

EXPRESS, INC.  
Form 10-Q  
December 07, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 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 October 29, 2016  
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
Commission File Number 001-34742

EXPRESS, INC.  
(Exact name of registrant as specified in its charter)

Delaware 26-2828128  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1 Express Drive 43230  
Columbus, Ohio  
(Address of principal executive offices) (Zip Code)  
Telephone: (614) 474-4001  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

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Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

The number of outstanding shares of the registrant's common stock was 78,411,825 as of November 26, 2016.

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**FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q ("Quarterly Report") contains forward-looking statements that are subject to risks and uncertainties. All statements other than statements of historical fact included in this Quarterly Report are forward-looking statements. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance, and business. You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. These statements may include words such as "anticipate," "estimate," "expect," "project," "plan," "intend," "believe," "may," "will," "should," "can have," "likely," and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events. For example, all statements we make relating to our estimated and projected costs, expenditures, cash flows, and financial results, our plans and objectives for future operations, growth, initiatives, or strategies, plans to repurchase shares of our common stock, or the expected outcome or impact of pending or threatened litigation are forward-looking statements. All forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those that we expected, including:

- changes in consumer spending and general economic conditions;
- our ability to identify and respond to new and changing fashion trends, customer preferences, and other related factors;
- fluctuations in our sales, results of operations, and cash levels on a seasonal basis and due to a variety of other factors, including our product offerings relative to customer demand, the mix of merchandise we sell, promotions, and inventory levels;
- competition from other retailers;
- customer traffic at malls, shopping centers, and at our stores and online;
- our dependence on a strong brand image;
- our ability to develop and maintain a relevant and reliable omni-channel experience for our customers;
- the failure or breach of information systems upon which we rely;
- our ability to protect our customer data from fraud and theft;
- our dependence upon independent third parties to manufacture all of our merchandise;
- changes in the cost of raw materials, labor, and freight;
- supply chain disruption;
- our dependence upon key executive management;
- our growth strategy, including our ability to improve the productivity of our existing stores, open new stores, and grow our e-commerce business;
- our substantial lease obligations;
- our reliance on third parties to provide us with certain key services for our business;
- claims made against us resulting in litigation or changes in laws and regulations applicable to our business;
- our inability to protect our trademarks or other intellectual property rights that may preclude the use of our trademarks or other intellectual property around the world;
- restrictions imposed on us under the terms of our asset-based loan facility, including restrictions on our ability to repurchase our common stock;
- fluctuations in energy costs;
- changes in tax requirements, results of tax audits, and other factors that may cause fluctuations in our effective tax rate;
- impairment charges on long-lived assets; and
- our failure to maintain adequate internal controls.

We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors, and it is impossible for us to anticipate all factors that could affect our actual results. For a discussion of these risks and other risks and uncertainties that could cause actual results to differ materially from those contained in our forward-looking statements, please refer to "Item 1A. Risk Factors" in our

Annual Report on Form 10-K for the year ended January 30, 2016 ("Annual Report"), filed with the Securities and Exchange Commission ("SEC") on March 30, 2016. The forward-looking statements included in this Quarterly Report are made only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events, or otherwise, except as otherwise required by law.

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## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

## EXPRESS, INC.

## CONSOLIDATED BALANCE SHEETS

(Amounts in Thousands, Except Per Share Amounts)

(Unaudited)

	October 29, 2016	January 30, 2016
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 101,855	\$ 186,903
Receivables, net	16,274	22,130
Inventories	341,936	255,350
Prepaid minimum rent	31,434	30,694
Other	21,786	18,342
Total current assets	513,285	513,419
<b>PROPERTY AND EQUIPMENT</b>	1,017,259	948,608
Less: accumulated depreciation	(550,725 )	(504,211 )
Property and equipment, net	466,534	444,397
<b>TRADENAME/DOMAIN NAMES/TRADEMARKS</b>	197,618	197,597
<b>DEFERRED TAX ASSETS</b>	21,612	21,227
<b>OTHER ASSETS</b>	12,696	2,004
Total assets	\$ 1,211,745	\$ 1,178,644
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 222,818	\$ 149,884
Deferred revenue	25,322	30,895
Accrued expenses	166,953	126,624
Total current liabilities	415,093	307,403
<b>DEFERRED LEASE CREDITS</b>	145,507	139,236
<b>OTHER LONG-TERM LIABILITIES</b>	40,451	114,052
Total liabilities	601,051	560,691
<b>COMMITMENTS AND CONTINGENCIES (Note 10)</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock – \$0.01 par value; 10,000 shares authorized; no shares issued or outstanding —		—
Common stock – \$0.01 par value; 500,000 shares authorized; 92,041 shares and 91,127 shares issued at October 29, 2016 and January 30, 2016, respectively, and 78,409 shares and 80,914 shares outstanding at October 29, 2016 and January 30, 2016, respectively		911
Additional paid-in capital	183,025	169,515
Accumulated other comprehensive loss	(4,050 )	(4,665 )
Retained earnings	667,941	633,298
Treasury stock – at average cost; 13,632 shares and 10,213 shares at October 29, 2016 and January 30, 2016, respectively	(237,142 )	(181,106 )

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Total stockholders' equity	610,694	617,953
Total liabilities and stockholders' equity	\$1,211,745	\$1,178,644

See Notes to Unaudited Consolidated Financial Statements.

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EXPRESS, INC.

## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Amounts in Thousands, Except Per Share Amounts)

(Unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
NET SALES	\$506,090	\$546,616	\$1,513,766	\$1,584,576
COST OF GOODS SOLD, BUYING AND OCCUPANCY COSTS	354,373	355,527	1,043,382	1,049,853
Gross profit	151,717	191,089	470,384	534,723
OPERATING EXPENSES:				
Selling, general, and administrative expenses	136,633	146,585	405,547	420,334
Other operating (income) expense, net	(17)	(29)	28	43
Total operating expenses	136,616	146,556	405,575	420,377
OPERATING INCOME	15,101	44,533	64,809	114,346
INTEREST EXPENSE, NET	567	1,207	12,845	14,751
OTHER EXPENSE (INCOME), NET	90	70	(404)	140
INCOME BEFORE INCOME TAXES	14,444	43,256	52,368	99,455
INCOME TAX EXPENSE	2,827	16,949	17,725	39,058
NET INCOME	\$11,617	\$26,307	\$34,643	\$60,397
OTHER COMPREHENSIVE INCOME:				
Foreign currency translation (loss) gain	(367)	(134)	615	(590)
COMPREHENSIVE INCOME	\$11,250	\$26,173	\$35,258	\$59,807
EARNINGS PER SHARE:				
Basic	\$0.15	\$0.31	\$0.44	\$0.72
Diluted	\$0.15	\$0.31	\$0.44	\$0.71
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	78,401	84,240	78,754	84,453
Diluted	78,595	84,849	79,151	85,009

See Notes to Unaudited Consolidated Financial Statements.



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EXPRESS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Amounts in Thousands)  
(Unaudited)

	Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 34,643	\$ 60,397
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	58,960	56,103
Loss on disposal of property and equipment	907	1,313
Impairment charge	829	—
Amortization of lease financing obligation discount	11,354	—
Excess tax benefit from share-based compensation	—	(334 )
Share-based compensation	10,783	15,114
Non-cash loss on extinguishment of debt	—	5,314
Deferred taxes	(385 )	(6,805 )
Landlord allowance amortization	(8,345 )	(9,208 )
Payment of original issue discount	—	(2,812 )
Changes in operating assets and liabilities:		
Receivables, net	5,883	(2,546 )
Inventories	(86,468 )	(123,806 )
Accounts payable, deferred revenue, and accrued expenses	28,749	42,514
Other assets and liabilities	2,954	20,389
Net cash provided by operating activities	59,864	55,633
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(80,900 )	(85,013 )
Purchase of intangible assets	(21 )	(35 )
Investment in equity interests	(10,133 )	—
Net cash used in investing activities	(91,054 )	(85,048 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of long-term debt	—	(198,038 )
Costs incurred in connection with debt arrangements	—	(1,006 )
Payments on lease financing obligations	(1,186 )	(1,168 )
Excess tax benefit from share-based compensation	—	334
Proceeds from exercise of stock options	2,735	1,265
Repurchase of common stock under share repurchase program (see Note 11)	(51,538 )	(22,020 )
Repurchase of shares for tax withholding obligations	(4,498 )	(4,400 )
Net cash used in financing activities	(54,487 )	(225,033 )
<b>EFFECT OF EXCHANGE RATE ON CASH</b>	<b>629</b>	<b>(496 )</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(85,048 )</b>	<b>(254,944 )</b>
<b>CASH AND CASH EQUIVALENTS, Beginning of period</b>	<b>186,903</b>	<b>346,159</b>

CASH AND CASH EQUIVALENTS, End of period	\$ 101,855	\$ 91,215
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See Notes to Unaudited Consolidated Financial Statements.

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### Notes to Unaudited Consolidated Financial Statements

#### 1. Description of Business and Basis of Presentation

##### Business Description

Express, Inc., together with its subsidiaries ("Express" or the "Company"), is a specialty apparel and accessories retailer of women's and men's merchandise, targeting the 20 to 30 year old customer. Express merchandise is sold through retail and factory outlet stores and the Company's e-commerce website, [www.express.com](http://www.express.com), as well as its mobile app. As of October 29, 2016, Express operated 554 primarily mall-based retail stores in the United States, Canada, and Puerto Rico as well as 99 factory outlet stores. Additionally, as of October 29, 2016, the Company earned revenue from 20 franchise stores in Latin America and the Middle East. These franchise stores are operated by franchisees pursuant to franchise agreements. Under the franchise agreements, the franchisees operate stand-alone Express stores that sell Express-branded apparel and accessories purchased directly from the Company. During the fourth quarter of 2015, the Company made a strategic decision to exit its franchise agreements in the Middle East and South Africa. As a result, 13 franchise stores in the Middle East and South Africa have been closed in 2016 and the remaining two stores are expected to be closed by the end of 2016.

##### Fiscal Year

The Company's fiscal year ends on the Saturday closest to January 31. Fiscal years are referred to by the calendar year in which the fiscal year commences. References herein to "2016" and "2015" represent the 52-week periods ended January 28, 2017 and January 30, 2016, respectively. All references herein to "the third quarter of 2016" and "the third quarter of 2015" represent the thirteen weeks ended October 29, 2016 and October 31, 2015, respectively.

##### Basis of Presentation

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") for interim financial information and therefore do not include all of the information or footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying unaudited Consolidated Financial Statements reflect all adjustments (which are of a normal recurring nature) necessary to state fairly the financial position, results of operations, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for 2016. Therefore, these statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto for the year ended January 30, 2016, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 30, 2016.

##### Principles of Consolidation

The unaudited Consolidated Financial Statements include the accounts of Express, Inc. and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

##### Use of Estimates in the Preparation of Financial Statements

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 at the date of the unaudited Consolidated Financial Statements and the reported amounts of revenue and expense during the reporting period, as well as the related disclosure of contingent assets and liabilities as of the date of the unaudited Consolidated Financial Statements. Actual results may differ from those estimates. The Company revises its estimates and assumptions as new information becomes available.

##### Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)," and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 to annual and interim reporting periods beginning after December 15, 2017 with early application permitted for annual and interim reporting periods beginning after December 15, 2016. The Company is currently evaluating the impact that adopting this standard will have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." ASU 2016-02 requires entities to recognize lease assets and lease liabilities on the balance sheet and to disclose key information about leasing arrangements. Under ASU

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2016-02, a lessee should recognize a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term on its balance sheet. The new standard is effective for annual and interim periods beginning after December 15, 2018. ASU 2016-02 mandates a modified retrospective transition method with early adoption permitted. The Company is currently evaluating the impact that adopting ASU 2016-02 will have on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718):

Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies several of the elements of accounting for share-based payments, including recognizing all excess tax benefits and tax deficiencies in the income statement immediately, allowing an entity to elect to either estimate the total number of awards that will vest or recognize forfeitures when they occur, modifying the tax withholding threshold to qualify for equity classification up to the employees' maximum statutory tax withholding, and clarifying the classification for excess tax benefits on the statement of cash flows. The Company elected to early adopt the new standard in the first quarter of 2016 on a prospective basis. The impact of adoption did not have a material impact on the Company's financial position, results of operations, or cash flows. The Company will continue to estimate forfeitures expected to occur in determining the amount of compensation cost to be recognized in each period.

## 2. Segment Reporting

The Company defines an operating segment on the same basis that it uses to evaluate performance internally. The Company has determined that, together, its President and Chief Executive Officer and its Chief Operating Officer are the Chief Operating Decision Maker, and that there is one operating segment. Therefore, the Company reports results as a single segment, which includes the operation of its Express brick-and-mortar retail and outlet stores, e-commerce operations, and franchise operations.

The following is information regarding the Company's major product categories and sales channels:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
	(in thousands)		(in thousands)	
Apparel	\$446,999	\$482,472	\$1,327,090	\$1,394,458
Accessories and other	51,301	52,898	157,963	155,110
Other revenue	7,790	11,246	28,713	35,008
Total net sales	\$506,090	\$546,616	\$1,513,766	\$1,584,576

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
	(in thousands)		(in thousands)	
Stores	\$401,963	\$451,525	\$1,241,669	\$1,313,126
E-commerce	96,337	83,845	243,384	236,442
Other revenue	7,790	11,246	28,713	35,008
Total net sales	\$506,090	\$546,616	\$1,513,766	\$1,584,576

Other revenue consists primarily of sell-off revenue related to mark-out-of-stock inventory sales to third parties, shipping and handling revenue related to e-commerce activity, and revenue from franchise agreements.

Revenue and long-lived assets relating to the Company's international operations for the thirteen and thirty-nine weeks ended and as of October 29, 2016 and October 31, 2015, respectively, were not material for any period presented and, therefore, are not reported separately from domestic revenue or long-lived assets.

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## 3. Earnings Per Share

The following table provides a reconciliation between basic and diluted weighted-average shares used to calculate basic and diluted earnings per share:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
	(in thousands)			
Weighted-average shares - basic	78,401	84,240	78,754	84,453
Dilutive effect of stock options, restricted stock units, and restricted stock	194	609	397	556
Weighted-average shares - diluted	78,595	84,849	79,151	85,009

Equity awards representing 3.6 million and 4.0 million shares of common stock were excluded from the computations of diluted earnings per share for the thirteen and thirty-nine weeks ended October 29, 2016, respectively, as the inclusion of these awards would have been anti-dilutive. Equity awards representing 1.1 million and 2.4 million shares of common stock were excluded from the computations of diluted earnings per share for the thirteen and thirty-nine weeks ended October 31, 2015, respectively, as the inclusion of these awards would have been anti-dilutive. Additionally, for the thirteen and thirty-nine weeks ended October 29, 2016, 0.7 million shares were excluded from the computations of diluted weighted average shares because the number of shares that will ultimately be issued is contingent on the Company's performance compared to pre-established performance goals which have not been achieved as of October 29, 2016.

## 4. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities measured at fair value are classified using the following hierarchy, which is based upon the transparency of inputs to the valuation as of the measurement date.

Level 1-Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2-Valuation is based upon quoted prices for similar assets and liabilities in active markets or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3-Valuation is based upon other unobservable inputs that are significant to the fair value measurement.

## Financial Assets

The following table presents the Company's financial assets measured at fair value on a recurring basis as of October 29, 2016 and January 30, 2016, aggregated by the level in the fair value hierarchy within which those measurements fall.

	October 29, 2016		
	Level 1	Level 2	Level 3
	(in thousands)		
Money market funds	\$63,430	\$	\$ —

	January 30, 2016		
	Level 1	Level 2	Level 3
	(in thousands)		
Money market funds	\$152,069	\$	\$ —

The carrying amounts reflected on the unaudited Consolidated Balance Sheets for cash, cash equivalents, receivables, prepaid expenses, and payables as of October 29, 2016 and January 30, 2016 approximated their fair values.



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## Non-Financial Assets

The Company's non-financial assets, which include fixtures, equipment, improvements, and intangible assets, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur indicating the carrying value of these assets may not be recoverable, or annually in the case of indefinite lived intangibles, an impairment test is required. The impairment test requires the Company to estimate the fair value of the assets and compare this to the carrying value of the assets. If the fair value of the asset is less than the carrying value, then an impairment charge is recognized and the non-financial assets are recorded at fair value. The Company estimates the fair value using a discounted cash flow model. Factors used in the evaluation include, but are not limited to, management's plans for future operations, recent operating results, and projected cash flows. During the thirteen weeks ended October 29, 2016, the Company did not recognize any impairment charges. During the thirty-nine weeks ended October 29, 2016, the Company recognized impairment charges of approximately \$0.8 million related to two stores, both of which are now fully impaired. During the thirteen and thirty-nine weeks ended October 31, 2015, the Company did not recognize any impairment charges.

## 5. Intangible Assets

The following table provides the significant components of intangible assets:

	October 29, 2016		
	Cost	Accumulated Amortization	Ending Net Balance
	(in thousands)		
Tradename/domain names/trademarks	\$ 197,618	\$ —	\$ 197,618
Licensing arrangements	425	208	217
	\$ 198,043	\$ 208	\$ 197,835
	January 30, 2016		
	Cost	Accumulated Amortization	Ending Net Balance
	(in thousands)		
Tradename/domain names/trademarks	\$ 197,597	\$ —	\$ 197,597
Licensing arrangements	425	172	253
	\$ 198,022	\$ 172	\$ 197,850

The Company's tradename, Internet domain names, and trademarks have indefinite lives. Licensing arrangements are amortized over a period of ten years and are included in other assets on the unaudited Consolidated Balance Sheets.

## 6. Income Taxes

The provision for income taxes is based on a current estimate of the annual effective tax rate adjusted to reflect the impact of discrete items. The Company's effective tax rate was 19.6% and 39.2% for the thirteen weeks ended October 29, 2016 and October 31, 2015, respectively. The Company's effective tax rate was 33.8% and 39.3% for the thirty-nine weeks ended October 29, 2016 and October 31, 2015, respectively.

The effective tax rates for the thirteen and thirty-nine weeks ended October 29, 2016 include a net discrete tax benefit of \$2.9 million. This tax benefit is the result of a \$7.1 million tax benefit attributable to the release of a reserve for uncertain tax positions as a result of the expiration of the associated statute of limitations, partially offset by an increase in tax expense of \$4.2 million related to the expiration of certain unexercised stock options previously held by the former Chairman of the Company's Board of Directors (the "Board"). Both items were recorded during the thirteen-week period ended October 29, 2016.

## 7. Lease Financing Obligations

In certain lease arrangements, the Company is involved in the construction of the building. To the extent the Company is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease, it is deemed the owner of the project for accounting purposes. Therefore, the Company records an asset in property and equipment on the unaudited Consolidated Balance Sheets, including any capitalized interest costs, and



related liabilities in accrued interest and lease financing obligations in other long-term liabilities on the unaudited Consolidated Balance Sheets, for the replacement

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cost of the Company's portion of the pre-existing building plus the amount of construction costs incurred by the landlord as of the balance sheet date.

The initial terms of the lease arrangements for which the Company is considered the owner are expected to expire in 2023 and 2030. The net book value of landlord funded construction, replacement cost of pre-existing property, and capitalized interest in property and equipment on the unaudited Consolidated Balance Sheets was \$64.7 million and \$67.4 million, as of October 29, 2016 and January 30, 2016, respectively. There was also \$5.6 million and \$69.6 million of lease financing obligations as of October 29, 2016 and January 30, 2016, respectively, in other long-term liabilities on the unaudited Consolidated Balance Sheets. In the first quarter of 2016, \$63.7 million was reclassified to accrued expenses as a result of the amendment to the Times Square store lease discussed further below. The remaining lease financing obligation of \$62.9 million is included in accrued expenses on the unaudited Consolidated Balance Sheets.

Rent expense relating to the land is recognized on a straight-line basis over the lease term. The Company does not report rent expense for the portion of the rent payment determined to be related to the buildings which are owned for accounting purposes. Rather, this portion of the rent payment under the lease is recognized as interest expense and a reduction of the lease financing obligations.

In February 2016, the Company amended its lease arrangement with the landlord of the Times Square Flagship store. The Company had previously determined it was the owner of the store for accounting purposes based on an assessment of the lease arrangement at inception as described above. The amendment provides the landlord with the option to cancel the lease upon sufficient notice through December 31, 2016. If the landlord exercises this option, the Company will be required to make a cash payment of \$15 million to the landlord. In conjunction with amending the lease, the Company recognized an \$11.4 million put option liability and a related offset as a discount on the lease financing obligation. The discount was amortized over the shortest period under which the landlord was able to exercise this option (60 days). This resulted in the full amortization of the \$11.4 million discount during the first quarter of 2016. The amortization of the discount was recorded as interest expense. As of October 29, 2016, the fair value of the put option was \$9.5 million and is included within accrued expenses on the unaudited Consolidated Balance Sheets.

## 8. Debt

A summary of the Company's financing activities are as follows:

### Revolving Credit Facility

On May 20, 2015, Express Holding, LLC, a wholly-owned subsidiary of the Company ("Express Holding"), and its subsidiaries entered into an Amended and Restated \$250.0 million secured Asset-Based Credit Facility ("Revolving Credit Facility"). The expiration date of the facility is May 20, 2020. As of October 29, 2016, there were no borrowings outstanding and approximately \$246.8 million available under the Revolving Credit Facility.

The Revolving Credit Facility requires Express Holding and its subsidiaries to maintain a fixed charge coverage ratio of at least 1.0:1.0 if excess availability plus eligible cash collateral is less than 10% of the borrowing base. In addition, the Revolving Credit Facility contains customary covenants and restrictions on Express Holding's and its subsidiaries' activities, including, but not limited to, limitations on the incurrence of additional indebtedness, liens, negative pledges, guarantees, investments, loans, asset sales, mergers, acquisitions, prepayment of other debt, distributions, dividends, the repurchase of capital stock, transactions with affiliates, the ability to change the nature of its business or fiscal year, and permitted business activities. All obligations under the Revolving Credit Facility are guaranteed by Express Holding and its domestic subsidiaries (that are not borrowers) and secured by a lien on, among other assets, substantially all working capital assets including cash, accounts receivable, and inventory, of Express Holding and its domestic subsidiaries.

### Senior Notes

On March 5, 2010, Express, LLC and Express Finance Corp., wholly-owned subsidiaries of the Company, co-issued, in a private placement, \$250.0 million of 8 3/4% Senior Notes due in 2018 (the "Senior Notes") at an offering price of 98.6% of the face value.

On March 1, 2015, the outstanding notes in the amount of \$200.9 million were redeemed in full at 102.19% of the principal amount, with total payments equal to \$205.3 million, plus accrued and unpaid interest to, but not including,

the redemption date.

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## Loss on Extinguishment

In connection with the redemption of the Senior Notes in the first quarter of 2015, the Company recognized a \$9.7 million loss on extinguishment of debt, which was recorded as interest expense in the unaudited Consolidated Statements of Income and Comprehensive Income. The redemption premium represented approximately \$4.4 million of this loss on extinguishment. The remaining loss on extinguishment was attributable to the unamortized debt issuance costs and unamortized debt discount write-offs totaling \$5.3 million. The unamortized debt issuance costs and unamortized debt discount write-offs are presented as a non-cash adjustment to reconcile net income to net cash provided by operating activities within the unaudited Consolidated Statements of Cash Flows.

## Letters of Credit

The Company may enter into stand-by letters of credit ("stand-by LCs") on an as-needed basis to secure payment obligations for merchandise purchases and other general and administrative expenses. As of October 29, 2016 and January 30, 2016, outstanding stand-by LCs totaled \$3.2 million and \$2.8 million, respectively.

## 9. Share-Based Compensation

The Company records the fair value of share-based payments to employees in the unaudited Consolidated Statements of Income and Comprehensive Income as compensation expense, net of forfeitures, over the requisite service period.

## Share-Based Compensation Plans

The following summarizes share-based compensation expense:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
	(in thousands)			
Restricted stock units and restricted stock	\$2,701	\$3,283	\$8,701	\$12,341
Stock options	502	762	2,082	2,773
Total share-based compensation	\$3,203	\$4,045	\$10,783	\$15,114

The stock compensation related income tax benefit recognized by the Company during the thirteen and thirty-nine weeks ended October 29, 2016 was \$0.1 million and \$6.0 million, respectively. The stock compensation related income tax benefit recognized by the Company during the thirteen and thirty-nine weeks ended October 31, 2015 was \$0.8 million and \$4.6 million, respectively.

## Stock Options

During the thirty-nine weeks ended October 29, 2016, the Company granted stock options under the 2010 Plan. Stock options granted in 2016 under the 2010 Plan vest 25% per year over four years or upon reaching retirement eligibility, defined as providing ten years of service and being at least 55 years old. These options have a ten year contractual life. The expense for stock options is recognized using the straight-line attribution method.

The Company's activity with respect to stock options during the thirty-nine weeks ended October 29, 2016 was as follows:

	Number of Shares	Grant Date Weighted Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
(in thousands, except per share amounts and years)				
Outstanding, January 31, 2016	3,446	\$ 18.31		
Granted	229	\$ 21.14		
Exercised	(159)	\$ 17.23		
Forfeited or expired	(1,184)	\$ 19.20		
Outstanding, October 29, 2016	2,332	\$ 18.21	5.9	\$ 28
Expected to vest at October 29, 2016	547	\$ 18.37	8.3	\$ —

Exercisable at October 29, 2016 1,760 \$ 18.14 5.1 \$ 28

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The following table provides additional information regarding the Company's stock options:

	Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015
	(in thousands, except per share amounts)	
Weighted average grant date fair value of options granted (per share)	\$9.50	\$ 7.79
Total intrinsic value of options exercised	\$547	\$ 175

As of October 29, 2016, there was approximately \$2.8 million of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted average period of approximately 1.6 years.

The Company uses the Black-Scholes-Merton option-pricing model to value stock options granted to employees. The Company's determination of the fair value of stock options is affected by the Company's stock price as well as a number of subjective and complex assumptions. These assumptions include the risk-free interest rate, the Company's expected stock price volatility over the term of the award, expected term of the award, and dividend yield.

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

	Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015
Risk-free interest rate <sup>(1)</sup>	1.60 %	1.60 %
Price volatility <sup>(2)</sup>	43.15 %	47.81 %
Expected term (years) <sup>(3)</sup>	6.54	6.25
Dividend yield <sup>(4)</sup>	—	—

(1) Represents the yield on U.S. Treasury securities with a term consistent with the expected term of the stock options.

(2) Primarily based on the historical volatility of the Company's common stock over a period consistent with the expected term of the stock options.

Beginning in 2016, the Company calculated the expected term assumption using the midpoint scenario, which

(3) combines historical exercise data with hypothetical exercise data for outstanding options. The Company believes this data currently represents the best estimate of the expected term of new employee options.

(4) The Company does not currently plan on paying regular dividends.

#### Restricted Stock Units and Restricted Stock

During the thirty-nine weeks ended October 29, 2016, the Company granted restricted stock units ("RSUs") under the 2010 Plan, including 0.3 million RSUs with performance conditions. The fair value of RSUs is determined based on the Company's closing stock price on the day prior to the grant date in accordance with the 2010 Plan. The expense for RSUs without performance conditions is recognized using the straight-line attribution method. The expense for RSUs with performance conditions is recognized using the graded vesting method based on the expected achievement of the performance conditions. The RSUs with performance conditions are also subject to time-based vesting. All of the RSUs granted during the thirty-nine weeks ended October 29, 2016 that are earned based on the achievement of performance criteria will vest on April 15, 2019. RSUs without performance conditions vest ratably over four years.

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The Company's activity with respect to RSUs and restricted stock, including awards with performance conditions, for the thirty-nine weeks ended October 29, 2016 was as follows:

	Grant Date	Number of Shares	Weighted Average Fair Value Per Share
			(in thousands, except per share amounts)
Unvested, January 31, 2016		2,212	\$ 16.66
Granted <sup>(1)</sup>		653	\$ 20.45
Performance Shares Adjustment <sup>(2)</sup>		(50 )	\$ 16.28
Vested		(790 )	\$ 17.26
Forfeited		(128 )	\$ 17.55
Unvested, October 29, 2016		1,897	\$ 17.66

Approximately 0.3 million RSUs with three-year performance conditions were granted in the first quarter of 2016.

(1) None of these RSUs are currently included as granted in the table above. The number of performance-based RSUs that are ultimately earned may vary from 0% to 200% of target depending on the achievement of predefined financial performance targets.

(2) Relates to a change in estimate of RSUs with performance conditions granted in 2015. Currently, 112% of the number of shares granted in 2015 are expected to vest based on estimates against predefined financial performance targets.

The total fair value of RSUs and restricted stock that vested during the thirty-nine weeks ended October 29, 2016 was \$13.6 million. As of October 29, 2016, there was approximately \$22.3 million of total unrecognized compensation expense related to unvested RSUs and restricted stock, which is expected to be recognized over a weighted-average period of approximately 1.7 years.

#### 10. Commitments and Contingencies

From time to time the Company is subject to various claims and contingencies arising out of the normal course of business. Management believes that the ultimate liability arising from such claims and contingencies, if any, is not likely to have a material adverse effect on the Company's results of operations, financial condition, or cash flows.

#### 11. Stockholders' Equity

##### Share Repurchase Program

On December 9, 2015, the Board approved a new share repurchase program which authorizes the Company to repurchase up to \$100.0 million of the Company's common stock during the 12 month period following the approval using available cash, including cash on hand or cash available for borrowing under the Company's Revolving Credit Facility (the "2015 Repurchase Program"). During the thirty-nine weeks ended October 29, 2016, the Company repurchased 3.2 million shares of its common stock under the 2015 Repurchase Program for an aggregate amount equal to \$51.5 million, including commissions. The remaining amount available for repurchase under the 2015 Repurchase Program was \$20.0 million as of October 29, 2016.

#### 12. Investment in Equity Interests

In the second quarter of 2016, the Company made a \$10.1 million investment in Homage, LLC, a privately held retail company based in Columbus, Ohio. The non-controlling investment in the entity is being accounted for under the equity method. The investment is included in other assets on the unaudited Consolidated Balance Sheets.

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

The following discussion summarizes the significant factors affecting the consolidated operating results, financial condition, liquidity, and cash flows of the Company as of the dates and for the periods presented below. The following discussion and analysis should be read in conjunction with our Annual Report on Form 10-K for the year ended January 30, 2016 and our unaudited Consolidated Financial Statements and the related notes included in Item 1 of this Quarterly Report. This discussion contains forward-looking statements that are based on the beliefs of our management, as well as assumptions made by, and information currently available to, our management. Actual results could differ materially from those discussed in or implied by forward-looking statements as a result of various factors. See "Forward-Looking Statements."

Overview

Express is a specialty apparel and accessories retailer offering both women's and men's merchandise. We have over 35 years of experience offering a distinct combination of style and quality at an attractive value, targeting women and men between 20 and 30 years old. We offer our customers an assortment of fashionable apparel and accessories to address fashion needs across multiple wearing occasions, including work, casual, jeanswear, and going-out occasions.

Q3 2016 vs. Q3 2015

- Net sales decreased 7% to \$506.1 million
- Comparable sales decreased 8%
- Comparable sales (excluding e-commerce sales) decreased 13%
- E-commerce sales increased 15% to \$96.3 million
- Gross margin percentage decreased 500 basis points
- Operating income decreased 66% to \$15.1 million
- Net income decreased 56% to \$11.6 million
- Diluted earnings per share (EPS) decreased 52% to \$0.15

The following charts show key performance metrics for the third quarter of 2016 compared to the third quarter of 2015:



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Key Business Initiatives

We are focused on generating long-term growth for our stockholders by increasing profitability through a combination of net sales growth, merchandise margin expansion, and expense leverage. Specific growth initiatives to accomplish this objective include:

- increasing the productivity of our existing stores;
- opening new outlet stores; and
- growing our e-commerce business.

In addition to increased profitability, we are also focused on other objectives to support long-term growth including:

- supporting and developing our employees;
- providing an exceptional brand and customer experience; and
- upgrading and enhancing our systems and processes to enable growth.

We believe that successful execution against these objectives will position Express for future growth.

Below is an update on our key initiatives:

Store Performance

In the third quarter of 2016, comparable sales (excluding e-commerce sales) decreased 13%. We believe this decrease was primarily driven by the following:

- Decreased traffic at our stores due in part to continued traffic challenges in malls; and
- A lack of fashion clarity in our product assortment, which offered too many choices.

E-commerce

In the third quarter of 2016, our e-commerce sales increased 15% compared to the third quarter of 2015. The increase was primarily driven by:

- A strong and clear marketing and merchandising message aimed at our target demographic; and
- The launch of several key initiatives, including improved site navigation and continued optimization across search and category pages.

Real Estate Activity

As of October 29, 2016, we operated 653 stores, including 99 factory outlet stores.

Third quarter of 2016 store openings and closures:

- Opened five new factory outlet stores in the U.S.

Expectations for the remainder of 2016:

- Open five factory outlet stores, one of which will be converted from an existing retail location.
- Close two U.S. retail stores, one of which will be converted to an outlet location.

Other Initiatives

- International. As of October 29, 2016, we were earning revenue from 20 franchise locations in Latin America and the Middle East. During the fourth quarter of 2015, we made the strategic decision to shift our international focus to growth within the Americas. As a result, 13 franchise stores in the Middle East and South Africa have been closed in 2016. The remaining two stores are expected to be closed by the end of 2016.

- Systems and Processes. In the third quarter of 2016, we launched a new retail management system and a new enterprise planning system. We believe these systems will lead to improved efficiencies in our business as we begin to fully leverage their capabilities.

E-commerce sales represented 19%  
of our total net sales in the third  
quarter of 2016.

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## How We Assess the Performance of Our Business

In assessing the performance of our business, we consider a variety of performance and financial measures. These key measures include net sales, comparable sales, cost of goods sold, buying and occupancy costs, gross profit/gross margin, and selling, general, and administrative expenses. The following table describes and discusses these measures.

Financial Measures	Description	Discussion
Net Sales	Revenue from the sale of merchandise, less returns and discounts, as well as shipping and handling revenue related to e-commerce, revenue from rental of our LED sign in Times Square, gift card breakage, and revenue earned from our franchise agreements.	Our business is seasonal, and we have historically realized a higher portion of our net sales in the third and fourth quarters due primarily to the impact of the holiday season. Generally, approximately 45% of our annual net sales occur in the Spring season (first and second quarters) and 55% occur in the Fall season (third and fourth quarters).
Comparable Sales	<p>Comparable sales is a measure of the amount of sales generated in a period relative to the amount of sales generated in the comparable prior year period.</p> <p>Comparable sales includes:</p> <ul style="list-style-type: none"> <li>• Sales from stores that were open 12 months or more as of the end of the reporting period, including conversions</li> <li>• E-commerce sales</li> </ul> <p>Comparable sales excludes:</p> <ul style="list-style-type: none"> <li>• Sales from stores where the square footage has changed by more than 20% due to remodel or relocation activity</li> <li>• Sales from stores in a phased remodel where a portion of the store is under construction and therefore not productive selling space</li> </ul>	Our business and our comparable sales are subject, at certain times, to calendar shifts, which may occur during key selling periods close to holidays such as Easter, Thanksgiving, and Christmas, and regional fluctuations for events such as sales tax holidays.
Cost of goods sold, buying and occupancy costs	<p>Includes the following:</p> <ul style="list-style-type: none"> <li>• Direct cost of purchased merchandise</li> <li>• Inventory shrink and other adjustments</li> <li>• Inbound and outbound freight</li> <li>• Merchandising, design, planning and allocation, and manufacturing/production costs</li> <li>• Occupancy costs related to store operations (such as rent and common area maintenance, utilities, and depreciation on assets)</li> </ul>	<p>Our cost of goods sold typically increases in higher volume quarters because the direct cost of purchased merchandise is tied to sales.</p> <p>The primary drivers of the costs of individual goods are raw materials, labor in the countries where our merchandise is sourced, and logistics costs associated with transporting our merchandise.</p> <p>Buying and occupancy costs related to stores are largely fixed and do not necessarily increase as volume increases.</p>

- Logistics costs associated with our e-commerce business
- Changes in the mix of our products may also impact our overall cost of goods sold, buying and occupancy costs.

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Financial Measures	Description	Discussion
		Gross profit/gross margin is impacted by the price at which we are able to sell our merchandise and the cost of our product.
Gross Profit/Gross Margin	Gross profit is net sales minus cost of goods sold, buying and occupancy costs. Gross margin measures gross profit as a percentage of net sales.	We review our inventory levels on an on-going basis in order to identify slow-moving merchandise and generally use markdowns to clear such merchandise. The timing and level of markdowns are driven primarily by seasonality and customer acceptance of our merchandise and have a direct effect on our gross margin.
	Includes operating costs not included in cost of goods sold, buying and occupancy costs such as:	Any marked down merchandise that is not sold is marked-out-of-stock. We use third-party vendors to dispose of this marked-out-of-stock merchandise.
Selling, General, and Administrative Expenses	<ul style="list-style-type: none"> <li>• Payroll and other expenses related to operations at our corporate offices</li> <li>• Store expenses other than occupancy costs</li> <li>• Marketing expenses, including production, mailing, print, and digital advertising costs, among other things</li> </ul>	With the exception of store payroll, certain marketing expenses, and incentive compensation, selling, general, and administrative expenses generally do not vary proportionally with net sales. As a result, selling, general, and administrative expenses as a percentage of net sales are usually higher in lower volume quarters and lower in higher volume quarters.

## Results of Operations

The Third Quarter of 2016 Compared to the Third Quarter of 2015

## Net Sales

	Thirteen Weeks Ended	
	October 29, 2016	October 31, 2015
Net sales (in thousands)	\$506,090	\$546,616
Comparable sales percentage change	(8 )%	6 %
Comparable sales percentage change (excluding e-commerce sales)	(13 )%	6 %
Gross square footage at end of period (in thousands)	5,639	5,684
Number of:		
Stores open at beginning of period	648	637
New retail stores	—	1
New outlet stores	5	18
Retail stores converted to outlets	—	(1 )
Closed stores	—	(1 )
Stores open at end of period	653	654



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Net sales decreased approximately \$40.5 million compared to the third quarter of 2015. Comparable sales decreased 8% in the third quarter of 2016 compared to the third quarter of 2015. The decrease in comparable sales resulted primarily from a decrease in transactions and in-store average dollar sales per transaction. We attribute these decreases to decreased traffic at our stores due in part to decreases in mall traffic overall and a lack of fashion clarity in our product assortment, which offered too many choices. This was partially offset by an increase in e-commerce sales which resulted from more targeted marketing as well as improvements to our website and the shopping experience. Non-comparable sales increased \$5.4 million, driven primarily by new outlet store openings.

**Gross Profit**

The following table shows cost of goods sold, buying and occupancy costs, gross profit in dollars, and gross margin percentage for the stated periods:

	Thirteen Weeks Ended	
	October 29, 2016	October 31, 2015
	(in thousands, except percentages)	
Cost of goods sold, buying and occupancy costs	\$354,373	\$355,527
Gross profit	\$151,717	\$191,089
Gross margin percentage	30.0	% 35.0 %

The 500 basis point decrease in gross margin percentage, or gross profit as a percentage of net sales, in the third quarter of 2016 compared to the third quarter of 2015 was comprised of a 340 basis point decrease in merchandise margin and a 160 basis point increase in buying and occupancy costs as a percentage of net sales. The decrease in merchandise margin was driven by increased promotions. The increase in buying and occupancy costs as a percentage of sales was primarily the result of the deleveraging effect of the decrease in sales, partially offset by a decrease in incentive compensation.

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## Selling, General, and Administrative Expenses

The following table shows selling, general, and administrative expenses in dollars and as a percentage of net sales for the stated periods:

	Thirteen Weeks Ended	
	October 29, 2016	October 31, 2015
	(in thousands, except percentages)	
Selling, general, and administrative expenses	\$ 136,633	\$ 146,585
Selling, general, and administrative expenses, as a percentage of net sales	27.0 %	26.8 %

The \$10.0 million decrease in selling, general, and administrative expenses in the third quarter of 2016 as compared to the third quarter of 2015 was primarily the result of decreased payroll related expenses of approximately \$9.6 million and decreased marketing expenses of \$2.4 million. The reduction in payroll expenses was primarily related to decreases in incentive compensation, store payroll, and performance-based RSU estimates resulting from decreased performance. The decreases were partially offset by an increase of \$4.1 million in information technology expenses primarily related to new system implementations.

## Income Tax Expense

The following table shows income tax expense in dollars for the stated periods:

	Thirteen Weeks Ended	
	October 29, 2016	October 31, 2015
	(in thousands)	
Income tax expense	\$ 2,827	\$ 16,949

The effective tax rate was 19.6% for the third quarter of 2016 compared to 39.2% for the third quarter of 2015. The effective tax rate for the thirteen weeks ended October 29, 2016 includes a net tax benefit of approximately \$2.9 million attributable to certain discrete items that occurred during the third quarter. Refer to Note 6 of the unaudited Consolidated Financial Statements for additional information.

The Thirty-Nine Weeks Ended October 29, 2016 Compared to the Thirty-Nine Weeks Ended October 31, 2015  
Net Sales

	Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015
Net sales (in thousands)	\$ 1,513,766	\$ 1,584,576
Comparable sales percentage change	(7) %	7 %
Comparable sales percentage change (excluding e-commerce sales)	(9) %	5 %
Gross square footage at end of period (in thousands)	5,639	5,684
Number of:		
Stores open at beginning of period	653	641
New retail stores	—	1
New outlet stores	18	37
Retail stores converted to outlets	(3)	(2)
Closed stores	(15)	(23)
Stores open at end of period	653	654



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Net sales decreased approximately \$70.8 million compared to the thirty-nine weeks ended October 31, 2015. Comparable sales decreased 7% in the thirty-nine weeks ended October 29, 2016 compared to the thirty-nine weeks ended October 31, 2015. The decrease in comparable sales resulted primarily from a decrease in transactions and in-store average dollar sales per transaction. We attribute these decreases to decreased traffic at our stores due in part to decreases in mall traffic overall, a strategic shift in marketing spend that resulted in a reduction of direct mail and other marketing communications to certain customer segments, and a lack of fashion clarity in our product assortment, which offered too many choices and was overly targeted at the younger customers in our demographic. This was partially offset by an increase in e-commerce sales which resulted from more targeted marketing as well as improvements to our website and the shopping experience. Non-comparable sales increased \$32.8 million, driven primarily by new outlet store openings, and were partially offset by closed retail stores.

**Gross Profit**

The following table shows cost of goods sold, buying and occupancy costs, gross profit in dollars, and gross margin percentage for the stated periods:

	Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015
	(in thousands, except percentages)	
Cost of goods sold, buying and occupancy costs	\$1,043,382	\$1,049,853
Gross profit	\$470,384	\$534,723
Gross margin percentage	31.1	% 33.7 %

The 260 basis point decrease in gross margin percentage, or gross profit as a percentage of net sales, in the thirty-nine weeks ended October 29, 2016 compared to the thirty-nine weeks ended October 31, 2015 was comprised of a 170 basis point decrease in merchandise margin and a 90 basis point increase in buying and occupancy costs as a percentage of net sales. The decrease in merchandise margin was driven by increased promotions, including increased markdowns on clearance items in the first half of the year, the effect of which was partially offset by continued discipline with respect to inventory management. The increase in buying and occupancy costs as a percentage of sales was primarily the result of the deleveraging effect of the decrease in sales, increased rent expense, and a \$0.8 million impairment charge recognized in the second quarter related to leasehold improvements at certain underperforming stores. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. The reviews are conducted at the store level, the lowest identifiable level of cash flow. Factors to assess stores for impairment include, but are not limited to, plans for future operations, brand initiatives, recent operating results, and projected future cash flows. Significant changes in

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any of these factors could lead to future impairments. These increases were partially offset by a decrease in incentive compensation.

## Selling, General, and Administrative Expenses

The following table shows selling, general, and administrative expenses in dollars and as a percentage of net sales for the stated periods:

	Thirty-Nine Weeks Ended October 29, 2016		October 31, 2015	
	(in thousands, except percentages)			
Selling, general, and administrative expenses	\$405,547		\$420,334	
Selling, general, and administrative expenses, as a percentage of net sales	26.8	%	26.5	%

The \$14.8 million decrease in selling, general, and administrative expenses in the thirty-nine weeks ended October 29, 2016 as compared to the thirty-nine weeks ended October 31, 2015 was primarily the result of decreased payroll related expenses of approximately \$19.0 million. The reduction in payroll expenses was primarily related to decreases in incentive compensation and performance-based RSU estimates resulting from decreased performance. The decreases were partially offset by an increase of \$7.5 million in information technology expenses primarily related to new system implementations.

## Interest Expense, Net

The following table shows interest expense, net in dollars for the stated periods:

	Thirty-Nine Weeks Ended October 29, 2016		October 31, 2015	
	(in thousands)			
Interest expense, net	\$12,845		\$14,751	

Interest expense, net \$12,845 \$14,751

The \$1.9 million decrease in interest expense is primarily related to a loss on extinguishment of debt in connection with the redemption of our Senior Notes in the first quarter of 2015, partially offset by the amortization of the debt discount related to the lease financing obligation associated with the amendment to our Times Square store lease agreement in the first quarter of 2016.

## Income Tax Expense

The following table shows income tax expense in dollars for the stated periods:

	Thirty-Nine Weeks Ended October 29, 2016		October 31, 2015	
	(in thousands)			
Income tax expense	\$17,725		\$39,058	

Income tax expense \$17,725 \$39,058

The effective tax rate was 33.8% for the thirty-nine weeks ended October 29, 2016 compared to 39.3% for the thirty-nine weeks ended October 31, 2015. The effective tax rate for the thirty-nine weeks ended October 29, 2016 includes a net tax benefit of approximately \$2.9 million attributable to certain discrete items that occurred during the third quarter. Refer to Note 6 of the unaudited Consolidated Financial Statements for additional information.

We anticipate that our effective tax rate, excluding discrete items, will be approximately 39% in 2016.

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## Non-GAAP Financial Measures

The following table presents Adjusted Net Income and Adjusted Diluted Earnings Per Share, each non-GAAP financial measures, and Net Income and Diluted Earnings Per Share, the most closely related GAAP measures, for the stated periods. Adjusted Net Income and Adjusted Diluted Earnings Per Share eliminate the non-core operating costs incurred in connection with the amendment to the Times Square Flagship store lease in the first quarter of 2016 and the redemption of our Senior Notes in the first quarter of 2015:

	Thirty-Nine Weeks Ended October 29, 2016		October 31, 2015
	(in thousands, except per share amounts)		
Net Income	\$34,643	\$ 60,397	
Adjusted Net Income	\$41,569	\$ 66,313	
Diluted Earnings Per Share	\$0.44	\$ 0.71	
Adjusted Diluted Earnings Per Share	\$0.53	\$ 0.78	

We supplement the reporting of our financial information determined under GAAP with certain non-GAAP financial measures: adjusted net income and adjusted diluted earnings per share. We believe that these non-GAAP measures provide additional useful information to assist stockholders in understanding our financial results and assessing our prospects for future performance. Management believes adjusted net income and adjusted diluted earnings per share are important indicators of our business performance because they exclude items that may not be indicative of, or are unrelated to, our underlying operating results, and provide a better baseline for analyzing trends in our business. In addition, adjusted diluted earnings per share is used as a performance measure in our executive compensation program for purposes of determining the number of equity awards that are ultimately earned. Because non-GAAP financial measures are not standardized, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. These adjusted financial measures should not be considered in isolation or as a substitute for reported net income and reported diluted earnings per share. These non-GAAP financial measures reflect an additional way of viewing our operations that, when viewed with our GAAP results and the below reconciliations to the corresponding GAAP financial measures, provide a more complete understanding of our business. We strongly encourage investors and stockholders to review our financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure.

The tables below reconcile the non-GAAP financial measures, adjusted net income and adjusted diluted earnings per share, with the most directly comparable GAAP financial measures, net income and diluted earnings per share.

	Thirty-Nine Weeks Ended October 29, 2016		
(in thousands, except per share amounts)	Net Income	Diluted Earnings per Share	Weighted Average Diluted Shares Outstanding
Reported GAAP Measure	\$34,643	\$ 0.44	79,151
Interest Expense (a)	11,354	0.14	
Income Tax Benefit (b)	(4,428 )	(0.06 )	
Adjusted Non-GAAP Measure	\$41,569	\$ 0.53	

(a) Represents non-core items related to the amendment of the Times Square Flagship store lease discussed in Note 7 of our unaudited Consolidated Financial Statements.

(b) Represents the tax impact of the interest expense adjustment at our statutory rate of approximately 39% for the thirty-nine weeks ended October 29, 2016.



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(in thousands, except per share amounts)	Thirty-Nine Weeks Ended October 31, 2015		
	Net Income	Diluted Earnings per Share	Weighted Average Diluted Shares Outstanding
Reported GAAP Measure	\$60,397	\$ 0.71	85,009
Interest Expense (a)	9,657	0.11	
Income Tax Benefit (b)	(3,741 )	(0.04 )	
Adjusted Non-GAAP Measure	\$66,313	\$ 0.78	

(a) Includes the redemption premium paid, the write-off of unamortized debt issuance costs, and the write-off of the unamortized debt discount related to the redemption of all \$200.9 million of our Senior Notes.

(b) Represents the tax impact of the interest expense adjustment at our statutory rate of approximately 39% for the thirty-nine weeks ended October 31, 2015.

Liquidity and Capital Resources

A summary of cash provided by or used in operating, investing, and financing activities is shown in the following table:

	Thirty-Nine Weeks Ended	
	October 29, 2016	October 31, 2015
	(in thousands)	
Provided by operating activities	\$59,864	\$ 55,633
Used in investing activities	(91,054 )	(85,048 )
Used in financing activities	(54,487 )	(225,033 )
Decrease in cash and cash equivalents	(85,048 )	(254,944 )
Cash and cash equivalents at end of period	\$101,855	\$ 91,215

Our business relies on cash flows from operations as our primary source of liquidity, with the majority of those cash flows being generated in the fourth quarter of the year. Our primary operating cash needs are for merchandise inventories, payroll, store rent, and marketing. For the thirty-nine weeks ended October 29, 2016, our cash flows provided by operating activities were \$59.9 million compared to \$55.6 million for the thirty-nine weeks ended October 31, 2015. The increase in cash flows from operating activities for the thirty-nine weeks ended October 29, 2016 was primarily driven by lower inventory levels as of October 29, 2016 versus October 31, 2015 partially offset by the decreased performance of the business and the resulting decline in net income as well as the payout of the 2015 incentive compensation accrual in the first quarter of 2016.

In addition to cash flows from operations, we have access to additional liquidity, if needed, through borrowings under our Revolving Credit Facility. As of October 29, 2016, we had \$246.8 million available for borrowing under our Revolving Credit Facility. Refer to Note 8 of our unaudited Consolidated Financial Statements for additional information on our Revolving Credit Facility.

We also use cash for capital expenditures and financing transactions. For the thirty-nine weeks ended October 29, 2016, we had capital expenditures of approximately \$80.9 million. These relate primarily to new outlet stores, store remodels, and information technology projects to support our key business initiatives. We expect capital expenditures for the remainder of 2016 to be approximately \$19 million to \$24 million, primarily driven by remodels, new store construction, and investments in information technology. These capital expenditures do not include the impact of landlord allowances, which are expected to be approximately \$2.0 million to \$4.0 million for the remainder of 2016. In the second quarter of 2016, we also made a \$10.1 million investment in Homage, LLC, a Columbus-based private apparel company, that is in the early stages of development.

In addition to the cash uses noted previously, we repurchased 3.2 million shares of our common stock under our 2015 Repurchase Program for an aggregate amount equal to \$51.5 million, including commissions, during the thirty-nine weeks ended October 29, 2016. As of December 7, 2016, we have \$20.0 million available under the 2015 Repurchase Program. The 2015 Repurchase Program is set to expire on December 9, 2016.

Our liquidity position benefits from the fact that we generally collect cash from sales to customers the same day or, in the case of credit or debit card transactions, within three to five days of the related sale, and have up to 75 days to pay certain merchandise vendors and 45 days to pay the majority of our non-merchandise vendors.

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We believe that cash generated from future operations and the availability of borrowings under our Revolving Credit Facility will be sufficient to meet working capital requirements and anticipated capital expenditures for at least the next 12 months.

### Contractual Obligations

Our contractual obligations and other commercial commitments did not change materially between January 30, 2016 and October 29, 2016. For additional information regarding our contractual obligations as of January 30, 2016, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended January 30, 2016.

### Critical Accounting Policies

Management has determined that our most critical accounting policies are those related to revenue recognition, merchandise inventory valuation, long-lived asset valuation, claims and contingencies, and income taxes. We continue to monitor our accounting policies to ensure proper application of current rules and regulations. There have been no significant changes to the policies discussed in our Annual Report on Form 10-K for the year ended January 30, 2016.

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

### Quantitative and Qualitative Disclosures About Market Risk

#### Interest Rate Risk

Our Revolving Credit Facility bears interest at variable rates, however, we did not borrow any amounts under the Revolving Credit Facility during the thirty-nine weeks ended October 29, 2016. Changes in interest rates are not expected to have a material impact on our future earnings or cash flows given our limited exposure to such changes.

#### Foreign Currency Exchange Risk

All of our merchandise purchases are denominated in U.S. dollars, therefore we are not exposed to foreign currency exchange risk on these purchases. However, we currently operate 17 stores in Canada, with the functional currency of our Canadian operations being the Canadian dollar. Our Canadian operations have intercompany accounts with our U.S. subsidiaries that eliminate upon consolidation, but the transactions resulting in such accounts do expose us to foreign currency exchange risk. Currently, we do not utilize hedging instruments to mitigate foreign currency exchange risks. As of October 29, 2016, a hypothetical 10% change in the Canadian dollar foreign exchange rate would not have had a material impact on our results of operations.

## ITEM 4. CONTROLS AND PROCEDURES.

### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934) that are designed to provide reasonable assurance that information required to be disclosed in our Securities Exchange Act of 1934 reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance of achieving the desired control objectives. In reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation prior to filing this report of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of October 29, 2016.

### Changes in Internal Control Over Financial Reporting

During the quarter ended October 29, 2016, we implemented a new Retail Management System to support customer orders and demand in both our store and e-commerce businesses. As part of the implementation, internal controls and processes have been appropriately designed and monitored to maintain internal controls over financial reporting.





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There were no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that occurred during the third quarter of 2016 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS.

Information relating to legal proceedings is set forth in Note 10 to our unaudited Consolidated Financial Statements included in Part I of this Quarterly Report and is incorporated herein by reference.

## ITEM 1A. RISK FACTORS.

In addition to the other information set forth in this Quarterly Report, careful consideration should be given to the risk factors set forth in Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended January 30, 2016, any of which could materially affect our business, operations, financial position, stock price, or future results. The risks described herein and in our Annual Report on Form 10-K for the year ended January 30, 2016, are important to an understanding of the statements made in this Quarterly Report, in our other filings with the SEC, and in any other discussion of our business. These risk factors, which contain forward-looking information, should be read in conjunction with Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, and the unaudited Consolidated Financial Statements and related notes included in this Quarterly Report.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

The following table provides information regarding the purchase of shares of our common stock made by or on behalf of the Company or any "affiliated purchaser" as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, during each month of the quarterly period ended October 29, 2016:

Month	Total Number of Shares Purchased (1)	Average Price Paid per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased under the Plans or Programs (2)
July 31, 2016 - August 27, 2016	1	\$ 15.28	—	\$ 20,000
August 28, 2016 - October 1, 2016	1	\$ 11.92	—	\$ 20,000
October 2, 2016 - October 29, 2016	6	\$ 12.15	—	\$ 20,000
Total	8	—	—	—

(in thousands, except per share amounts)

(1) Includes shares purchased in connection with employee tax withholding obligations under the 2010 Plan.

(2) On December 9, 2015, the Board authorized us to repurchase up to \$100 million of the Company's outstanding common stock. Since the 2015 Repurchase Program began, the Company has repurchased 4.9 million shares for an aggregate amount equal to \$80.0 million, excluding commissions. The 2015 Repurchase Program is set to expire on December 9, 2016.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

## ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

## ITEM 5. OTHER INFORMATION.

None

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ITEM 6. EXHIBITS.

Exhibits. The following exhibits are filed or furnished with this Quarterly Report:

Exhibit Number	Exhibit Description
10.1+	Form of Indemnification Agreement (incorporated by reference to Exhibit 10.1 to the Form 8-K filed by the Company with the SEC on August 3, 2016).
31.1*	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.

+ Indicates a management contract or compensatory plan or arrangement.

\* Filed herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: December 7, 2016 EXPRESS, INC.

By: /s/ Periclis Pericleous

Periclis Pericleous

Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer)