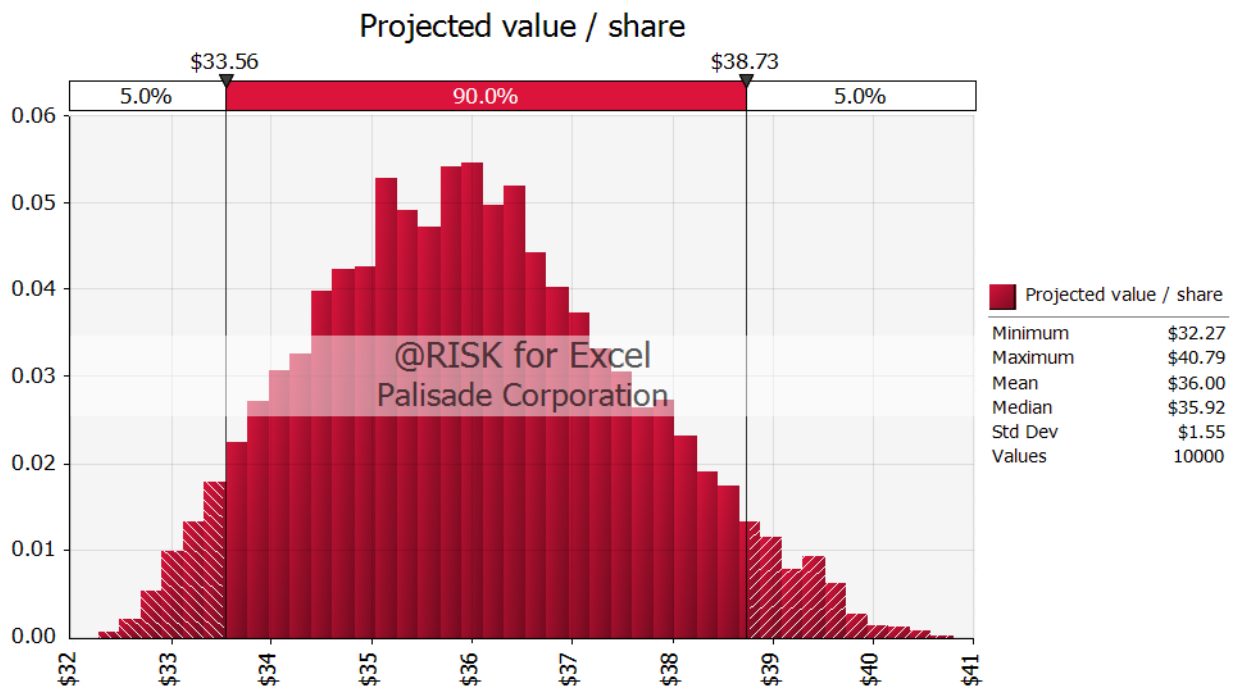
1. Basic shares
2. Closing price 1/2/2013
3. ZUMZ 2013 10K page 65. Assumes market value equals book value since Blue Tomato was recently acquired
4. The Marginal Tax rate is based on the weighted average of all corporate income tax rates paid by ZUMZ.
5. Source: Value Line, November 1, 2013
6. Ten year Treasury Yield. Closing price 1/2/2013. <http://www.treasury.gov/>
7. Source: Bloomberg Terminal data, rough estimate of previous 5 years risk premium

## Appendix 9: Discount Cash Flow Analysis of Free Cash Flow to Equity

Discount Cash Flow Analysis - Zumiez, Inc							
(\$ Thousands)	Fiscal 2013	1	2	3	4	5	Terminal year
Revenue growth rate		10.4%	10.3%	10.1%	10.0%	9.9%	9.8%
Revenues	\$669,393	\$738,828	\$814,603	\$897,201	\$987,129	\$1,084,919	\$1,191,132
EBIT (Operating) %	10.2%	10.8%	10.6%	10.1%	10.5%	10.4%	10.5%
EBIT (Operating income)	68,542	79,835	86,031	90,710	103,681	112,776	124,772
Tax rate	37.4%	37.4%	37.4%	37.4%	37.4%	37.4%	37.4%
EBIT(1-t)	42,900	49,969	53,847	56,775	64,894	70,587	78,095
Depreciation	22,957	23,994	24,764	25,559	26,380	27,226	26,380
Change FCInv	(15,562)	(3,245)	(3,501)	(3,777)	(4,076)	(4,398)	(3,799)
Change WCInv	17,814	(20,489)	35,736	(411)	(10,866)	(5,631)	(332)
FCFF		50,230	110,846	78,146	76,332	87,784	100,343
Interest Expense (1.7% on LTD)		(33)	(33)	(33)	(33)	(33)	(33)
Interest Expense x (1 - tax rate)		(21)	(21)	(21)	(21)	(21)	(21)
Debt Repayment		(327)	(333)	(262)	(234)	(209)	(187)
FCFE		49,882	110,492	77,863	76,077	87,555	100,135
Cost of Equity		11.0%	10.8%	10.6%	10.4%	10.2%	10.1%
Cumulated discount factor		0.9006	0.8125	0.7344	0.6649	0.6031	
PV(FCFE)		\$44,923	\$89,776	\$57,180	\$50,584	\$52,805	

Terminal cash flow	\$100,135
Terminal cost of equity	10.1%
Terminal value	\$1,420,359
PV(Terminal value)	\$856,626
PV (CF over next 5 years)	\$295,268
Sum of PV	\$1,151,894
Value of equity	\$1,151,894
- Value of options	\$15,189
Value of equity in common stock	\$1,136,705
Number of shares	30,742
Projected value / share	\$36.98
Value / Share with Sensitivity	\$36.00
Price	\$26.21
% difference	37.35%

## Appendix 10: Sensitivity Analysis – Monte Carlo Outputs



## Appendix 11: Relative Valuation

\$ in Millions, except per share data		Symbol	Price as of:	P / EPS Adjusted			Enterprise Value / Revenue			Enterprise Value / EBITDA		
Company		11/29/2013	LTM	FTM	2014 EST	LTM	FTM	2014 EST	LTM	FTM	2014 EST	
Peers												
Private Label Cloting Retailers												
Abercrombie and Fitch	ANF	34.28	N/A	20.06	23.42	N/A	0.63	0.62	N/A	6.04	6.30	
American Eagle Outitters	AEO	16.27	13.23	17.76	19.19	0.80	0.80	0.82	5.38	6.38	7.20	
Aeropastle	ARO	10.32	N/A	N/A	N/A	0.31	0.33	0.33	15.79	N/A	N/A	
American Apparel	APP	1.19	N/A	N/A	N/A	0.59	0.56	0.59	24.46	8.33	18.00	
GAP	GPS	40.97	14.63	14.22	15.23	1.19	1.16	1.20	7.19	7.09	7.46	
L Brands	LB	64.99	12.14	10.19	11.25	8.09	9.73	9.80	20.57	31.63	34.91	
Resellers Clothing Retailers												
Tilly's	TLYS	12.04	15.64	17.08	18.84	0.58	0.53	0.58	4.95	5.08	5.68	
Pacific Sunware	PSUN	2.91	N/A	N/A	N/A	0.30	0.32	0.31	37.06	24.70	25.47	
Buckle	BKE	53.06	15.47	14.92	15.44	2.09	2.04	2.09	8.14	7.94	8.14	
Urban Outfitters	URBN	39.02	20.98	19.04	20.70	1.65	1.50	1.61	9.24	8.24	8.87	
Off-Price Clothing Retailers												
The TJX Companies, Inc.	TJX	62.88	22.06	19.99	21.92	1.61	1.52	1.60	11.22	10.37	11.15	
Ross	ROST	76.46	19.51	18.23	19.72	1.59	1.52	1.59	10.38	9.97	10.50	
Burlington Coat Factory	BURL	28.44	N/A	26.93	29.02	N/A	0.82	0.83	N/A	9.65	10.08	
Sports Retailers (Softline and Hardline)												
Dick's Sporting Goods	DKS	56.52	21.57	19.41	21.34	1.18	1.08	1.16	10.61	9.48	10.36	
Big 5 Sporting Goods Corp.	BGFV	18.62	14.78	13.09	14.22	0.46	0.44	0.45	6.93	6.31	6.52	
Hibbett Sports, Inc.	HIBB	64.57	23.14	21.59	23.37	1.89	1.76	1.88	12.24	11.48	12.35	
Zumiez, Inc.	ZUMZ	27.77	17.58	17.16	17.73	1.05	0.97	1.01	6.71	7.09	7.33	
Private Label Cloting Retailers												
	Mean		8.00	12.45	13.82	2.20	2.20	2.23	14.68	9.91	12.31	
	Median		13.23	15.99	17.21	0.80	0.72	0.72	15.79	6.74	7.33	
Resellers Clothing Retailers												
	Mean		17.36	17.01	18.33	1.16	1.10	1.15	14.85	11.49	12.04	
	Median		15.64	17.08	18.84	1.12	1.02	1.10	8.69	8.09	8.51	
Off-Price Retailers												
	Mean		20.79	21.72	23.55	1.60	1.29	1.34	10.80	10.00	10.58	
	Median		N/A	19.99	21.92	N/A	1.52	1.59	N/A	9.97	10.50	
Sports Retailers (Softline and Hardline)												
	Mean		19.83	18.03	19.64	1.18	1.09	1.16	9.93	9.09	9.74	
	Median		21.57	19.41	21.34	1.18	1.08	1.16	10.61	9.48	10.36	
Total Comparables												
	Mean		17.56	17.89	19.51	1.60	1.55	1.59	13.15	10.85	12.20	
	Median		15.64	18.23	19.72	1.185	0.95	0.995	10.495	8.33	10.08	
	Min		12.14	10.19	11.25	0.3	0.32	0.31	4.95	5.08	5.68	
	Max		23.14	26.93	29.02	8.09	9.73	9.8	37.06	31.63	34.91	



## Appendix 11 (continued): Relative Valuation

Analysis			
P / EPS Adjusted	LTM	FTM	2014 EST
Price	27.77	27.77	27.77
Price / EPS	17.58	17.16	17.73
Shares Outstanding	30742	30742	30742
Expected Earnings Per Share	1.58	1.62	1.57
Comparable Companies Average P / E			
Private Label Cloting Retailers	8.00	12.45	13.82
Resellers Clothing Retailers	17.36	17.01	18.33
Off-Price Retailers	20.79	21.72	23.55
Sports Retailers (Softline and Hardline)	19.83	18.03	19.64
Total Comparables	17.56	17.89	19.51
Implied Value			
Private Label Cloting Retailers	12.64	20.14	21.64
Resellers Clothing Retailers	27.43	27.53	28.70
Off-Price Retailers	32.83	35.14	36.89
Sports Retailers (Softline and Hardline)	31.32	29.18	30.77
Total Comparables	27.74	28.94	30.56
EV / Rev	LTM	FTM	2014 EST
EV / Rev	1.05	0.97	1.01
EV	746.33	748.37	746.34
Revenue	711	772	739
Shares Outstanding	31	31	31
Comps EV / Revenue			
Private Label Cloting Retailers	2.20	2.20	2.23
Resellers Clothing Retailers	1.16	1.10	1.15
Off-Price Retailers	1.60	1.29	1.34
Sports Retailers (Softline and Hardline)	1.18	1.09	1.16
Total Comparables	1.60	1.55	1.59
Implied Value			
Private Label Cloting Retailers	50.77	55.25	53.52
Resellers Clothing Retailers	26.70	27.54	27.58
Off-Price Retailers	36.99	32.29	32.21
Sports Retailers (Softline and Hardline)	27.21	27.44	27.96
Total Comparables	36.88	38.81	38.25
Enterprise Value / EBITDA	LTM	FTM	2014 EST
EV / EBITDA	6.71	7.09	7.33
EV	744.94	744.73	744.51
EBITDA	111	105	102
Shares Outstanding	31	31	31
Comps EV / Revenue			
Private Label Cloting Retailers	14.68	9.91	12.31
Resellers Clothing Retailers	14.85	11.49	12.04
Off-Price Retailers	10.80	10.00	10.58
Sports Retailers (Softline and Hardline)	9.93	9.09	9.74
Total Comparables	13.15	10.85	12.20
Implied Value			
Private Label Cloting Retailers	53.01	33.87	40.68
Resellers Clothing Retailers	53.62	39.26	39.78
Off-Price Retailers	39.00	34.16	34.94
Sports Retailers (Softline and Hardline)	35.85	31.06	32.19
Total Comparables	47.50	37.06	40.31
Average	37.37	34.94	36.37
Price Target	36.23		

All data obtained from the Bloomberg Terminal on 11/29/2013

## Appendix 12: Management Bios



### **Thomas D. Campion, Co-founder and Chairman of the Board**

Thomas co-founded Zumiez in 1978 with Gary Haakenson. He has served on the board of directors since 1978. Before co-founding Zumiez he held several management positions at JC Penny Corporation. He has a B.A. in Political Science from Seattle University and serves as a board member for several organizations focusing on preserving the environment. He is also the trustee of the Campion Foundation, a nonprofit organization focused on ensuring that biologically important ecosystems in Northwestern North American are preserved. The Foundation also works on homelessness issues in the Pacific Northwest.



### **Richard Brooks, Chief Executive Officer, Director**

Richard joined Zumiez in 1992 and served as Vice President and Chief Financial Officer between 1993-2000. Richard was named CEO in 2000 and has held that position since. Prior to joining Zumiez, Richard was a financial officer at Interchecks, Inc., a subsidiary of Bowater PLC. Mr. Brooks holds a B.A. in Business from the University of Puget Sound. Mr. Brooks has served on the University of Puget Sound Board of Trustees from May 2002 to the present and he currently chairs its Board of Trustees as well as its Compensation and Executive Committees.

### **Chris Work, Chief Financial Officer**

Chris has served as Chief Financial Officer since August 2012. Mr. Work has been employed with the Company since October 2007, where he last served as Vice President, Controller. From September 2002 to October 2007, Mr. Work was an employee of Ernst & Young LLP, obtaining the level of Manager. Mr. Work received a Master of Professional Accounting from the University of Washington and a B.A. in Accountancy from Western Washington University. Mr. Work is a Certified Public Accountant in the State of Washington.

### **Lynn K. Kilbourne, President and General Merchandising Manager**

Lynn has served as our President and General Merchandising Manager (“GMM”) since September 2008. Prior to September 2008 and since September 2004, Ms. Kilbourne served as our Executive Vice President and GMM. From July 1991 until May 2001, she was with Banana Republic, a subsidiary of Gap, Inc., in various senior management positions. After leaving Banana Republic, Ms. Kilbourne served as an independent consultant in the retail industry until she joined Zumiez in September 2004. Ms. Kilbourne holds a B.A. in Economics and Political Science from Yale University and an M.B.A. from the Harvard University Graduate School of Business Administration.

### **Troy Brown, Executive Vice President – Ecommerce and Omni-Channel**

Troy has served as our Executive Vice President of E-commerce and Omni-channel since August 2012. From October 2008 through July 2012, he served as the Senior Vice President of E-commerce. From February 2007 through August 2008, Mr. Brown was with Tommy Bahama as the Director of E-commerce. From March 2005 until September 2006, he was with Expedia, where he served as General Manager (“GM”) of Vacation Packages. From August 1994 until March 2005, Mr. Brown was with Eddie Bauer in various management positions including Vice President of E-commerce. Prior to August 1994, he was employed by Nautica Inc. and ZCMI, where he held various management positions. Mr. Brown has more than 30 years’ experience in the retail, wholesale, and E-commerce industries.

### **Chris K. Visser, General Counsel and Corporate Secretary**

Chris has served as our General Counsel and Corporate Secretary since October 2012. From 2001 until October 2012, Mr. Visser was with K&L Gates LLP where he was a partner in the corporate, securities, and mergers and acquisitions practice group. Mr. Visser also worked as a process engineer with Vista Chemical Company prior to earning his law degree. Mr. Visser holds a Bachelor of Science degree in Chemical Engineering from the University of Washington. Mr. Visser also obtained an M.B.A. with a Concentration in Finance, from the University of Houston and a J.D. from the University of Houston Law Center where he graduated with academic honors and served as an editor on the Houston Law Review.

### **Ford K. Wright, Executive Vice President of Stores**

Ford has served as our Executive Vice President of Stores since March 2007. From May 2000 through February 2007, he served as the Director of Store Systems. From June 1994 through April 2000, Mr. Wright has served in Store, District and Regional Management positions. Prior to June 1994, Mr. Wright was employed with Nordstrom. Mr. Wright has over 20 years’ experience in the retail and wholesale clothing industry.

Source: <http://phx.corporate-ir.net/phoenix.zhtml?c=188692&p=irol-governance>

**Appendix 13: Board of Directors**

<b>Board of Directors</b>	<b>Years at Zumiez</b>	<b>Relevant Experience</b>
Thomas Campion	<b>36</b>	<b>Co-founder of Zumiez/Chairman of the Board</b>
Richard Brooks	<b>22</b>	<b>CEO of Zumiez</b>
Matthew L. Hyde	<b>8</b>	<b>CEO and President at West Marine, Inc./Vice President of REI</b>
Ernest R. Johnson	<b>2.5</b>	<b>Chairman of Cutter and Buck/CEO at New Wave USA Inc.</b>
Sarah (Sally) G. McCoy	<b>3</b>	<b>CEO and President of CamelBak Products</b>
Gerald F. Ryles	<b>8</b>	<b>Chairman and major shareholder of Microserv Technology Services</b>
Travis D. Smith	<b>1.5</b>	<b>CEO and President of Jo-Ann Fabric and Craft stores</b>
James M. Weber	<b>8</b>	<b>President and CEO of Brooks Sports</b>

## Appendix 14: Assessment of the Board of Directors

### **Independence of board members**

Zumiez board of directors consists of 75% independent directors. Currently Zumiez has 8 board members, 6 of which are independent.

### **CEO and Chairman are separate positions**

The CEO of Zumiez is Richard Brooks, and the Chairman is Thomas Campion. Richard is responsible for overseeing the current leadership, setting the strategic direction and maintaining the unique culture within the company. Thomas is responsible for providing guidance to the CEO and setting the agenda for each board meeting.

### **Independent directors on each committee**

Zumiez is also compliant with this standard. Each committee has three to four people, and all are independent directors.

### **Independent directors with finance experience on audit committee**

Zumiez is compliant with this standard as per their audit committee charter, and Ernest R. Johnson is designated as the audit committee financial expert.

### **Directors are knowledgeable and have relevant experience**

This standard is also met, as each director has significant retail and finance experience.

### **Other commitments and time constraints for Directors**

Each director sits on no more than 3 boards, which gives him or her adequate time for Zumiez.

### **Annual Elections (staggered)**

The current length of each board member term is 3 years, where two or three board members terms will expire each year.