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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED OCTOBER 28, 2006

OR

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

Commission file number 000-51300

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

Washington	**91-1040022**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6300 Merrill Creek Parkway, Suite B, Everett, WA 98203
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code**: (425) 551-1500**

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

Number of shares of Common Stock outstanding as of November 30, 2006 was 27,640,664 shares.

ZUMIEZ INC.

FORM 10-Q
TABLE OF CONTENTS

Part I.	**Financial Information**		3
	Item 1.	Condensed Consolidated Financial Statements (unaudited)	3
		Condensed Consolidated Balance Sheet at October 28, 2006 and January 28, 2006	3
		Condensed Consolidated Statements of Operations for the three and nine months ended October 28, 2006 and October 29, 2005	4
		Condensed Consolidated Statements of Changes in Shareholders' Equity for the nine months ended October 28, 2006	5
		Condensed Consolidated Statements of Cash Flows for the nine months ended October 28, 2006 and October 29, 2005	6
		Notes to Condensed Consolidated Financial Statements	7

	Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
	Item 3.	Quantitative and Qualitative Disclosures About Market Risk	31
	Item 4.	Controls and Procedures	31
Part II.		Other Information	32
	Item 1.	Legal Proceedings	32
	Item 2.	Changes in Securities; Use of Proceeds and Issuer Purchases of Equity Securities	32
	Item 3	Defaults Upon Senior Securities	32
	Item 4.	Submission of Matters to a Vote of Security Holders	32
	Item 5.	Other Information	32
	Item 6.	Exhibits	32
Signatures			33
Exhibit 10.14			
Exhibit 31.1			
Exhibit 31.2			
Exhibit 32.1			

ZUMIEZ INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	October 28, 2006 (Unaudited)	January 28, 2006
Assets		
Current assets		
Cash and cash equivalents	$ 2,111	$ 4,737
Marketable Securities	17,835	38,264
Receivables	5,816	3,746
Inventory	56,694	30,559
Prepaid expenses and other assets	965	711
Deferred tax assets	1,618	938
Total current assets	85,039	78,955
Leasehold improvements and equipment, net	48,930	35,456
Goodwill	12,766	—
Total long-term assets	61,696	35,456
Total assets	$ 146,735	$ 114,411
Liabilities and Shareholders' Equity		
Current liabilities		
Trade accounts payable	$ 32,002	$ 18,623
Accrued payroll and payroll taxes	2,296	4,388
Income taxes payable	2,974	3,309
Current portion of deferred rent and tenant allowances	1,331	900
Other accrued liabilities	6,262	4,378
Total current liabilities	44,865	31,598
Long-term deferred rent and tenant allowances, less current portion	11,302	7,595
Deferred tax liabilities	602	1,534
Total long-term liabilities	11,904	9,129
Commitments and contingencies (Note 4)	—	—
Shareholders' equity		
Preferred stock, no par value, 40,000,000 shares authorized; none issued and outstanding	—	—
Common stock, no par value, 100,000,000 shares authorized; 27,640,664 shares issued and outstanding at October 28, 2006; 27,259,297 shares issued and outstanding at January 28, 2006	41,734	35,031

Accumulated other comprehensive income (loss)	(4)	(5)
Retained earnings	48,236	38,658
Total shareholders' equity	89,966	73,684
Total liabilities and shareholders' equity	$ 146,735	$ 114,411

See accompanying notes to condensed consolidated financial statements

ZUMIEZ INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
Net sales	$ 82,258	$ 57,412	$ 185,799	$ 130,188
Cost of goods sold	51,994	35,999	121,494	86,153
Gross profit	30,264	21,413	64,305	44,035
Selling, general and administrative expenses	19,343	13,198	49,919	34,530
Operating profit	10,921	8,215	14,386	9,505
Interest income, net	230	221	813	269
Other income (expense)	—	1	(16)	2
Earnings before income taxes	11,151	8,437	15,183	9,776
Provision for income taxes	4,324	3,158	5,605	3,689
Net income	$ 6,827	$ 5,279	$ 9,578	$ 6,087
Basic net income per share	$ 0.25	$ 0.19	$ 0.35	$ 0.24
Diluted net income per share	$ 0.24	$ 0.18	$ 0.33	$ 0.23
Weighted average shares outstanding, Basic	27,600,574	27,089,364	27,454,193	25,424,554
Weighted average shares outstanding , Diluted	28,861,871	28,601,778	28,756,468	26,923,744

See accompanying notes to condensed consolidated financial statements

ZUMIEZ INC.
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(in thousands)
(Unaudited)

	Common Stock		Accumulated Other Comprehensive Gain (Loss)	Retained Earnings	Total
	Shares	Amount			
Balance at January 28, 2006	27,259	$ 35,031	$ (5)	$ 38,658	$ 73,684
Common shares issued including tax benefit of $4,057	381	5,309	—	—	5,309
Stock-based compensation expense	—	1,394	—	—	1,394
Unrealized gains and losses, net	—	—	1	—	1
Net income	—	—	—	9,578	9,578
Balance at October 28, 2006	27,640	$ 41,734	$ (4)	$ 48,236	$ 89,966

See accompanying notes to condensed consolidated financial statements

ZUMIEZ INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)
(Unaudited)

	For the Nine Months Ended October 28, 2006	For the Nine Months Ended October 29, 2005
Cash flows from operating activities		
Net income	$ 9,578	$ 6,087
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	7,478	5,361
Deferred tax expense	(1,611)	(377)
Stock compensation expense	1,394	123
Loss on disposal of assets	15	33
Loss on sale of marketable securities	17	—
Excess tax benefit from stock options	(4,057)	—
Changes in operating assets and liabilities		
Receivables	(1,902)	(2,647)
Inventory	(17,824)	(17,143)
Prepaid expenses	(85)	127
Trade accounts payable	7,556	15,816
Accrued payroll and payroll taxes	(2,158)	117
Income taxes payable	3,722	(2,611)
Other accrued liabilities	1,202	(1,920)
Deferred rent	(18)	385
Net cash provided by operating activities	3,307	3,351
Cash flows from investing activities		
Additions to leasehold improvements and equipment	(14,469)	(8,554)
Acquisitions, net of cash acquired	(16,404)	—
Purchases of marketable securities	(79,977)	(6,086)
Sales and maturities of marketable securities	100,340	—
Net cash used in investing activities	(10,510)	(14,640)
Cash flows from financing activities		
Change in book overdraft	—	(429)
Borrowings on revolving credit facility	—	16,450
Payments on revolving credit facility	(732)	(16,450)
Proceeds from exercise	1,252	1,007
Proceeds from sale of stock	—	33,700
Excess tax benefit from stock options	4,057	—
Net cash provided by financing activities	4,577	34,278
Net increase (decrease) in cash and cash equivalents	(2,626)	22,989
Cash and cash equivalents, Beginning of period	4,737	1,026
Cash and cash equivalents, End of period	$ 2,111	$ 24,015
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$ —	$ 59
Cash paid during the period for income taxes	3,577	2,746

See accompanying notes to condensed consolidated financial statements

ZUMIEZ INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Nature of Business and Basis of Presentation

Basis of Presentation—The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements.

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the consolidated balance sheet as of October 28, 2006, the consolidated statement of operations for the three and nine months ended October 28, 2006 and October 29, 2005, the consolidated statement of shareholders’ equity for the nine months ended October 28, 2006, and the consolidated statement of cash flows for the nine months ended October 28, 2006 and October 29, 2005. The results of operations for the three and nine months ended October 28, 2006 are not necessarily indicative of the results to be expected for the year ending February 3, 2007.

The financial data at January 28, 2006 is derived from audited financial statements which are included in the Company’s Annual Report on Form 10-K for the year ended January 28, 2006, and should be read in conjunction with the audited financial statements and notes thereto. Interim results are not necessarily indicative of results for the full year.

Principles of Consolidation—The condensed consolidated financial statements include the accounts of Zumiez Inc. and its subsidiary, Zumiez Nevada, LLC, (collectively, "the Company"). All significant intercompany transactions and balances are eliminated in consolidation.

Reclassifications—Certain amounts in the prior periods have been reclassified to conform to the current period presentation. These reclassifications had no impact on revenue, net income, assets or liabilities in either period presented.

Use of Estimates—The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. These estimates can also affect supplemental information disclosed by the Company, including information about contingencies, risk, and financial condition. In preparing the financial statements, the Company makes routine estimates and judgments in determining the net realizable value of accounts receivable, inventory, fixed assets, and prepaid assets. Some of the more significant estimates include the allowance for sales returns, the reserve for inventory valuation estimates and the expected useful lives of fixed assets. Actual results could differ from those estimates. The results of operations for the three and nine months ended October 28, 2006 are not necessarily indicative of the results that might be expected for fiscal 2006. For further information, refer to the Company's financial statements and notes included in the Company's Form 10-K filed on March 23, 2006.

Nature of Business—The Company is a leading specialty retailer of action sports related apparel, footwear, equipment and accessories operating under the Zumiez brand name. As of October 28, 2006 the Company operated 233 stores primarily located in shopping malls, giving the Company a presence in 23 states. The Company's stores cater to young men and women between the ages of 12 and 24 who seek brands representing a lifestyle centered on activities that include skateboarding, surfing, snowboarding, bicycle motocross (or "BMX") and motocross. The Company supports the action sports lifestyle and promotes its brand through a multi-faceted marketing approach that is designed to integrate its brand image with its customers' interests. In addition, the Company operates a website which sells merchandise online and provides content and a community for its target customers. The Company, based in Everett, WA, was formed in August 1978 and operates within one reportable segment.

Fiscal Year—The Company uses a fiscal calendar widely used by the retail industry which results in a fiscal year consisting of a 52- or 53- week period ending on the Saturday closest to January 31. Each fiscal year consists of four 13-week quarters, with an extra week added to the fourth quarter every five or six years. "Fiscal 2005" was the 52-week period ended January 28, 2006. The first nine months of fiscal 2006 was the 39-week period ended October 28, 2006. The first nine months of fiscal 2005 was the 39-week period ended October 29, 2005. "Fiscal 2006" is the 53-week period ending February 3, 2007.

Stock Split—On April 14, 2005, the Company's Board of Directors and shareholders approved an amendment to the Company's Certificate of Incorporation to effect a 1 for 258.6485 split of the Company's common stock (the "Stock Split"). The Stock Split became effective on April 20, 2005. All reference to shares in the financial statements and the accompanying notes, including but not limited to the number of shares and per share amounts, unless otherwise noted, have been adjusted to reflect the Stock Split on a retroactive basis. Previously awarded stock options in the Company's common stock have been retroactively adjusted to reflect the Stock Split.
On March 15, 2006, the Company's Board of Directors approved a two for one stock split of the Company's common stock that was affected by a share dividend and became effective April 19, 2006. All reference to shares in the financial statements and the accompanying notes, including but not limited to the number of shares and per share amounts, unless otherwise noted, have been adjusted to reflect the stock split on a retroactive basis. Previously awarded stock options in the Company's common stock have been retroactively adjusted to reflect the stock split.

Reincorporation—On April 29, 2005, the Company reincorporated in the State of Washington from the State of Delaware. In connection with the reincorporation, the Company filed new articles of incorporation and adopted new bylaws. The new articles of incorporation changed the Company's common stock from $0.01 par value per share to no par value per share and increased the Company's authorized capital stock.

Initial Public Offering—In May 2005, the Company completed an initial public offering of its common stock in which the Company sold 3,750,000 shares and the Company's selling shareholders sold 3,437,500 shares. Net proceeds from the offering received by the Company totaled approximately $29.7 million, after payment of underwriters' commissions and offering expenses. The Company did not receive any of the proceeds from the sale of shares of its common stock by the selling shareholders. Prior to this initial public offering, the Company was a majority owned subsidiary of Zumiez Holdings LLC (the "Parent"), a holding company with no operating activities. The financial position and operating results of the Parent are not included in the Company's financial statements included in this quarterly report. The Parent was dissolved in connection with the Company's initial public offering.

Secondary Offerings—In November 2005, a secondary offering of shares of the Company's common stock by certain of its shareholders was completed. The offering consisted of 5,462,500 shares of common stock, including 712,500 shares that were subject to the underwriters' over-allotment option. All of the shares were sold by shareholders of the Company and, as a result, the Company did not receive any of the proceeds from the offering.

In June 2006, a secondary offering of shares of the Company's common stock by certain of its shareholders was completed. The offering consisted of 1,609,090 shares of common stock. All of the shares were sold by shareholders of the Company and, as a result, the Company did not receive any of the proceeds from the offering.

2. Summary of Significant Accounting Policies

Information regarding the Company's significant accounting policies is contained in Note 2, "Summary of Significant Accounting Policies," to the financial statements in the Company's Form 10-K filed on March 23, 2006. Presented below in this and the following notes is supplemental information that should be read in conjunction with "Notes to Financial Statements" in that annual report.

Marketable Securities—At October 28, 2006, marketable securities, classified as available for sale, were $17.8 million and consisted of municipal and U.S. agency debt instruments with original maturities over 90 days. The portfolio is carried at market value with net unrealized gains and losses recorded as other comprehensive income (loss).

Stock Compensation—Effective January 29, 2006 the Company adopted the fair value method of accounting for stock-based compensation arrangements in accordance with Financial Accounting Standards Board ("FASB")

Statement No. 123(R), Share-Based Payment ("SFAS No. 123(R)"), using the modified prospective method of transition. Under the provisions of SFAS No. 123(R), the estimated fair value of share based awards granted under the 2005 Stock Incentive Plan is recognized as compensation expense over the vesting period. Using the modified prospective method, compensation expense is recognized beginning with the effective date of adoption of SFAS No. 123(R) for all share based payments (i) granted after the effective date of adoption and (ii) granted prior to the effective date of adoption and after the Company's initial public offering on May 5, 2005.

Prior to January 29, 2006, the Company accounted for stock-based employee compensation plans using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), and its related interpretations. Under the provisions of APB 25, no compensation expense was recognized when stock options were granted with exercise prices equal to or greater than market value on the date of grant. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, Accounting for Stock Based Compensation. The expected option term is estimated based upon historical industry data on employee exercises and management's expectation of exercise behavior. The expected volatility of the Company's stock price is based upon the historical volatility of similar entities whose share prices are publicly available. The risk-free interest rate is based upon the current yield on U.S. Treasury securities having a term similar to the expected option term. Dividend yield is estimated at zero because the Company does not anticipate paying dividends in the foreseeable future. The fair value of employee stock-based awards is amortized using the straight-line method over the vesting period.

The fair values of the options granted after the effective date were estimated using the Black-Scholes valuation model with the assumptions from the table below:

	Three Months Ended October 28, 2006	Nine Months Ended October 28, 2006
Dividend yield	—%	—%
Volatility rate	35.00%	35.00%
Forfeiture rate	8.00%	8.00%
Average expected life (in years):		
Expected lives—Eight years	6.38	6.38
Expected lives—Five years	6.00	6.00
Expected lives—Three years	6.00	6.00
Average risk-free interest rate:	4.85%	4.77%

The following table summarizes the Company's stock option activity for the nine months ended October 28, 2006 (in thousands except weighted-average exercise price):

	Number of Options	Weighted-Average Exercise Price
Options outstanding at January 28, 2006	2,812	1.95
Options granted Year to Date	507	27.86
Options exercised Year to Date	(371)	1.84
Options forfeited Year to Date	(43)	15.39
Options outstanding at October 28, 2006	2,905	6.18
Options exercisable at October 28, 2006	1,381	1.38

The Company recorded $514,977 and $1,392,968 of total stock-based compensation expense for the three and nine month periods ended October 28, 2006, respectively of which $82,623 and $151,475 was attributable to the Board

of Directors as required by the provisions of SFAS No. 123(R). The stock-based compensation expense is calculated on an accelerated method over the vesting periods of the related options. This charge had no impact on the Company's reported cash flows. For the three and nine-month periods ended October 29, 2005, the Company recorded $41,113 and $123,336, respectively in stock compensation expense pursuant to APB 25. Under the modified prospective method of transition under SFAS No. 123(R), the Company is not required to restate its prior period financial statements to reflect expensing of share-based compensation under SFAS No. 123(R). Therefore, the results as of October 28, 2006 are not directly comparable to the same period in the prior year.

At October 28, 2006, there was approximately 4.9 million of total unrecognized compensation cost related to unvested stock options of which $524,530 was attributable to the Board of Directors. This cost is expected to be recognized over a weighted-average period of approximately eight years.

The Company accounts for unvested stock-based employee compensation arrangements granted prior to the initial public offering on the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related amendments and interpretations. For these awards, the Company complies with the disclosure provisions of Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation."

If the computed fair values of the awards had been amortized to expense over the vesting period of the awards, pro forma net income (loss) and net income (loss) per share would have been reduced to the pro forma amounts indicated in the following table (in thousands, except per share data):

	For the Three Months Ended		For the Nine Months Ended	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
Net income, as reported	$ 6,827	$ 5,279	$ 9,578	$ 6,087
Add: Stock-based compensation expense, as reported, net of tax	325	26	554	77

Deduct: Stock-based employee compensation expense determined under fair-value-based method, net of tax	(357)	(91)	(618)	(274)
Pro forma net income	6,795	5,214	9,514	5,889
Net income per share:				
Basic-as reported	$ 0.25	$ 0.19	$ 0.35	$ 0.24
Basic—pro forma	$ 0.25	$ 0.19	$ 0.35	$ 0.23
Diluted—as reported	$ 0.24	$ 0.18	$ 0.33	$ 0.23
Diluted—pro forma	$ 0.24	$ 0.18	$ 0.33	$ 0.22

Goodwill — In accordance with Statement of Financial Accounting Standards No. 142, "Accounting for Goodwill and Other Intangible Assets" ("SFAS No. 142"), the Company does not amortize goodwill derived from purchase business combinations. The Company performs annual impairment testing which considers the Company's fair value to determine whether an impairment charge related to the carrying value of the Company's recorded goodwill. Additional impairment assessments may be performed on an interim basis if the Company encounters events or changes in circumstances, that would indicate that, more likely than not, the book value of goodwill has been impaired. The Company concluded that there was no such impairment loss at October 28, 2006 or October 29, 2005.

Recent accounting pronouncements—In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, "Inventory Costs—an Amendment of ARB No. 43, Chapter 4." This statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and spoilage, requiring these items be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005 and became effective for the Company beginning in fiscal 2006. The effect of adopting this statement has not been significant to the Company's financial position and results of operations.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections." This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle. The provisions of this statement became effective for fiscal periods beginning after December 15, 2005. The standard dictates that changes in accounting principle that are a result of a new pronouncement shall be subject to the reporting provisions of that pronouncement if they exist.

In June 2005 EITF 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination", was ratified by the FASB. The EITF reached a consensus on two issues, that leasehold improvements acquired in a business combination should be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date of acquisition, and that leasehold improvements that are placed in service significantly after and not contemplated at or near the beginning of the lease term should be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. The consensus should be applied to leasehold improvements that are purchased or acquired in reporting periods beginning after the FASB ratification on June 29, 2005. On September 28, 2005 the FASB ratified a modification to clarify that the application does not apply to preexisting leasehold improvements. The Company amortizes leasehold improvements per the guidance set forth in this consensus.

In June 2006, the FASB issued Interpretation ("FIN") No. 48, Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN No. 48 to have a material effect on the Company's consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect the adoption of SFAS No. 157 to have a material effect on the Company's consolidated financial position or results of operations.

In September 2006, The SEC released Staff Accounting Bulletin ("SAB") No. 108, *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*. SAB 108 provides guidance on how the effects of the carryover or reversal of prior year financial statement misstatements should be considered in quantifying a current year misstatement. The Company must apply the guidance in SAB 108 beginning in the fourth quarter of fiscal year 2006. The Company believes that SAB 108 will not have a material impact on the Company's consolidated financial position or results of operations.

3. Related Party Transactions—During the nine months ended October 29, 2005, the Company paid $1,000 in fees on behalf of its Parent, which subsequently was dissolved with the initial public offering. During the nine months ended October 29, 2005, with the additional payments by the Company on behalf of the Parent, the balance of $149,000 was deemed uncollectible and forgiven by the Company. This amount was reported in shareholders' equity and expensed to selling, general and administrative expense.

During the nine months ended October 29, 2005, the Company paid Brentwood Private Equity III, LLC a consulting fee of $53,000 under a Corporate Development and Administrative Services Agreement. This agreement was subsequently terminated in connection with the initial public offering.

4. Commitments and Contingencies

Litigation—The Company is involved from time to time in litigation incidental to its business and the Company may make provisions for potential litigation losses relating thereto. The Company follows SFAS 5, "Accounting for Contingencies" when assessing pending or potential litigation. Management believes, after considering a number of factors and the nature of the contingencies to which the Company is subject, that the outcome of these contingencies will not have a material adverse effect upon the results of operations or financial condition of the Company.

Insurance Reserves—The Company is responsible for medical insurance claims up to a specified aggregate amount. The Company maintains a reserve for estimated medical insurance claims based on historical claims experience and other estimated assumptions. The Company follows SFAS 5, "Accounting for Contingencies" when assessing pending or potential claims.

5. Net Income Per Share, Basic and Diluted

The Company calculates net income per share in accordance with SFAS No. 128, *Earnings Per Share*, as amended by SFAS No. 123(R). Basic net income per share is based on the weighted average number of common shares outstanding during the period. Diluted net income per share is based on the weighted average number of common shares and common share equivalents outstanding during the period. Common share equivalents included in the computation represent shares issuable upon assumed exercise of outstanding stock options. Potentially dilutive securities included in the calculation of diluted earnings per share include options to purchase common stock. Common stock options granted to the Board of Directors to purchase 40,000 shares and 0 shares of common stock for three and nine months ended October 28, 2006 and October 29, 2005 respectively, were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price of the Company's common stock.

The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except share and per share data):

	Three Months Ended	
	October 28, 2006	October 29, 2005
Net income	$ 6,827	$ 5,279
Weighted average common shares for basic net income per share	27,600,574	27,089,364
Dilutive effect of stock options	1,261,297	1,512,414
Weighted average common shares for diluted net income per share	28,861,871	28,601,778
Basic net income per share	$ 0.25	$ 0.19
Diluted net income per share	$ 0.24	$ 0.18

	Nine Months Ended	
	October 28, 2006	October 29, 2005
Net income	$ 9,578	$ 6,087
Weighted average common shares for basic net income per share	27,454,193	25,424,554
Dilutive effect of stock options	1,302,275	1,499,190
Weighted average common shares for diluted net income per share	28,756,468	26,923,744
Basic net income per share	$ 0.35	$ 0.24
Diluted net income per share	$ 0.33	$ 0.23

6. Intangible Assets and Goodwill

In connection with the acquisition of Fast Forward on June 24, 2006, the Company recorded goodwill in accordance with SFAS No. 141 "Business Combinations." The Company recorded $12.8 million of goodwill as the excess of the purchase price of $15.1 million over the fair value of the net amounts assigned to assets acquired and liabilities assumed. In accordance with SFAS 142, "Accounting for Goodwill and Other Tangible Assets", the Company will continue to assess, in accordance with our "Goodwill" policy as stated in Note 2, whether goodwill is impaired.

7. Business Acquisitions

During the quarter ended July 29, 2006, we completed the acquisition of 100% of the ownership of Action Concepts Fast Forward, Ltd. (a limited partnership) ("Fast Forward"), an apparel and accessory retail sales company which operated 20 stores (17 in Texas, 2 in Oklahoma and 1 in California). The ability to expand operations into Texas with a full complement of stores at one time was the primary reason for the acquisition. Total costs of the acquisition were $15.1 million and were paid in cash plus assumption of liabilities. The Company completed an independent appraisal to determine the final allocation of the purchase price. The following table summarizes the allocation of fair values of the assets acquired and liabilities assumed (in thousands):

Cash in Stores	$ 15
Prepaid Expenses	143
Other Current Assets	168
Merchandise Inventory	4,227
Property & Equipment	1,819
Goodwill	12,766
Checks drawn in excess of bank balance	(608)
Accounts Payable	(1,712)
Short-term debt	(732)
Other current liabilities	(957)
Fair value of net assets acquired, including Goodwill	$ 15,129

The fair value of net assets including goodwill and the goodwill amounts reported for the period ended July 29, 2006 was $13,998 and $11,635 respectively. The change in the amounts reported for the period ended October 28, 2006 is accounted for in the following table (in thousands):

	Balance July 29, 2006	Cash Payments	Adjustments to Estimates	Balance October 28, 2006
Long term debt	$ —	$ —	$ 516	$ 516
Transaction fees & costs	188	—	42	230
Associate severance & relocation	638	—	25	663
Inventory reserve for discontinued merchandise	225	—	438	663
Escrow reserve distribution	—	110	—	110
Total	$ 1,051	$ 110	$ 1,021	$ 2,182

The transaction was accounted for under the purchase method of accounting and, accordingly, the purchased assets and assumed liabilities were recorded at their estimated fair values. The preliminary purchase price allocation resulted in an excess of purchase price over net tangible assets acquired of $12.8 million. All of the excess of purchase price over net tangible assets acquired was attributed to goodwill, which is not subject to amortization for book purposes. The Company will amortize the goodwill for tax purposes utilizing the 338(h)(10) Federal tax code election. At October 28, 2006, $250,000 was held in escrow and due for payment to either the Company or the ownership of Action Concepts, Ltd Fast Forward dependent on future claims. This amount has not been reflected in the purchase price of the related acquisition, but will be reflected in the allocable cost of the acquisition at the time of determination of the contingencies and ultimate distribution to the sellers in accordance with Paragraph 46 of SFAS 141, Business Combinations.

The condensed consolidated statement of operations for the period ended October 28, 2006, includes the operating results of Fast Forward from June 24, 2006. The following summarized unaudited pro forma information (in thousands) assumes the acquisition of Fast Forward had occurred at the beginning of the period presented. The pro forma information does not purport to indicate what would have occurred had the acquisition been made at the beginning of the period presented, nor of the results which may occur in the future.

	For the Nine Month Period Ended	
	October 28, 2006	October 29, 2005
Pro Forma Information (Unaudited)		
Net Sales	$ 194,383	$ 147,126
Net Income	8,805	6,401
Basic Earnings Per Share	$ 0.32	$ 0.25
Diluted Earnings Per Share	$ 0.31	$ 0.24

The Company incurred transaction expenses of approximately $663,000 related to the employee severance and transition expense of the acquisition. To date, this amount has been paid in full. In addition, the company has a reserve of $340,000 as of October 28, 2006 for the potential clearance of discontinued merchandise from Fast Forward locations and raw materials that may not be consumed. These costs were accounted for under Emerging Issues Task Force (EITF) 95-3 “Recognition of Liabilities in Connection with a Purchase Business Combination”.

Item 2: MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this quarterly report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed in the section entitled “Risk Factors” in our Form 10-K filed with the SEC on March 23, 2006 and in this Form 10-Q.

Forward-looking statements are based on our expectations regarding net sales, selling, general and administrative expenses, profitability, financial position, business strategy, new store openings, and plans and objectives of management. The words “believe,” “may,” “will,” “estimate,” “continue,” “anticipate,” “intend,” “expect” and similar expressions, as they relate to us and our business, industry, markets and consumers, are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including, among others, those described in “Risk Factors” and elsewhere in this quarterly report and in the Form 10-K referred to in the preceding paragraph. New risk factors emerge from time to time and it is not possible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments. References in the following discussion to “we”, “us”, “our”, “the Company” and similar references mean Zumiez Inc. and its consolidated subsidiary, unless otherwise expressly stated or the context otherwise requires.

<u>Overview</u>

We are a leading specialty retailer of action sports related apparel, footwear, equipment and accessories operating under the Zumiez brand name. Our stores cater to young men and women between the ages of 12 and 24 who seek popular brands representing a lifestyle centered on activities that include skateboarding, surfing, snowboarding, BMX, and motocross. We support the action sports lifestyle and promote our brand through a multi-faceted marketing approach that is designed to integrate our brand image with our customers' activities and interests.

In May 2005, we completed an initial public offering of our common stock in which we sold 3,750,000 shares and our selling shareholders sold 3,437,500 shares. Net proceeds received by us from the offering totaled approximately $29.7 million, after payment of underwriters' commissions and offering expenses. We did not receive any of the proceeds from the sale of shares of our common stock by the selling shareholders.

In November 2005, a secondary public offering of 5,462,500 shares of our common stock was completed by certain of our shareholders. We did not receive any of the proceeds from the offering.

In June 2006, a secondary public offering of 1,609,090 shares of common stock was completed by certain of our shareholders. We did not receive any of the proceeds from the offering.

During the quarter ended July 29, 2006, we completed the acquisition of 100% of the ownership of Action Concepts Fast Forward, Ltd. (a limited partnership) ("Fast Forward"), an apparel and accessory retail sales company which operated 20 stores (17 in Texas, 2 in Oklahoma and 1 in California). The ability to expand operations into Texas with a full complement of stores at one time was the primary reason for the acquisition.

General

Net sales constitute gross sales net of returns. Net sales include our in-store sales and our internet sales and, accordingly, information in this quarterly report with respect to comparable store sales, net sales per store and net sales per square foot includes our internet sales. Our internet sales are and have historically been less than 1% of total sales. Sales with respect to gift cards are deferred and recognized when gift cards are redeemed.

We report "comparable store sales" based on net sales, and stores are included in our comparable store sales beginning on the first anniversary of their first day of operation. Changes in our comparable store sales between two periods are based on net sales of stores which were in operation during both of the two periods being compared and, if a store is included in the calculation of comparable store sales for only a portion of one of the two periods being compared, then that store is included in the calculation for only the comparable portion of the other period. When additional square footage is added to a store that is included in comparable store sales, the store remains in comparable store sales. The 20 stores that we recently acquired in the Fast Forward transaction are being treated as new stores and will move into our comparable store base according to our current reporting method, and will be a comparable store on the first anniversary of the acquisition date, June 24, 2007. There may be variations in the way in which some of our competitors and other apparel retailers calculate comparable or same store sales. As a result, data regarding our comparable store sales may not be comparable to similar data made available by our competitors or other retailers.

Cost of goods sold consists of the cost of merchandise sold to customers, inbound shipping costs, distribution costs, depreciation on leasehold improvements at our distribution center, buying and merchandising costs and store occupancy costs. This may not be comparable to the way in which our competitors or other retailers compute their cost of goods sold.

Selling, general and administrative expenses consist primarily of store personnel wages and benefits, administrative staff and infrastructure expenses, store supplies, depreciation on leasehold improvements at our home office and stores, facility expenses, and training, advertising and marketing costs. Credit card fees, insurance and other miscellaneous operating costs are also included in selling, general and administrative expenses. This may not be comparable to the way in which our competitors or other retailers compute their selling, general and administrative expenses. Our selling, general and administrative expenses have increased, as described below, and will further increase in future periods due in part to increased expenses associated with operating as a public company, including compliance with the Sarbanes-Oxley Act of 2002 and in particular, compliance with Section 404 thereof.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in conformity with generally accepted accounting principles in the United States (GAAP). In preparing financial statements in accordance with GAAP, we are required to make estimates and assumptions that have an impact on the assets, liabilities, revenue and expense amounts reported. These estimates can also affect supplemental information disclosed by us, including information about contingencies, risk, and financial condition. We believe, given current facts and circumstances that our estimates and assumptions are reasonable, adhere to GAAP, and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates and estimates may vary as new facts and circumstances arise. In preparing the financial statements, we make routine estimates and judgments in determining the net realizable value of accounts receivable, inventory, fixed assets, and prepaid expenses. We believe our most critical accounting estimates and assumptions are in the following areas:

Valuation of merchandise inventories. We carry our merchandise inventories at the lower of cost or market. Merchandise inventories may include items that have been written down to our best estimate of their net realizable value. Our decisions to write-down our merchandise inventories are based on our current rate of sale, the age of the inventory and other factors. Actual final sales prices to our customers may be higher or lower than our estimated sales prices and could result in a fluctuation in gross margin. Historically, any additional write-downs have not been significant and we do not adjust the historical carrying value of merchandise inventories upwards based on actual sales experience.

Leasehold improvements and equipment. We review the carrying value of our leasehold improvements and equipment for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Measurement of the impairment loss is based on the fair value of the asset or group of assets. Generally, fair value will be determined using valuation techniques, such as the expected present value of future cash flows. The actual economic lives of these assets may be different than our estimated useful lives, thereby resulting in a different carrying value. These evaluations could result in a change in the depreciable lives of those assets and therefore our depreciation expense in future periods.

Revenue recognition and sales returns reserve. We recognize revenue upon purchase by customers at our retail store locations or upon shipment for orders placed through our website as both title and risk of loss have transferred. We offer a return policy of generally 30 days and we accrue for estimated sales returns based on our historical sales returns results. The amounts of these sales returns reserves vary during the year due to the seasonality of our business. Actual sales returns could be higher or lower than our estimated sales returns due to customer buying patterns that could differ from historical trends.

Impairment of Long-Lived Assets. We account for long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is determined by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered impaired, the impairment recognized is measured by comparing projected individual store discounted cash flow to the asset carrying values. Declines in projected store cash flow could result in the impairment of assets.

Accounting for Income Taxes. As part of the process of preparing the financial statements, income taxes are estimated for each of the jurisdictions in which we operate. This process involves estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the balance sheet. The likelihood that deferred tax assets will be recovered from future taxable income is assessed, recognizing that future taxable income may give rise to new deferred tax assets. To the extent that future recovery is not likely, a valuation allowance would be established. To the extent that a valuation allowance is established or increased, an expense will be included within the tax provision in the income statement.

Significant management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. Based on our history of operating earnings, no valuation allowance has been recorded as of October 28, 2006. In the event that actual results differ

from these estimates, or these estimates are adjusted in future periods, a valuation allowance may need to be established, which could impact our financial position and results of operations.

Provisions for income taxes are based on numerous factors that are subject to audit by the Internal Revenue Service and the tax authorities in the various jurisdictions in which we do business.

Stock-based compensation. Effective January 29, 2006 we adopted the fair value method of accounting for stock-based compensation arrangements in accordance with Financial Accounting Standards Board ("FASB") Statement No. 123(R), Share-Based Payment ("SFAS No. 123(R)"), using the modified prospective method of transition. Under the provisions of SFAS No. 123(R), the estimated fair value of share based awards granted under the 2005 Stock Incentive Plan is recognized as compensation expense over the vesting period. Using the modified prospective method, compensation expense is recognized beginning with the effective date of adoption of SFAS No. 123(R) for all share based payments (i) granted after the effective date of adoption and (ii) granted prior to the effective date of adoption and after our initial public offering on May 5, 2005.

Prior to January 29, 2006, we accounted for stock-based employee compensation plans using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), and its related interpretations. Under the provisions of APB 25, no compensation expense was recognized when stock options were granted with exercise prices equal to or greater than market value on the date of grant. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, Accounting for Stock Based Compensation. We recorded $514,977 and $1,392,968 of total stock-based compensation expense for the three and nine month periods ended October 28, 2006, respectively of which $82,623 and $151,475 was attributable to the Board of Directors , respectively as required by the provisions of SFAS No. 123(R). The stock-based compensation expense is calculated on an accelerated method over the vesting periods of the related options. This charge had no impact on our reported cash flows. For the three and nine month period ended October 29, 2005, we recorded $41,113 and $123,336, respectively in stock compensation expense pursuant to APB 25. Under the modified prospective method of transition under SFAS No. 123(R), we are not required to restate its prior period financial statements to reflect expensing of share-based compensation under SFAS No. 123(R). Therefore, the results as of October 28, 2006 are not directly comparable to the same period in the prior year.

At October 28, 2006, there was approximately $4.9 million of total unrecognized compensation cost related to unvested stock options of which $524,530 was attributable to the Zumiez Board of Directors. This cost is expected to be recognized on a weighted-average basis over a period of approximately eight years.

We account for unvested stock-based employee compensation arrangements granted prior to the initial public offering on the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related amendments and interpretations. For these awards, we comply with the disclosure provisions of Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation."

Results of Operations

The following table presents, for the periods indicated, selected items in the statements of operations as a percent of net sales:

	Three Months Ended		**Nine Months Ended**	
	October 28, 2006	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Net sales	100.0%	100%	100.0%	100.0%
Cost of goods sold	63.2	62.7	65.4	66.2
Gross margin	36.8	37.3	34.6	33.8
Selling, general and administrative expenses	23.5	23.0	26.9	26.5
Operating profit	13.3	14.3	7.7	7.3
Interest income, net	0.3	0.4	0.4	0.2
Other income	—	—	—	—

Earnings before income taxes	13.6	14.7	8.1	7.5
Provision for income taxes	5.3	5.5	3.0	2.8
Net income	8.3%	9.2%	5.1%	4.7%

Three Months (13 weeks) Ended October 28, 2006 Compared With Three Months (13 weeks) Ended October 29, 2005

Net Sales

Net sales increased to $82.3 million for the three months ended October 28, 2006 from $57.4 million for the three months ended October 29, 2005, an increase of $24.9 million, or 43.3%. Comparable store net sales increased by 10.7% for the three months ended October 28, 2006 compared to 9.8% for the three months ended October 29, 2005. The increase in total net sales was due to an increase in comparable store net sales of approximately $6.1 million and an increase in net sales from non-comparable stores of approximately $18.8 million. The increase in non-comparable store net sales was primarily due to the opening of 69 new and Fast Forward acquisition stores subsequent to October 29, 2005. The increase at comparable stores was primarily due to higher net sales of men's apparel, footwear and juniors. For information as to how we define comparable stores, see "—General" above.

Gross Margin

Gross margin for the three months ended October 28, 2006 was $30.3 million compared with $21.4 million for the three months ended October 29, 2005, an increase of $8.9 million, or 41.3%. As a percentage of net sales, gross margin decreased to 36.8% for the three months ended October 28, 2006 from 37.3% for the three months ended October 29, 2005. The decrease in gross margin as a percentage of net sales was due primarily to occupancy costs related to the 32 new stores we added in the three months ended October 28, 2006 compared to 14 stores added in the three months ended October 29, 2005 and stock based compensation expense, new this year. Partially offsetting this decrease was an increase in product margin due to improved pricing from some of our vendors due to our larger merchandise purchases, a reduced markdown rate from prior year due to less aged inventory and to a lesser extent, our ability to leverage certain fixed costs, such as distribution, and product teams over greater overall net sales.

Selling, General and Administrative Expenses

Selling, general and administrative, or "SG&A," expenses in the three months ended October 28, 2006 were $19.3 million compared with $13.2 million in the three months ended October 29, 2005, an increase of $6.1 million, or 46.6%. As a percentage of net sales, SG&A expenses increased to 23.5% in the three months ended October 28, 2006 from 23.0% in the three months ended October 29, 2005. The increase in SG&A expenses was primarily attributable to the expensing of stock based compensation of $0.4 million, related to the adoption of FAS 123R this

year, and an increase in store payroll for new stores of $2.7 million and additional depreciation of $0.9 million.

Operating Profit

As a result of the above factors, operating profit increased by $2.7 million to $10.9 million in the three months ended October 28, 2006 compared with an operating profit of $8.2 million in the three months ended October 29, 2005. As a percentage of net sales, operating profit was 13.3% in the three months ended October 28, 2006 compared with 14.3% in the three months ended October 29, 2005.

Provision for Income Taxes

Provision for income taxes was $4.3 million for the three months ended October 28, 2006 compared with $3.2 million for the three months ended October 29, 2005. The effective income tax rate was 36.9% in the three months ended October 28, 2006 versus 37.7% in the three months ended October 29, 2005. The decrease in the effective income tax rate was primarily attributable to an increase in non-taxable interest income on marketable securities. Our weighted average effective state income tax rate will vary over time depending on a number of factors, such as differing average income tax rates and net incomes in the respective states.

Net Income

Net income increased by $1.5 million, or 29.3%, to $6.8 million in the three months ended October 28, 2006 from $5.3 million in the three months ended October 29, 2005. As a percentage of net sales, net income was 8.3% in the three months ended October 28, 2006 compared with 9.2% in the three months ended October 29, 2005.

Nine Months (26 weeks) Ended October 28, 2006 Compared With Nine Months (26 weeks) Ended October 29, 2005

Net Sales

Net sales increased to $185.8 million for the nine months ended October 28, 2006 from $130.2 million for the nine months ended October 29, 2005, an increase of $55.6 million, or 42.7%. Comparable store net sales increased by 13.6% for the nine months ended October 28, 2006 compared to the nine months ended October 29, 2005, and 10.8% for the nine months ended October 29, 2005 compared to the nine months ended October 30, 2004. The increase in total net sales was due to an increase in comparable store net sales of approximately $17.7 million and an increase in net sales from non-comparable stores of approximately $37.9 million. The increase in non-comparable store net sales was primarily due to the opening of 69 new and Fast Forward acquisition stores subsequent to October 29, 2005. The increase in comparable stores was primarily due to higher net sales of men's apparel, juniors and footwear. For information as to how we define comparable stores, see "General" above.

Gross Margin

Gross margin for the nine months ended October 28, 2006 was $64.3 million compared with $44.0 million for the nine months ended October 29, 2005, an increase of $20.3 million, or 46.0%. As a percentage of net sales, gross margin increased to 34.6% for the nine months ended October 28, 2006 from 33.8%

for the nine months ended October 29, 2005. The increase in gross margin as a percentage of net sales was due primarily to improved pricing from some of our vendors due to our larger merchandise purchases, our ability to leverage certain fixed costs, primarily non-variable costs over greater overall net sales, and a reduced markdown rate from prior year due to less aged inventory, offset by the impact of stock based compensation expense of $0.3 million.

Selling, General and Administrative Expenses

Selling, general and administrative, or "SG&A," expenses in the nine months ended October 28, 2006 were $49.9 million compared with $34.5 million in the nine months ended October 29, 2005, an increase of $15.4 million, or 44.6%. As a percentage of net sales, SG&A expenses increased to 26.9% in the nine months ended October 28, 2006 from 26.5% in the nine months ended October 29, 2005. The increase in SG&A expenses was primarily attributable to the expensing of stock based compensation of $1.1 million, related to the adoption of FAS 123R this year, and an increase in store payroll for new stores of $7.0 million and additional depreciation of $2.0 million. We also had increased infrastructure expenses and administrative staff expenses to support our new store growth, as well as increased costs associated with being a public company including Sarbanes-Oxley compliance.

Operating Profit

As a result of the above factors, operating profit increased to $14.4 million in the nine months ended October 28, 2006 compared with $9.5 million in the nine months ended October 29, 2005. As a percentage of net sales, operating profit was 7.7% in the nine months ended October 28, 2006 compared with 7.3% in the nine months ended October 29, 2005.

Provision for Income Taxes

Provision for income taxes was $5.6 million for the nine months ended October 28, 2006 compared with $3.7 million for the nine months ended October 29, 2005. The effective income tax rate was 36.9% in the nine months ended October 28, 2006 versus 37.7% in the nine months ended October 29, 2005. The decrease in the effective income tax rate was primarily attributable to an increase in non-taxable interest income on marketable securities. Our weighted average effective state income tax rate will vary over time depending on a number of factors, such as differing average income tax rates and net incomes in the respective states.

Net Income

Net income increased to $9.6 million in the nine months ended October 28, 2006 from net income of $6.1 million in the nine months ended October 29, 2005, an increase of 57.4%. As a percentage of net sales, net income was 5.1% in the nine months ended October 28, 2006 compared with 4.7% in the nine months ended October 29, 2005.

Liquidity and Capital Resources

Our primary capital requirements are for inventory, store fixtures, store construction and remodeling, capital investments and ongoing infrastructure improvements such as technology enhancements and distribution capabilities. Historically, our main sources of liquidity have been cash flows from operations, borrowings under our revolving credit facility and proceeds from the sale of our equity securities.

The Registration Statement (SEC File No. 333-122865) for our initial public offering was declared effective by the Securities and Exchange Commission on May 5, 2005. We and the selling shareholders sold 3,750,000 shares and 3,437,500 shares of common stock, respectively, in the offering at a public offering price of $9.00 per share (on a split-adjusted basis), for aggregate gross proceeds of approximately $33.8 million and $30.9 million, respectively. In connection with this offering we paid underwriters' commissions of approximately $2.4 million and incurred offering expenses of approximately $1.7 million. After deducting the underwriters' commissions and the offering expenses, we received net proceeds of approximately $29.7 million from the offering. We did not receive any of the proceeds from the sale of the shares offered by the selling shareholders.

The significant components of our working capital are inventory and liquid assets such as cash, marketable securities and receivables, specifically tenant allowances and credit card receivables, reduced by short-term debt, accounts payable and accrued expenses. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day or within several days of the related sale, while we typically have extended payment terms with our vendors.

Our capital requirements include construction and fixture costs related to the opening of new stores and for maintenance and remodeling expenditures for existing stores. Future capital requirements will depend on many factors, including the pace of new store openings, the availability of suitable locations for new stores, and the nature of arrangements negotiated with landlords. In that regard, our net investment to open a new store has varied significantly in the past due to a number of factors, including the geographic location and size of the new store, and is likely to vary significantly in the future. During fiscal 2006, we expect to spend approximately $19.1 million on capital expenditures, a majority of which will relate to leasehold improvements and fixtures for the 42 total new stores we plan to open in fiscal 2006, and a smaller amount will relate to equipment, systems and improvements for our distribution center and support infrastructure. However, there can be no assurance that the number of stores that we actually open in fiscal 2006 will not be different from the number of stores we plan to open, or that actual fiscal 2006 capital expenditures will not differ from this expected amount.

We expect cash flows from operations, available borrowings under our revolving credit facility and the remaining net proceeds from our initial public offering will be sufficient to meet our foreseeable cash requirements for operations and planned capital expenditures for at least the next twelve months. Beyond this time frame, if these sources are not sufficient to meet our capital requirements, then we will be required to obtain additional equity or debt financing in the future. There can be no assurance that equity or debt financing will be available to us when and if we need it or, if available, that the terms will be satisfactory to us and not dilutive to our then-current shareholders.

Net cash provided by operating activities in the nine months ended October 28, 2006 was $3.3 million primarily related to results from operations and an increase in accounts payable, partially offset by an increase in inventory levels. Net cash provided by operating activities was $3.4 million in the nine months ended October 29, 2005 related to operating activities and an increase in operating liabilities, partially offset by an increase in inventory levels and receivables.

Net cash used in investing activities was $10.5 million in the nine months ended October 28, 2006, with $16.4 million used for the Fast Forward acquisition and $14.5 million for capital expenditures offset by the net sale of marketable securities, and net cash used in investing activities was $14.7 million in the nine months ended October 29, 2005, related to capital expenditures for new store openings and existing store renovations and purchases of marketable securities.

Net cash provided by financing activities in the nine months ended October 28, 2006 was $4.6 million, related to the tax benefits received from the exercise of stock options, and $34.3 million in the nine months ended October 29, 2005 related to our initial public offering.

We have a secured revolving credit facility with Wells Fargo HSBC Trade Bank, N.A. The Credit Agreement provides us with a senior revolving credit facility through August 30, 2009 of up to $25.0 million. This facility replaces our $20.0 million secured revolving credit facility with Bank of America, N.A., which terminated effective August 31, 2006. The secured revolving credit facility provides for the issuance of Standby Commercial Letters of Credit in an amount not to exceed $5.0 million outstanding at any time and with a term not to exceed 365 days, although the amount of borrowings available at any time under our revolving credit facility is reduced by the amount of Standby Letters of Credit outstanding at that time. There were no outstanding borrowings under the revolving credit facility at October 28, 2006 or January 28, 2006. We had open letters of credit of $1.4 million at October 28, 2006 and $374,000 at January 28, 2006. The revolving credit facility bears interest at floating rates based on the lower of the prime rate (8.25% at October 28, 2006) minus 0.50% or the LIBOR rate (5.40% at October 28, 2006) plus 1.00% for advances over $500,000 for a minimum of 30 days and a maximum of 180 days. The New Facility also contains financial covenants that require us to meet certain specified financial ratios, including, minimum net income after taxes, maximum leverage, and quick ratio. Our obligations under the revolving credit facility are secured by almost all of our personal property, including, among other things, our inventory, equipment and fixtures. We must also provide financial information and statements to our lender. Our revolving credit facility also contains financial covenants that require us to meet certain specified financial ratios, including a debt to earnings ratio, earnings to interest expense ratio and an inventory to debt ratio. We were in compliance with all covenants at October 28, 2006.

Contractual Obligations and Commercial Commitments

There were no material changes outside the ordinary course of business in our contractual obligations during the quarter ended October 28, 2006. Our operating lease obligations are not recognized as liabilities in the financial statements. The following table summarizes the total amount of future payments due under certain of our contractual obligations at October 28, 2006:

	Total	2006 (last 9 months)	Payments Due In Fiscal Year 2007	2008	2009	2010	2011 and Beyond
	(Dollars in thousands)						
Contractual obligations:							
Non-cancelable operating lease obligations	$ 144,674	$ 4,904	$ 18,900	$ 18,396	$ 18,426	$ 17,757	$ 66,291
Total contractual cash obligations	$ 144,674	$ 4,904	$ 18,900	$ 18,396	$ 18,426	$ 17,757	$ 66,291

We occupy our retail stores and combined home office and distribution center under operating leases generally with terms of seven to ten years. Some of our leases have early cancellation clauses, which permit the lease to be terminated by us if certain sales levels are not met in specific periods. Some leases contain renewal options for periods ranging from one to five years under substantially the same terms and conditions as the original leases. In addition to future minimum lease payments, substantially all of our store leases provide for additional rental payments (or "percentage rent") if sales at the respective stores exceed specified levels, as well as the payment of common area maintenance charges and real estate taxes. Amounts in the above table do not include percentage rent, common area maintenance charges or real estate taxes. Most of our lease agreements have defined escalating rent provisions, which we have straight-lined over the term of the lease, including any lease renewals deemed to be probable. For certain locations, we receive cash tenant allowances and we have reported these amounts as a deferred liability which is amortized to rent expense over the term of the lease, including any lease renewals deemed to be probable. Total rental expenses, including percentage rent, common area maintenance costs and real estate taxes, under operating leases were $21.9 million and $15.4 million for the nine months ended October 28, 2006 and the nine months ended October 29, 2005, respectively, and $13.9 million, $17.1 million and $22.2 million for fiscal 2003, 2004 and 2005, respectively. We amortize our leasehold improvements over the shorter of the useful life of the asset or the lease term.

Off-Balance Sheet Obligations

Our only off-balance sheet contractual obligations and commercial commitments as of October 28, 2006 related to operating lease obligations and letters of credit. We have excluded these items from our balance sheet in accordance with generally accepted accounting principles. We presently do not have any non-cancelable purchase commitments. At October 28, 2006, we had outstanding purchase orders to acquire merchandise from vendors for approximately $55.4 million. These purchases are expected to be financed by cash flows from operations and borrowings under our revolving credit facility. We have an option to cancel these commitments with no notice prior to shipment. At October 28, 2006, we had $1.4 million of letters of credit outstanding under our revolving credit facility.

Impact of Inflation

We do not believe that inflation has had a material impact on our net sales or operating results in the recent past. There can be no assurance that our business will not be affected by inflation in the future.

Risk Factors

You should carefully consider the risks described below and elsewhere in this quarterly report, which could materially and adversely affect our business, results of operations or financial condition. If any of the following risks actually occurs, the market price of our common stock would likely decline.

Our growth strategy depends on our ability to open and operate a significant number of new stores each year, which could strain our resources and cause the performance of our existing stores to suffer.

Our growth largely depends on our ability to open and operate new stores successfully. However, our ability to open new stores is subject to a variety of risks and uncertainties, and we may be unable to open new stores as planned, and any failure to successfully open, integrate and operate new stores would have a material adverse effect on our results of operations and on the market price of our common stock. We intend to continue to open a significant number of new stores in future years while remodeling a portion of our existing store base annually. In addition, our proposed expansion will place increased demands on our operational, managerial and administrative resources. These increased demands could cause us to operate our business less effectively, which in turn could cause deterioration in the financial performance of our individual stores and our overall business. To the extent new stores that we open or acquire are in markets where we already have stores, we may experience reduced net sales in existing stores in those markets. In addition, successful execution of our growth strategy may require that we obtain additional financing, and we cannot assure you that we will be able to obtain that financing on acceptable terms or at all.

If we fail to effectively execute our expansion strategy, we may not be able to successfully open new store locations in a timely manner, if at all, which could have an adverse affect on our net sales and results of operations.

Our ability to open and operate new stores successfully depends on many factors, including, among others, our ability to:

- identify suitable store locations, the availability of which is outside of our control;
- negotiate acceptable lease terms, including desired tenant improvement allowances;
- source sufficient levels of inventory at acceptable costs to meet the needs of new stores;
- hire, train and retain store personnel;
- successfully integrate new stores into our existing operations; and
- identify and satisfy the merchandise preferences of new geographic areas.

In addition, many of our planned new stores are to be opened in regions of the United States in which we currently have few, or no, stores. The expansion into these markets may present competitive, merchandising and distribution challenges that are different from those currently encountered in our existing markets. Any of these challenges could adversely affect our business and results of operations.

Our business is dependent upon our being able to anticipate, identify and respond to changing fashion trends, customer preferences and other fashion-related factors; failure to do so could have a material adverse effect on us.

Customer tastes and fashion trends in the action sports lifestyle market are volatile and tend to change rapidly. Our success depends on our ability to effectively anticipate, identify and respond to changing fashion tastes and consumer preferences, and to translate market trends into appropriate, saleable product offerings in a timely manner. If we are unable to successfully anticipate, identify or respond to changing styles or trends and misjudge the market for our products or any new product lines, our sales may be lower than predicted and we may be faced with a substantial amount of unsold inventory or missed opportunities. In response to such a situation, we may be forced to

rely on markdowns or promotional sales to dispose of excess or slow-moving inventory, which could have a material adverse effect on our results of operations.

Our ability to attract customers to our stores depends heavily on the success of the shopping malls in which our stores are located; any decrease in customer traffic in those malls could cause our sales to be less than expected.

In order to generate customer traffic we depend heavily on locating our stores in prominent locations within successful shopping malls. Sales at these stores are derived, in part, from the volume of traffic in those malls. Our stores benefit from the ability of a mall's other tenants to generate consumer traffic in the vicinity of our stores and the continuing popularity of malls as shopping destinations. Our sales volume and mall traffic generally may be adversely affected by, among other things, economic downturns in a particular area, competition from Internet retailers, non-mall retailers and other malls, increases in gasoline prices and the closing or decline in popularity of other stores in the malls in which we are located. A reduction in mall traffic as a result of these or any other factors could have a material adverse effect on our business, results of operations and financial condition.

Our sales and inventory levels fluctuate on a seasonal basis, leaving our operating results particularly susceptible to changes in back-to-school and holiday shopping patterns.

Our sales are typically disproportionately higher in the third and fourth fiscal quarters of each fiscal year due to increased sales during the back-to-school and winter holiday shopping seasons. Sales during these periods cannot be used as an accurate indicator of annual results. Our sales in the first and second fiscal quarters are typically lower than in our second and third fiscal quarters due, in part, to the traditional retail slowdown immediately following the winter holiday season. Any significant decrease in sales during the back-to-school and winter holiday seasons would have a material adverse effect on our financial condition and results of operations.

In addition, in order to prepare for the back-to-school and winter holiday shopping seasons, we must order and keep in stock significantly more merchandise than we carry during other parts of the year. Any unanticipated decrease in demand for our products during these peak shopping seasons could require us to sell excess inventory at a substantial markdown, which could have a material adverse effect on our business, results of operations and financial condition.

Our quarterly results of operations are volatile and may decline.

Our quarterly results of operations have fluctuated significantly in the past and can be expected to continue to fluctuate significantly in the future. As discussed above, our sales and operating results are typically lower in the first and second quarters of our fiscal year due, in part, to the traditional retail slowdown immediately following the winter holiday season. Our quarterly results of operations are affected by a variety of other factors, including:

- the timing of new store openings and the relative proportion of our new stores to mature stores;
- the successful integration of any new stores that we acquire and the absence of any unanticipated liabilities in connection therewith;
- fashion trends and changes in consumer preferences;
- calendar shifts of holiday or seasonal periods;
- changes in our merchandise mix;
- timing of promotional events;
- general economic conditions and, in particular, the retail sales environment;
- actions by competitors or mall anchor tenants;

- weather conditions;
- the level of pre-opening expenses associated with our new stores; and
- inventory shrinkage beyond our historical average rates.

Failure to successfully integrate any businesses or stores that we acquire could have an adverse impact on our results of operations and financial performance.

We may from time to time acquire other retail stores, individually or in groups, or businesses. In particular, in June 2006 we completed the acquisition of the Fast Forward sporting goods store chain. We may experience difficulties in assimilating any stores or businesses we may acquire, including the Fast Forward operations, and any such acquisitions may also result in the diversion of our capital and our management's attention from other business issues and opportunities. We may not be able to successfully integrate any stores or businesses that we may acquire, including their facilities, personnel, financial systems, distribution, operations and general operating procedures. If we fail to successfully integrate acquisitions or if such acquisitions fail to provide the benefits that we expect to receive, we could experience increased costs and other operating inefficiencies, which could have an adverse effect on our results of operations and financial performance. ***Our business is susceptible to weather conditions that are out of our control, and unseasonable weather could have a negative impact on our results of operations.***

Our business is susceptible to unseasonable weather conditions. For example, extended periods of unseasonably warm temperatures during the winter season or cool weather during the summer season could render a portion of our inventory incompatible with those unseasonable conditions. These prolonged unseasonable weather conditions, particularly in the western United States where we have a concentration of stores, could have a material adverse effect on our business and results of operations.

We may be unable to compete favorably in the highly competitive retail industry, and if we lose customers to our competitors, our sales could decrease. The teenage and young adult retail apparel, hardgoods and accessories industry is highly competitive. We compete with other retailers for vendors, teenage and young adult customers, suitable store locations, qualified store associates and management personnel. In the softgoods markets, which includes apparel, accessories and footwear, we currently compete with other teenage-focused retailers such as Abercrombie & Fitch Co., Aeropostale, Inc., American Eagle Outfitters, Inc., Anchor Blue Clothing Company, Charlotte Russe Inc., Claire's Stores, Inc., Forever 21, Inc., Hollister Co., Hot Topic, Inc., Old Navy, Inc., Pacific Sunwear of California, Inc., The Buckle, Inc., The Wet Seal, Inc. and Urban Outfitters, Inc. In addition, in the softgoods market we compete with independent specialty shops, department stores, and direct marketers that sell similar lines of merchandise and target customers through catalogs and e-commerce. In the hardgoods markets, which includes skateboards, snowboards, bindings, components and other equipment, we compete directly or indirectly with the following categories of companies: other specialty retailers that compete with us across a significant portion of our merchandising categories, such as local snowboard and skate shops; large-format sporting goods stores and chains, such as Big 5 Sporting Goods Corporation, Dick's Sporting Goods, Inc., Sport Chalet, Inc. and The Sports Authority Inc., which operates stores under the brand names Sports Authority, Gart Sports, Oshman's and Sportmart; and Internet retailers. Some of our competitors are larger than we are and have substantially greater financial, marketing and other resources than we do. Direct competition with these and other retailers may increase significantly in the future, which could require us, among other things, to lower our prices and could result in the loss of our customers. Current and increased competition could have a material adverse effect on our business, results of operations and financial condition.

If we fail to maintain good relationships with vendors or if a vendor is otherwise unable or unwilling to supply us with adequate quantities of their products at acceptable prices, our business and financial performance could suffer.

Our business is dependent on continued good relations with our vendors. In particular, we believe that we generally are able to obtain attractive pricing and other terms from vendors because we are perceived as a desirable customer, and deterioration in our relationship with our vendors would likely have a material adverse effect on our business. We do not have any contractual relationships with our vendors and, accordingly, there can be no assurance that our vendors will provide us with an adequate supply or quality of products or acceptable pricing. Our vendors could

discontinue selling to us or raise the prices they charge at any time. There can be no assurance that we will be able to acquire desired merchandise in sufficient quantities on terms acceptable to us in the future. Also, certain of our vendors sell their products directly to the retail market and therefore compete with us directly, and other vendors may decide to do so in the future. There can be no assurance that such vendors will not decide to discontinue supplying their products to us, supply us only less popular or lesser quality items, raise the prices they charge us or focus on selling their products directly. Any inability to acquire suitable merchandise at acceptable prices, or the loss of one or more key vendors, would have a material adverse effect on our business, results of operations and financial condition.

If we lose key management or are unable to attract and retain the talent required for our business, our financial performance could suffer.

Our performance depends largely on the efforts and abilities of our senior management, including our Co-Founder and Chairman, Thomas D. Campion, our President and Chief Executive Officer, Richard M. Brooks, our Chief Financial Officer, Brenda I. Morris, and our General Merchandising Manager, Lynn K. Kilbourne. None of our employees, except Mr. Brooks, has an employment agreement with us and we do not plan to obtain key person life insurance covering any of our employees. If we lose the services of one or more of our key executives, we may not be able to successfully manage our business or achieve our growth objectives. As our business grows, we will need to attract and retain additional qualified management personnel in a timely manner and we may not be able to do so.

Our failure to meet our staffing needs could adversely affect our ability to implement our growth strategy and could have a material impact on our results of operations.

Our success depends in part upon our ability to attract, motivate and retain a sufficient number of qualified employees, including regional managers, district managers, store managers and store associates, who understand and appreciate our corporate culture based on a passion for the action sports lifestyle and are able to adequately represent this culture to our customers. Qualified individuals of the requisite caliber, skills and number needed to fill these positions may be in short supply in some areas, and the employee turnover rate in the retail industry is high. Competition for qualified employees could require us to pay higher wages to attract a sufficient number of suitable employees. If we are unable to hire and retain store managers and store associates capable of consistently providing a high level of customer service, as demonstrated by their enthusiasm for our culture and knowledge of our merchandise, our ability to open new stores may be impaired and the performance of our existing and new stores could be materially adversely affected. We are also dependent upon temporary personnel to adequately staff our stores and distribution center, particularly during busy periods such as the back-to-school and winter holiday seasons. There can be no assurance that we will receive adequate assistance from our temporary personnel, or that there will be sufficient sources of temporary personnel.

Although none of our employees is currently covered by collective bargaining agreements, we cannot guarantee that our employees will not elect to be represented by labor unions in the future, which could increase our labor costs and could subject us to the risk of work stoppages and strikes. Any such failure to meet our staffing needs, any material increases in employee turnover rates, any increases in labor costs or any work stoppages or interruptions or strikes could have a material adverse effect on our business or results of operations.

Our operations, including our sole distribution center, are concentrated in the western United States, which makes us susceptible to adverse conditions in this region.

Our home office and sole distribution center are located in a single facility in Washington, and a substantial number of our stores are located in Washington and the western half of the United States. As a result, our business may be more susceptible to regional factors than the operations of more geographically diversified competitors. These factors include, among others, economic and weather conditions, demographic and population changes and fashion tastes. In addition, we rely on a single distribution center in Everett, Washington to receive, store and distribute merchandise to all of our stores and to fulfill our Internet sales. As a result, a natural disaster or other catastrophic event, such as an earthquake affecting western Washington, in particular, or the West Coast, in general, could significantly disrupt our operations and have a material adverse effect on our business, results of operations and financial condition.

We are required to make substantial rental payments under our operating leases and any failure to make these lease payments when due would likely have a material adverse effect on our business and growth plans.

We do not own any of our retail stores or our combined home office and distribution center, but instead we lease all of these facilities under operating leases. Payments under these operating leases account for a significant portion of our operating expenses. For example, total rental expense, including additional rental payments (or "percentage rent") based on sales of some of the stores, common area maintenance charges and real estate taxes, under operating leases was $21.9 million and $15.4 million for the nine months ended October 28, 2006 and October 29, 2005, respectively, and $13.9 million, $17.1 million and $22.2 million for fiscal 2003, 2004 and 2005, respectively, and, as of October 28, 2006, we were a party to operating leases requiring future minimum lease payments aggregating approximately $78.4 million through fiscal year 2010 and approximately $66.3 million thereafter. In addition, substantially all of our store leases provide for additional rental payments based on sales of the respective stores, as well as common area maintenance charges, and require that we pay real estate taxes, none of which is included in the amount of future minimum lease payments. We expect that any new stores we open will also be leased by us under operating leases, which will further increase our operating lease expenses.

Our substantial operating lease obligations could have significant negative consequences, including:

- increasing our vulnerability to general adverse economic and industry conditions;

- limiting our ability to obtain additional financing;
- requiring that a substantial portion of our available cash be applied to pay our rental obligations, thus reducing cash available for other purposes;
- limiting our flexibility in planning for or reacting to changes in our business or in the industry in which we compete; and
- placing us at a disadvantage with respect to some of our competitors.

We depend on cash flow from operations to pay our lease expenses and to fulfill our other cash needs. If our business does not generate sufficient cash flow from operating activities, and sufficient funds are not otherwise available to us from the remaining proceeds of our initial public offering, borrowings under bank loans or from other sources, we may not be able to service our operating lease expenses, grow our business, respond to competitive challenges or to fund our other liquidity and capital needs, which would have a material adverse effect on us.

The terms of our revolving credit facility impose operating and financial restrictions on us that may impair our ability to respond to changing business and economic conditions. This impairment could have a significant adverse impact on our business.

At the end of the quarter ended October 28, 2006 we have a $25 million revolving credit with Wells Fargo HSBC Trade Bank, N.A., which we use for inventory financing and other general corporate purposes, that contains a number of significant restrictions and covenants that generally limit our ability to, among other things, (1) incur additional indebtedness or certain lease obligations outside the ordinary course of business; (2) enter into sale/leaseback transactions; (3) make certain changes in our management; and (4) undergo a change in ownership. In addition, our obligations under the revolving credit facility are secured by almost all of our personal property, including, among other things, our inventory, equipment and fixtures. Our revolving credit facility also contains financial covenants that require us to meet certain specified financial ratios, including a debt to earnings ratio, an earnings to interest expense ratio and an inventory to debt ratio. Our ability to comply with these ratios may be affected by events beyond our control.

A breach of any of these restrictive covenants or our inability to comply with the required financial ratios could result in a default under the revolving credit facility. If a default occurs, the lender may elect to declare all borrowings outstanding, together with accrued interest and other fees, to be immediately due and payable. If we are unable to repay outstanding borrowings when due, whether at their maturity or if declared due and payable by the

lender following a default, the lender has the right to proceed against the collateral granted to it to secure the indebtedness. As a result, any breach of these covenants or failure to comply with these ratios could have a material adverse effect on us. There can be no assurance that we will not breach the covenants or fail to comply with the ratios in our revolving credit facility or any other debt agreements we may enter into in the future and, if a breach occurs, there can be no assurance that we will be able to obtain necessary waivers or amendments from the lenders.

The restrictions contained in our revolving credit facility could: (1) limit our ability to plan for or react to market conditions or meet capital needs or otherwise restrict our activities or business plans; and (2) adversely affect our ability to finance our operations, strategic acquisitions, investments or other capital needs or to engage in other business activities that would be in our interest.

Our business could suffer as a result of United Parcel Service being unable to distribute our merchandise.

We rely upon United Parcel Service for our product shipments, including shipments to, from and between our stores. Accordingly, we are subject to risks, including employee strikes and inclement weather, which may affect United Parcel Service's ability to meet our shipping needs. Among other things, any circumstances that require us to use other delivery services for all or a portion of our shipments could result in increased costs and delayed deliveries and could harm our business materially. In addition, although we have a contract with United Parcel Service that expires in June 2008, United Parcel Service has the right to terminate the contract upon 30 days written notice. Although the contract with United Parcel Service provides certain discounts from the shipment rates in effect at the time of shipment, the contract does not limit United Parcel Services' ability to raise the shipment rates at any time. Accordingly, we are subject to the risk that United Parcel Service may increase the rates they charge, that United Parcel Service may terminate their contract with us, that United Parcel Service may decrease the rate discounts provided to us when an existing contract is renewed or that we may be unable to agree on the terms of a new contract with United Parcel Service, any of which could materially adversely affect our operating results.

Our business could suffer if a manufacturer fails to use acceptable labor practices.

We do not control our vendors or the manufacturers that produce the products we buy from them, nor do we control the labor practices of our vendors and these manufacturers. The violation of labor or other laws by any of our vendors or these manufacturers, or the divergence of the labor practices followed by any of our vendors or these manufacturers from those generally accepted as ethical in the United States, could interrupt, or otherwise disrupt, the shipment of finished products to us or damage our reputation. Any of these, in turn, could have a material adverse effect on our financial condition and results of operations. In that regard, most of the products sold in our stores are manufactured overseas, primarily in Asia and Central America, which may increase the risk that the labor practices followed by the manufacturers of these products may differ from those considered acceptable in the United States.

Our failure to adequately anticipate a correct mix of private label merchandise may have a material adverse effect on our business.

Sales from private label merchandise accounted for 12.9% of our net sales in fiscal 2005. We may take steps to increase the percentage of net sales of private label merchandise in the future, although there can be no assurance that we will be able to achieve increases in private label merchandise sales as a percentage of net sales. Because our private label merchandise generally carries higher gross margins than other merchandise, our failure to anticipate, identify and react in a timely manner to fashion trends with our private label merchandise, particularly if the percentage of net sales derived from private label merchandise increases, may have a material adverse effect on our comparable store sales, financial condition and results of operations.

Most of our merchandise is produced by foreign manufacturers; therefore the availability and costs of these products may be negatively affected by risks associated with international trade and other international conditions.

Most of our merchandise is produced by manufacturers in Asia and Central America. Some of these facilities are also located in regions that may be affected by natural disasters, political instability or other conditions that could cause a disruption in trade. Trade restrictions such as increased tariffs or quotas, or both, could also affect the

importation of merchandise generally and increase the cost and reduce the supply of merchandise available to us. Any reduction in merchandise available to us or any increase in its cost due to tariffs, quotas or local issues that disrupt trade could have a material adverse effect on our results of operations. Although the prices charged by vendors for the merchandise we purchase are all denominated in United States dollars, a continued decline in the relative value of the United States dollar to foreign currencies could lead to increased merchandise costs, which could negatively affect our competitive position and our results of operation.

If our information systems hardware or software fails to function effectively or does not scale to keep pace with our planned growth, our operations could be disrupted and our financial results could be harmed.

Over the past several years, we have made improvements to our existing hardware and software systems, as well as implemented new systems. If these or any other information systems and software do not work effectively, this could adversely impact the promptness and accuracy of our transaction processing, financial accounting and reporting and our ability to manage our business and properly forecast operating results and cash requirements. To manage the anticipated growth of our operations and personnel, we may need to continue to improve our operational and financial systems, transaction processing, procedures and controls, and in doing so could incur substantial additional expenses which could harm our financial results. In addition, as discussed below, we will be required to improve our financial and managerial controls, reporting systems and procedures to comply with Section 404 of the Sarbanes-Oxley Act of 2002.

Our inability or failure to protect our intellectual property or our infringement of other's intellectual property could have a negative impact on our operating results.

We believe that our trademarks and domain names are valuable assets that are critical to our success. The unauthorized use or other misappropriation of our trademarks or domain names could diminish the value of the Zumiez brand, our store concept, our private label brands or our goodwill and cause a decline in our net sales. At this time, we have not secured protection for our trademarks in any jurisdiction outside of the United States, and thus we cannot prevent other persons from using our trademarks outside of the United States, which also could materially adversely affect our business. We are also subject to the risk that we may infringe on the intellectual property rights of third parties. Any infringement or other intellectual property claim made against us, whether or not it has merit, could be time-consuming, result in costly litigation, cause product delays or require us to pay royalties or license fees. As a result, any such claim could have a material adverse effect on our operating results.

The effects of war or acts of terrorism could adversely affect our business.

Substantially all of our stores are located in shopping malls. Any threat of terrorist attacks or actual terrorist events, particularly in public areas, could lead to lower customer traffic in shopping malls. In addition, local authorities or mall management could close shopping malls in response to security concerns. Mall closures, as well as lower customer traffic due to security concerns, would likely result in decreased sales. Additionally, the escalation of the armed conflicts in the Middle East, or the threat, escalation or commencement of war or other armed conflict elsewhere, could significantly diminish consumer spending, and result in decreased sales for us. Decreased sales would have a material adverse effect on our business, financial condition and results of operations.

The outcome of litigation could have a material adverse effect on our business.

We are involved, from time to time, in litigation incidental to our business. Management believes, after considering a number of factors and the nature of the legal proceedings to which we are subject, that the outcome of current litigation is not expected to have a material adverse effect upon our results of operations or financial condition. However, management's assessment of our current litigation could change in light of the discovery of facts not presently known to us or determinations by judges, juries or other finders of fact that are not in accord with management's evaluation of the possible liability or outcome of such litigation. As a result, there can be no assurance that the actual outcome of pending or future litigation will not have a material adverse effect on our results of operations or financial condition.

Our Internet operations subject us to numerous risks that could have an adverse effect on our results of operations.

Although Internet sales constitute a small portion of our overall sales, our Internet operations subject us to certain risks that could have an adverse effect on our operational results, including:

- diversion of traffic and sales from our stores;
- liability for online content; and
- risks related to the computer systems that operate our website and related support systems, including computer viruses and electronic break-ins and similar disruptions.

In addition, risks beyond our control, such as governmental regulation of the Internet, entry of our vendors in the Internet business in competition with us, online security breaches and general economic conditions specific to the Internet and online commerce could have an adverse effect on our results of operations.

We have incurred and will continue to incur significant expenses as a result of being a public company, which will negatively impact our financial performance.

We completed our initial public offering in May 2005 and we have incurred and will continue to incur significant legal, accounting, insurance and other expenses as a result of being a public company. The Sarbanes-Oxley Act of 2002, as well as related rules implemented by the SEC and The Nasdaq Stock Market, have required changes in corporate governance practices of public companies. We expect that compliance with these laws, rules and regulations, including compliance with Section 404 of the Sarbanes-Oxley Act as discussed in the following risk factor, will substantially increase our expenses, including our legal and accounting costs, and make some activities more time-consuming and costly. We also expect these laws, rules and regulations to make it more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors or as officers. As a result of the foregoing, we expect a substantial increase in legal, accounting, insurance and certain other expenses in the future, which will negatively impact our financial performance and could have a material adverse effect on our results of operations and financial condition.

Failure to maintain adequate financial and management processes and controls could lead to errors in our financial reporting and could harm our ability to manage our expenses.

Reporting obligations as a public company and our anticipated growth are likely to place a considerable strain on our financial and management systems, processes and controls, as well as on our personnel. In addition, as a public company we will be required to document and test our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 so that our management can certify as to the effectiveness of our internal controls and our independent registered public accounting firm can render an opinion on management’s assessment and on the effectiveness of our internal control over financial reporting by the time our annual report for fiscal 2006 is due and thereafter, which will require us to document and make significant changes to our internal controls over financial reporting. As a result, we may be required to improve our financial and managerial controls, reporting systems and procedures, to incur substantial expenses to test our systems and to make such improvements and to hire additional personnel. If our management is unable to certify the effectiveness of our internal controls or if our independent registered public accounting firm cannot render an opinion on management’s assessment and on the effectiveness of our internal control over financial reporting, or if material weaknesses in our internal controls are identified, we could be subject to regulatory scrutiny and a loss of public confidence, which could have a material adverse effect on our business and our stock price. In addition, if we do not maintain adequate financial and management personnel, processes and controls, we may not be able to accurately report our financial performance on a timely basis, which could cause a decline in our stock price and adversely affect our ability to raise capital.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

During different times of the year, due to the seasonality of our business, we may borrow under our revolving credit facility. To the extent we borrow under our revolving credit facility, which bears interests at floating rates based either on the prime rate or LIBOR, we are exposed to market risk related to changes in interest rates. At October 28, 2006, we had no borrowings outstanding under our credit facility. We are not a party to any derivative financial instruments.

Item 4: Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)). Based on this evaluation, our CEO and CFO concluded that, as of October 28, 2006, our disclosure controls and procedures were effective.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity’s disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors or mistakes or intentional circumvention of the established process.

Changes in Internal Control Over Financial Reporting. There has been no change in our internal control over financial reporting (as defined in Securities Exchange Act Rule 13a-15(f)) during the quarter ended October 28, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved from time to time in litigation incidental to our business. We believe that the outcome of current litigation will not have a material adverse effect on our results of operations or financial condition.

See Note 4 to the Notes to Consolidated Financial Statements found in Item 1 of this Form 10-Q (listed under “Litigation” under Commitments and Contingencies).

Item 2. Changes in Securities; Use of Proceeds and Issuer Purchases of Equity Securities

None.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibits

Exhibit No.	Description of Exhibits
10.14	Credit Agreement with Wells Fargo HSBC Trade Bank, N.A. dated September 1, 2006.
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

ZUMIEZ INC.

By: /s/ BRENDA I. MORRIS
Brenda I. Morris
Chief Financial Officer

Dated: December 08, 2006

CREDIT AGREEMENT

by and between

ZUMIEZ INC., a Washington corporation

and

WELLS FARGO HSBC TRADE BANK, NATIONAL ASSOCIATION

Dated as of

September 1, 2006

Exhibit A – Addendum to Credit Agreement
Exhibit B – Revolving Credit Facility Supplement
Exhibit C – Collateral/Credit Support Document

WELLS FARGO HSBC TRADE BANK **CREDIT AGREEMENT**

ZUMIEZ INC., a Washington corporation ("Borrower"), organized under the laws of the State of Washington whose chief executive office is located at the address specified after its signature to this Agreement ("Borrower's Address") and **WELLS FARGO HSBC TRADE BANK, NATIONAL ASSOCIATION** ("Trade Bank"), whose address is specified after its signature to this Agreement, have entered into this **CREDIT AGREEMENT** as of September 1, 2006 ("Effective Date"). All references to this "Agreement" include those covenants included in the Addendum to Agreement ("Addendum") attached as Exhibit A hereto.

I. CREDIT FACILITY

1.1 **The Facility**. Subject to the terms and conditions of this Agreement, Trade Bank will make available to Borrower a Revolving Credit Facility ("Facility") for which a Facility Supplement ("Supplement") is attached as Exhibit B hereto. Additional terms for the Facility (and each subfacility thereof ("Subfacility")) are set forth in the Supplement. The Facility will be available from the Closing Date up to and until August 30, 2009 ("Facility Termination Date"). Collateral and credit support required for the Facility is set forth in Exhibit C hereto. Definitions for those capitalized terms not otherwise defined are contained in Article 8 below.

1.2 **Credit Extension Limit**. The aggregate outstanding amount of all Credit Extensions may at no time exceed Twenty-Five Million Dollars ($25,000,000) ("Overall Credit Limit"). The aggregate outstanding amount of all Credit Extensions outstanding at any time under Revolving Credit Facility may not exceed that amount specified as the "Credit Limit" in the Supplement for the Facility, and the aggregate outstanding amount of all Credit Extensions outstanding at any time under each Subfacility (or any subcategory thereof) may not exceed that amount specified as the "Credit Sublimit" in the Supplement for the Facility. An amount equal to 100% of each unfunded Credit Extension shall be used in calculating the outstanding amount of Credit Extensions under this Agreement.

The Subfacility(s) of the Revolving Credit Facility are as follows:

(a) Sight Commercial Letters of Credit
(b) Standby Letters of Credit

1.3 **Overadvance**. All Credit Extensions made hereunder shall be added to and deemed part of the Obligations when made. If, at any time and for any reason, the aggregate outstanding amount of all Credit Extensions made pursuant to this Agreement exceeds the dollar limitation in Section 1.2, then Borrower shall immediately pay to Trade Bank on demand, in cash, the amount of such excess.

1.4 **Repayment; Interest and Fees**. Each funded Credit Extension shall be repaid by Borrower, and shall bear interest from the date of disbursement at those per annum rates and such interest shall be paid, at the times specified in the Supplement, Note or Facility Document. Borrower agrees to pay to Trade Bank with respect to (a) the Revolving Credit Facility, interest at a per annum rate equal to (i) the Prime Rate minus .50% as specified in the Note, or (ii) Wells Fargo's LIBOR Rate plus 1.00% as specified in the Note, and (b) the Subfacilities, the fees specified in the Supplement as well as those fees specified in the relevant Facility Document(s). Interest and fees will be calculated on the basis of a 360 day year, actual days elapsed. Any overdue payments of principal (and interest to the extent permitted by law) shall bear interest at a per annum floating rate equal to the Prime Rate plus 5%.

1.5 **Prepayments**. Credit Extensions under any Facility may only be prepaid in accordance with the terms of the Supplement. At the time of any prepayment (including, but not limited to, any prepayment which is a result of the occurrence of an Event of Default and an acceleration of the Obligations) Borrower will pay to Trade Bank all interest accrued on the amount so prepaid to the date of such prepayment and all costs, expenses and fees specified in the Loan Documents.

II. REPRESENTATIONS AND WARRANTIES

Borrower represents and warrants to Trade Bank that the following representations and warranties are true and correct:

2.1 **Legal Status**. Borrower is duly organized and existing and in good standing under the laws of the jurisdiction indicated in this Agreement, and is qualified or licensed to do business in all jurisdictions in which such qualification or licensing is required and in which the failure to so qualify or to be so licensed could have a material adverse affect on Borrower.

2.2 **Authorization and Validity**. The execution, delivery and performance of this Agreement, and all other Loan Documents to which Borrower is a party, have been duly and validly authorized, executed and delivered by Borrower and constitute legal, valid and binding agreements of Borrower, and are enforceable against Borrower in accordance with their respective terms.

2.3 **Borrower's Name**. The name of Borrower set forth at the end of this Agreement is its correct name. If Borrower is conducting business under a fictitious business name, Borrower is in compliance with all laws relating to the conduct of such business under such name.

2.4 **Financial Condition and Statements**. All financial statements of Borrower delivered to Trade Bank have been prepared in conformity with GAAP, and completely and accurately reflect the financial condition of Borrower (and any consolidated Subsidiaries) at the times and for the periods stated in such financial statements. Neither Borrower nor any Subsidiary has any material contingent liability not reflected in the aforesaid financial statement. Since the date of the financial statements delivered to Trade Bank for the last fiscal period of Borrower to end before the Effective Date, there has been no material adverse change in the financial condition, business or prospects of Borrower. Borrower is solvent.

2.5 **Litigation**. Except as disclosed in writing to Trade Bank prior to the Effective Date, there is no action, claim, suit, litigation, proceeding or investigation pending or (to best of Borrower's knowledge) threatened by or against or affecting Borrower or any Subsidiary in any court or before any governmental authority, administrator or agency which may result in (a) any material adverse change in the financial condition or business of Borrower's, or (b) any material impairment of the ability of Borrower to carry on its business in substantially the same manner as it is now being conducted.

2.6 **No Violation**. The execution, delivery, and performance by Borrower of each of the Loan Documents do not violate any provision of any law or regulation, or contravene any provision of the Articles of Incorporation or By-Laws of Borrower, or result in a breach of or constitute a default under any contract, obligation, indenture, or other instrument to which Borrower is a party or by which Borrower may be bound.

2.7 **Income Tax Returns**. Borrower has no knowledge of any pending assessments or adjustments of its income tax payable with respect to any year.

2.8 **No Subordination**. There is no agreement, indenture, contract, or instrument to which Borrower is a party or by which Borrower may be bound that requires the subordination in right of payment of any of Borrower's obligations subject to this Agreement to any other obligation of Borrower.

2.9 **ERISA**. Borrower is in compliance in all material respects with all applicable provisions of the Employee Retirement Income Security Act of 1974, as amended or recodified from time to time ("ERISA"); Borrower has not violated any provision of any defined employee pension benefit plan (as defined in ERISA) maintained or contributed to by Borrower (each, a "Plan"); no Reportable Event, as defined in ERISA, has occurred and is continuing with respect to any Plan initiated by Borrower; Borrower has met its minimum funding requirements under ERISA with respect to each Plan; and each Plan will be able to fulfill its benefit obligations as they come due in accordance with the Plan documents and under GAAP.

2.10 **Other Obligations**. Except as disclosed in writing to Trade Bank prior to the Effective Date, neither Borrower nor any Subsidiary are in default of any obligation for borrowed money, any purchase money obligation or any material lease, commitment, contract, instrument or obligation.

2.11 **No Defaults**. No Event of Default, and event which with the giving of notice or the passage of time or both would constitute an Event of Default, has occurred and is continuing.

2.12 **Information Provided to Trade Bank**. The information provided to the Trade Bank concerning Borrower's business is true and correct.

2.13 **Environmental Matters**. Except as disclosed by Borrower to Trade Bank in writing prior to the Effective Date, Borrower (as well as any Subsidiary) is each in compliance in all material respects with all applicable Federal or state environmental, hazardous waste, health and safety statutes, and any rules or regulations adopted pursuant thereto, which govern or affect any Borrower's or any Subsidiary's operations and/or properties, including without limitation, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, the Superfund Amendments and Reauthorization Act of 1986, the Federal Resource Conservation and Recovery Act of 1976, the Federal Toxic Substances Control Act and the California Health and Safety Code, as any of the same may be amended, modified or supplemented from time to time. None of the operations of Borrower or of any Subsidiary is the subject of any Federal or state investigation evaluating whether any remedial action involving a material expenditure is needed to respond to a release of any toxic or hazardous waste or substance into the environment.

III. CONDITIONS TO EXTENDING FACILITIES

3.1 **Conditions to Initial Credit Extension**. The obligation of Trade Bank to make the first Credit Extension is subject to the fulfillment to Trade Bank's satisfaction of the following conditions:

(a) **Approval of Trade Bank Counsel**. All legal matters relating to making the Facility available to Borrower must be satisfactory to counsel for Trade Bank.

(b) **Documentation**. Trade Bank must have received, in form and substance satisfactory to Trade Bank, the following documents and instruments duly executed and in full force and effect:

(1) a corporate borrowing resolution and incumbency certificate if Borrower is a corporation, a partnership or joint venture borrowing certificate if Borrower is a partnership or joint venture, and a limited liability company borrowing certificate if Borrower is a limited liability company;

(2) the Facility Documents for the Facility, including, but not limited to, note(s) ("Notes") for the Revolving Credit Facility, Trade Bank's standard Commercial Letter of Credit Agreement or Standby Letter of Credit Agreement for any letter of credit Facility;

(3) those guarantees, security agreements, deeds of trust, subordination agreements, intercreditor agreements, factoring agreements, tax service contracts, and other Collateral Documents required by Trade Bank to evidence the collateral/credit support specified in the Supplement;

(4) if an audit or inspection of any books, records or property is specified in the Supplement for the Facility, an audit or inspection report from Wells Fargo or another auditor or inspector acceptable to Trade Bank reflecting values and property conditions satisfactory to Trade Bank; and

(5) if insurance is required in the Addendum, the insurance policies specified in the Addendum (or other satisfactory proof thereof) from insurers acceptable to Trade Bank.

3.2 **Conditions to Making Each Credit Extension**. The obligation of Trade Bank to make each Credit Extension is subject to the fulfillment to Trade Bank's satisfaction of the following conditions:

(a) **Representations and Warranties**. The representations and warranties contained in this Agreement, the Facility Documents and the Collateral Documents will be true and correct on and

as of the date of the Credit Extension with the same effect as though such representations and warranties had been made on and as of such date;

(b) **Documentation**. Trade Bank must have received, in form and substance satisfactory to Trade Bank, the following documents and instruments duly executed and in full force and effect:

(1) if the Credit Extension is the issuance of a Commercial Letter of Credit, Trade Bank's standard Application For Commercial Letter of Credit or standard Application and Agreement For Commercial Letter of Credit;

(2) if the Credit Extension is the issuance of a Standby Letter of Credit, Trade Bank's standard Application For Standby Letter of Credit or standard Application and Agreement For Standby Letter of Credit;

(3) if a Borrowing Base Certificate is required for the Credit Extension, a Borrowing Base Certificate demonstrating compliance with the requirements for such Credit Extension.

(c) **Fees**. Trade Bank must have received any fees required by the Loan Documents to be paid at the time such Credit Extension is made.

IV. AFFIRMATIVE COVENANTS

Borrower covenants that so long as Trade Bank remains committed to make Credit Extensions to Borrower, and until payment of all Obligations and Credit Extensions, Borrower will comply with each of the following covenants: (For purposes of this Article IV, and Article V below, reference to "Borrower" may also extend to Borrower's subsidiaries, if so specified in the Addendum.)

4.1 **Punctual Payments**. Punctually pay all principal, interest, fees and other Obligations due under this Agreement or under any Loan Document at the time and place and in the manner specified herein or therein.

4.2 **Notification to Trade Bank**. Promptly, but in no event more than 5 calendar days after the occurrence of each such event, provide written notice in reasonable detail of each of the following:

(a) **Occurrence of a Default**. The occurrence of any Event of Default or any event which with the giving of notice or the passage of time or both would constitute an Event of Default;

(b) **Borrower's Trade Names; Place of Business**. Any change of Borrower's (or any Subsidiary's) name, trade name or place of business, or chief executive officer;

(c) **Litigation**. Any action, claim, proceeding, litigation or investigation threatened or instituted by or against or affecting Borrower (or any Subsidiary) in any court or before any government authority, administrator or agency which may materially and adversely affect Borrower's (or any Subsidiary's) financial condition or business or Borrower's ability to carry on its business in substantially the same manner as it is now being conducted;

(d) **Uninsured or Partially Uninsured Loss**. Any uninsured or partially uninsured loss through liability or property damage or through fire, theft or any other cause affecting Borrower's (or any Subsidiary's) property in excess of the aggregate amount required hereunder;

(e) **Reports Made to Insurance Companies**. Copies of all material reports made to insurance companies; and

(f) **ERISA**. The occurrence and nature of any Reportable Event or Prohibited Transaction, each as defined in ERISA, or any funding deficiency with respect to any Plan.

4.3 **Books and Records**. Maintain at Borrower's address books and records in accordance with GAAP, and permit any representative of Trade Bank, at any reasonable time, to inspect, audit and examine such books and records, to make copies of them, and to inspect the properties of Borrower.

4.4 **Tax Returns and Payments**. Timely file all tax returns and reports required by foreign, federal, state and local law, and timely pay all foreign, federal, state and local taxes, assessments, deposits and contributions owed by Borrower. Borrower may, however, defer payment of any contested taxes, provided that Borrower (i) in good faith contests Borrower's obligation to pay the taxes by appropriate proceedings promptly instituted and diligently conducted, (ii) notifies Trade Bank in writing of the commencement of, and any material development in, the proceedings, (iii) posts bonds or takes any other steps required to keep the contested taxes from becoming a lien upon any of the Collateral, and (iv) makes provision, to Trade Bank's satisfaction, for eventual payment of such taxes in the event Borrower is obligated to make such payment.

4.5 **Compliance with Laws**. Comply in all material respects with the provisions of all foreign, federal, state and local laws and regulations relating to Borrower, including, but not limited to, those relating to Borrower's ownership of real or personal property, the conduct and licensing of Borrower's business, and health and environmental matters.

4.6 **Taxes and Other Liabilities**. Pay and discharge when due any and all indebtedness, obligations, assessments and taxes, both real and personal, including without limitation federal and state income taxes and state and local property taxes and assessments, except (a) such as Borrower may in good faith contest or as to which a bona fide dispute may arise, and (b) for which Borrower has made provision, to Trade Bank's satisfaction, for eventual payment thereof in the event that Borrower is obligated to make such payment.

4.7 **Insurance**. Maintain and keep in force insurance of the types and in amounts customarily carried in lines of business similar to that of Borrower, including, but not limited to, fire, extended coverage, public liability, flood, property damage and workers' compensation, with all such insurance to be in amounts satisfactory to Trade Bank and to be carried with companies approved by Trade Bank before such companies are retained, and deliver to Trade Bank from time to time at Trade Bank's request schedules setting forth all insurance then in effect. All insurance policies shall name Trade Bank as an additional loss payee, and shall contain a lenders loss payee endorsement in form reasonably acceptable to Trade Bank. (Upon receipt of the proceeds of any such insurance, Trade Bank shall apply such proceeds in reduction of the outstanding funded Credit Extensions and shall hold any remaining proceeds as collateral for the outstanding unfunded Credit Extensions, as Trade Bank shall determine in its sole discretion, except that, provided no Event of Default has occurred, Trade Bank shall release to Borrower insurance proceeds with respect to equipment totaling less than $100,000, which shall be utilized by Borrower for the replacement of the equipment with respect to which the insurance proceeds were paid, if Trade Bank receives reasonable assurance that the insurance proceeds so released will be so used.) If Borrower fails to provide or pay for any insurance, Trade Bank may, but is not obligated to, obtain the insurance at Borrower's expense.

4.8 **Further Assurances**. At Trade Bank's request and in form and substance satisfactory to Trade Bank, execute all documents and take all such actions at Borrower's expense as Trade Bank may deem reasonably necessary or useful to perfect and maintain Trade Bank's perfected security interest in the Collateral and in order to fully consummate all of the transactions contemplated by the Loan Documents.

V. NEGATIVE COVENANTS

Borrower covenants that so long as Trade Bank remains committed to make any Credit Extensions to Borrower and until all Obligations and Credit Extensions have been paid, Borrower will not:

5.1 **Merge or Consolidation, Transfer of Assets**. Merge into or consolidate with any other entity; make any substantial change in the nature of Borrower's business as conducted as of the date hereof; acquire all or substantially all of the assets of any other entity; nor sell, lease, transfer or otherwise dispose of all or a substantial or material portion of Borrower's assets except in the ordinary course of its business.

5.2 **Use of Proceeds**. Borrower will not use the proceeds of any Credit Extension except for the purposes, if any, specified for such Credit Extension in the Supplement covering the Facility under which such Credit Extension is made.

5.3 **Liens**. Mortgage, pledge, grant or permit to exist a security interest in, or lien upon, all or any portion of Borrower's assets now owned or hereafter acquired, except any of the foregoing in favor of Trade Bank or which is existing as of, and disclosed to Trade Bank in writing prior to, the date hereof.

5.4 **Acquisitions of Assets**. Borrower will not acquire any assets or enter into any other transaction outside the ordinary course of Borrower's business.

5.5 **Loans and Investments**. Borrower will not make any loans or advances to, or investments in, any person or entity except for accounts receivable created in the ordinary course of Borrower's business.

5.6 **Indebtedness For Borrowed Money**. Borrower will not incur any indebtedness for borrowed money, except to Trade Bank and except for indebtedness subordinated to the Obligations by an instrument or agreement in form acceptable to Trade Bank.

5.7 **Guarantees**. Borrower will not guarantee or otherwise become liable with respect to the obligations of any other person or entity, except for endorsement of instruments for deposit into Borrower's account in the ordinary course of Borrower's business.

VI. EVENTS OF DEFAULT AND REMEDIES

6.1 **Events of Default**. The occurrence of any of the following shall constitute an "Event of Default":

(a) **Failure to Make Payments When Due**. Borrower's failure to pay principal, interest, fees or other amounts when due under any Loan Document.

(b) **Failure to Perform Obligations**. Any failure by Borrower to comply with any covenant or obligation in this Agreement or in any Loan Document (other than those referred to in subsection (a)above), and such default shall continue for a period of twenty calendar days from the earlier of (i) Borrower's failure to notify Trade Bank of such Event of Default pursuant to Section 4.2(a) above, or (ii) Trade Bank's notice to Borrower of such Event of Default.

(c) **Untrue or Misleading Warranty or Statement**. Any warranty, representation, financial statement, report or certificate made or delivered by Borrower under any Loan Document is untrue or misleading in any material respect when made or delivered.

(d) **Defaults Under Other Loan Documents**. Any "Event of Default" occurs under any other Loan Document; any Guaranty is no longer in full force and effect (or any claim thereof made by Guarantor) or any failure of a Guarantor to comply with the provisions thereof; or any breach of the provisions of any Subordination Agreement or Intercreditor Agreement by any party other than the Trade Bank.

(e) **Defaults Under Other Agreements or Instruments**. Any default in the payment or performance of any obligation, or the occurrence of any event of default, under the terms of any other agreement or instrument pursuant to which Borrower, any Subsidiary or any Guarantor or general partner of Borrower has incurred any debt or other material liability to any person or entity.

(f) **Concealing or Transferring Property**. Borrower conceals, removes or transfers any part of its property with intent to hinder, delay or defraud its creditors, or makes or suffers any transfer of any of its property which may be fraudulent under any bankruptcy, fraudulent conveyance or similar law.

(g) **Judgments and Levies Against Borrower**. The filing of a notice of judgment lien against Borrower, or the recording of any abstract of judgment against Borrower, in any county in which Borrower has an interest in real property, or the service of a notice of levy and/or of a writ of attachment or execution, or other like process, against the assets of Borrower, or the entry of a judgment against Borrower.

(h) **Event or Condition Impairing Payment or Performance**. Any event occurs or condition arises which Trade Bank in good faith believes impairs or is substantially likely to impair the prospect of payment or performance by Borrower of the Obligations, including, but not limited to any material adverse change in Borrower's financial condition, business or prospects.

(i) **Voluntary Insolvency**. Borrower, any Subsidiary or any Guarantor (i) becomes insolvent, (ii) suffers or consents to or applies for the appointment of a receiver, trustee, custodian or liquidator of itself or any of its property, (iii) generally fails to pay its debts as they become due, (iv) makes a general assignment for the benefit of creditors, or (v) files a voluntary petition in bankruptcy, or seeks reorganization, in order to effect a plan or other arrangement with creditors or any other relief under the Bankruptcy Reform Act, Title 11 of the United States Code, as amended or recodified from time to time ("Bankruptcy Code"), or under any state or Federal law granting relief to debtors, whether now or hereafter in effect.

(j) **Involuntary Insolvency**. Any involuntary petition or proceeding pursuant to the Bankruptcy Code or any other applicable state or federal law relating to bankruptcy, reorganization or other relief for debtors is filed or commenced against Borrower, any Subsidiary or Guarantor, or an order for relief is entered against it by any court of competent jurisdiction under the Bankruptcy Code or any other applicable state or federal law relating to bankruptcy, reorganization or other relief for debtors.

(k) **Change in Ownership**. Any change in the ownership of Borrower, any general partner of Borrower or any Guarantor which the Trade Bank determines, in its sole discretion, may adversely affect the creditworthiness of Borrower or credit support for the Obligations.

6.2 **Remedies**. Upon the occurrence of any Event of Default, or at any time thereafter, Trade Bank, at its option, and without notice or demand of any kind (all of which are hereby expressly waived by Borrower), may do any one or more of the following: (a) terminate Trade Bank's obligation to make Credit Extensions or to make available to Borrower the Facility or other financial accommodations; (b) accelerate and declare all or any part of the Obligations to be immediately due, payable, and performable, notwithstanding any deferred or installment payments allowed by any instrument evidencing or relating to any Credit Extension; and/or (c) exercise all its rights, powers and remedies available under the Loan Documents, or accorded by law, including, but not limited to, the right to resort to any or all Collateral or other security for any of the Obligations and to exercise any or all of the rights of a beneficiary or secured party pursuant to applicable law. Notwithstanding the provisions in the foregoing sentence, if any Event of Default set out in subsections (i) and (j) of Section 6.1 above shall occur, then all the remedies specified in the preceding sentence shall automatically take effect without notice or demand of any kind (all of which are hereby expressly waived by Borrower) with respect to any and all Obligations. All rights, powers and remedies of Trade Bank may be exercised at any time by Trade Bank and from time to time after the occurrence of an Event of Default, are cumulative and not exclusive, and shall be in addition to any other rights, powers or remedies provided by law or equity.

VII. GENERAL PROVISIONS

7.1 **Notices**. All notices to be given under this Agreement shall be in writing and shall be given personally or by regular first-class mail, by certified mail return receipt requested, by a private delivery service which obtains a signed receipt, or by facsimile transmission addressed to Trade Bank or Borrower at the address indicated after their signature to this Agreement, or at any other address designated in writing by one party to the other party. Trade Bank is hereby authorized by Borrower to act on such instructions or notices sent by facsimile transmission or telecommunications device which Trade Bank believes come from Borrower. All notices shall be deemed to have been given upon delivery, in the case of notices personally delivered or delivered by private delivery service, upon the expiration of 3 calendar days following the deposit of the notices in the United States mail, in the case of notices deposited in the United States mail with postage prepaid, or upon receipt, in the case of notices sent by facsimile transmission.

7.2 **Waivers**. No delay or failure of Trade Bank in exercising any right, power or remedy under any of the Loan Documents shall affect or operate as a waiver of such right, power or remedy; nor shall any single or partial exercise of any such right, power or remedy preclude, waive or otherwise affect any other or further exercise thereof or the exercise

---

of any other right, power or remedy. Any waiver, consent or approval by Trade Bank under any of the Loan Documents must be in writing and shall be effective only to the extent set out in such writing.

7.3 **Benefit of Agreement**. The provisions of the Loan Documents shall be binding upon and inure to the benefit of the respective successors, assigns, heirs, executors, administrators, beneficiaries and legal representatives of Borrower and Trade Bank; provided, however, that Borrower may not assign or transfer any of its rights under any Loan Document without the prior written consent of Trade Bank, and any prohibited assignment shall be void. No consent by Trade Bank to any assignment shall release Borrower from its liability for the Obligations unless such release is specifically given by Trade Bank to Borrower in writing. Trade Bank reserves the right to sell, assign, transfer, negotiate or grant participations in all or any part of, or any interest in, Trade Bank's rights and benefits under each of the Loan Documents. In connection therewith, Trade Bank may disclose any information relating to the Facility, Borrower or its business, or any Guarantor or its business.

7.4 **Joint and Several Liability**. If Borrower consists of more than one person or entity, the liability of each of them shall be joint and several, and the compromise of any claim with, or the release of, any one such Borrower shall not constitute a compromise with, or a release of, any other such Borrower.

7.5 **No Third Party Beneficiaries**. This Agreement is made and entered into for the sole protection and benefit of Borrower and Trade Bank and their respective permitted successors and assigns, and no other person or entity shall be a third party beneficiary of, or have any direct or indirect cause of action or claim in connection with, any of the Loan Documents to which it is not a party.

7.6 **Governing Law and Jurisdiction**. This Agreement shall, unless provided differently in any Loan Document, be governed by, and be construed in accordance with, the internal laws of the State of California, except to the extent Trade Bank has greater rights or remedies under federal law whether as a national bank or otherwise. Borrower and Trade Bank (a) agree that all actions and proceedings relating directly or indirectly to this Agreement shall be litigated in courts located within California; (b) consent to the jurisdiction of any such court and consent to service of process in any such action or proceeding by personal delivery or any other method permitted by law; and (c) waive any and all rights Borrower may have to object to the jurisdiction of any such court or to transfer or change the venue of any such action or proceeding.

7.7 **Mutual Waiver of Jury Trial**. Borrower and Trade Bank each hereby waive the right to trial by jury in any action or proceeding based upon, arising out of, or in any way relating to, (a) any Loan Document, (b) any other present or future agreement, instrument or document between Trade Bank and Borrower, or (c) any conduct, act or omission of Trade Bank or Borrower or any of their directors, officers, employees, agents, attorneys or any other persons or entities affiliated with Trade Bank or Borrower, which waiver will apply in all of the mentioned cases whether the case is a contract or tort case or any other case. Borrower represents and warrants that no officer, representative or agent of Trade Bank has represented, expressly or otherwise, that Trade Bank would not seek to enforce this waiver of jury trial.

7.8 **Severability**. Should any provision of any Loan Document be prohibited by, or invalid under applicable law, or held by any court of competent jurisdiction to be void or unenforceable, such defect shall not affect, the validity of the other provisions of the Loan Documents.

7.9 **Entire Agreement; Amendments**. This Agreement and the other Loan Documents are the final, entire and complete agreement between Borrower and Trade Bank concerning the Credit Extensions and the Facility; supersede all prior and contemporaneous negotiations and oral representations and agreements. There are no oral understandings, representations or agreements between the parties concerning the Credit Extensions or the Facility which are not set forth in the Loan Documents. This Agreement and the Supplement may not be waived, amended or superseded except in a writing executed by Borrower and Trade Bank.

7.10 **Collection of Payments**. Unless otherwise specified in any Loan Document, other than this Agreement or any Note, all principal, interest and any fees due to Trade Bank by Borrower under this Agreement, the Addendum, any Supplement, any Facility Document, any Collateral Document or any Note, will be paid by Trade Bank having Wells Fargo debit any of Borrower's accounts with Wells Fargo and forwarding such amount debited to Trade Bank, without presentment, protest, demand for reimbursement or payment, notice of dishonor or any other notice whatsoever, all of which are hereby expressly waived by Borrower. Such debit will be made at the time principal, interest or any fee is due to

---

Trade Bank pursuant to this Agreement, the Addendum, any Supplement, any Facility Document, any Collateral Document or any Note.

7.11 **Costs, Expenses and Attorneys' Fees**. Borrower will reimburse Trade Bank for all costs and expenses, including, but not limited to, reasonable attorneys' fees and expenses (which counsel may be Trade Bank or Wells Fargo employees), expended or incurred by Trade Bank in the preparation and negotiation of this Agreement, the Notes, the Collateral Documents, the Addendum, and the Facility Documents, in amending this Agreement, the Collateral Documents, the Notes, the Addendum, or the Facility Documents, in collecting any sum which becomes due Trade Bank on the Notes, under this Agreement, the Collateral Documents, the Addendum, the Supplement, or any of the Facility Documents, in the protection, perfection, preservation and enforcement of any and all rights of Trade Bank in connection with this Agreement, the Notes, any of the Collateral Documents, the Supplement, any of the Addendum, or any of the Facility Documents, including, without limitation, the fees and costs incurred in any out-of-court work out or a bankruptcy or reorganization proceeding.

VIII. DEFINITIONS

8.1 **"Accounts Receivable"** means all presently existing and hereafter arising "Rights to Payment" (as that term is defined in the "Continuing Security Agreement – Rights to Payment and Inventory" executed by Borrower in favor of Trade Bank) which arise from the sale, lease or other disposition of Inventory, or from performance of contracts for service, manufacture, construction or repair, together with all goods returned by Borrower's customers in connection with any of the foregoing.

8.2 **"Agreement"** means this Agreement and the Addendum attached hereto, as corrected or modified from time to time by Trade Bank and Borrower.

8.3 **"Banking Day"** means each day except Saturday, Sunday and a day specified as a holiday by federal or California statute.

8.4 **"Closing Date"** means the date on which the first Credit Extension is made.

8.5 **"Collateral"** means all property securing the Obligations.

8.6 **"Collateral Documents"** means those security agreement(s), deed(s) of trust, guarantee(s), subordination agreement(s), intercreditor agreement(s), and other credit support documents and instruments required by the Trade Bank to effect the collateral and credit support requirements set forth in the Supplement with respect to the Facility.

8.7 **"Credit Extension"** means each extension of credit under the Facility (whether funded or unfunded), including, but not limited to, (a) the issuance of sight or usance commercial letters of credit or commercial letters of credit supported by back-up letters of credit, (b) the issuance of standby letters of credit, (c) the issuance of shipping guarantees, (d) the making of revolving credit working capital loans, (e) the making of loans against imports for letters of credit, (f) the making of clean import loans outside letters of credit, (g) the making of advances against export orders, (h) the making of advances against export letters of credit, (i) the making of advances against outgoing collections, (j) the making of term loans, and (k) the entry into foreign exchange contracts.

8.8 **"Credit Limit"** means, with respect to the any Facility, the amount specified under the column labeled "Credit Limit" in the Supplement for that related Facility.

8.9 **"Credit Sublimit"** means, with respect to any Subfacility, the amount specified after the name of that Subfacility under the column labeled "Credit Sublimit" in the Supplement for the related Facility.

8.10 **"Dollars"** and **"$"** means United States dollars.

8.11 **"Facility Documents"** means, with respect to the Facility, those documents specified in the Supplement for the Facility, and any other documents customarily required by Trade Bank for said Facility.

8.12 **"GAAP"** means generally accepted accounting principles, which are applicable to the circumstances, as of the date of determination, set out in the opinions and pronouncements of the Accounting Principles Board and the

American Institute of Certified Public Accountants and in the statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other entity as may be approved by a significant segment of the accounting profession.

8.13 **"Inventory"** has the meaning assigned to such term in the "Continuing Security Agreement — Rights to Payment and Inventory" executed by Borrower in favor of Trade Bank.

8.14 **"Loan Documents"** means this Agreement, the Addendum, the Supplement, the Facility Documents and the Collateral Documents.

8.15 **"Note"** has the meaning specified in Section 3.1(b)(2) above.

8.16 **"Obligations"** means (a) the obligation of Borrower to pay principal, interest and fees on all funded Credit Extensions and fees on all unfunded Credit Extensions, and (b) the obligation of Borrower to pay and perform when due all other indebtedness, liabilities, obligations and covenants required under the Loan Documents.

8.17 **"Person"** means and includes natural persons, corporations, limited partnerships, general partnerships, joint stock companies, joint ventures, associations, companies, trusts, banks, trust companies, land trusts, business trusts or other organizations, whether or not legal entities, and governments and agencies and political subdivisions thereof.

8.18 **"Prime Rate"** means the rate most recently announced by Wells Fargo at its principal office in San Francisco, California as its "Prime Rate", with the understanding that the Prime Rate is one of Wells Fargo's base rates and serves as the basis upon which effective rates of interest are calculated for those loans making reference thereto, and is evidenced by the recording thereof after its announcement in such internal publication or publications as Wells Fargo may designate. Any change in an interest rate resulting from a change in the Prime Rate shall become effective as of 12:01 a.m. of the Banking Day on which each change in the Prime Rate is announced by Wells Fargo.

8.19 **"Subsidiary"** means (i) any corporation at least the majority of whose securities having ordinary voting power for the election of directors (other than securities having such power only by reason of the happening of a contingency) are at the time owned by Borrower and/or one or more Subsidiaries, and (ii) any joint venture or partnership in which Borrower and/or one or more Subsidiaries has a majority interest.

8.20 **"Wells Fargo"** means Wells Fargo Bank, N.A.

IX. ARBITRATION

9.1 **Arbitration**. The parties hereto agree, upon demand by any party, to submit to binding arbitration all claims, disputes and controversies between or among them (and their respective employees, officers, directors, attorneys, and other agents), whether in tort, contract or otherwise arising out of or relating to in any way (i) the loan and related loan and security documents which are the subject of this Agreement and its negotiation, execution, collateralization, administration, repayment, modification, extension, substitution, formation, inducement, enforcement, default or termination; or (ii) requests for additional credit.

9.2 **Governing Rules**. Any arbitration proceeding will (i) proceed in a location in California selected by the American Arbitration Association ("AAA"); (ii) be governed by the Federal Arbitration Act (Title 9 of the United States Code), notwithstanding any conflicting choice of law provision in any of the documents between the parties; and (iii) be conducted by the AAA, or such other administrator as the parties shall mutually agree upon, in accordance with the AAA's commercial dispute resolution procedures, unless the claim or counterclaim is at least $1,000,000.00 exclusive of claimed interest, arbitration fees and costs in which case the arbitration shall be conducted in accordance with the AAA's optional procedures for large, complex commercial disputes (the commercial dispute resolution procedures or the optional procedures for large, complex commercial disputes to be referred to, as applicable, as the "Rules"). If there is any inconsistency between the terms hereof and the Rules, the terms and procedures set forth herein shall control. Any party who fails or refuses to submit to arbitration following a demand by any other party shall bear all costs and expenses incurred by such other party in compelling arbitration of any dispute. Nothing contained herein shall be deemed to be a waiver by any party that is a bank of the protections afforded to it under 12 U.S.C. §91 or any similar applicable state law.

9.3 **No Waiver of Provisional Remedies, Self-Help and Foreclosure**. The arbitration requirement does not limit the right of any party to (i) foreclose against real or personal property collateral; (ii) exercise self-help remedies relating to collateral or proceeds of collateral such as setoff or repossession; or (iii) obtain provisional or ancillary remedies such as replevin, injunctive relief, attachment or the appointment of a receiver, before during or after the pendency of any arbitration proceeding. This exclusion does not constitute a waiver of the right or obligation of any party to submit any dispute to arbitration or reference hereunder, including those arising from the exercise of the actions detailed in sections (i), (ii) and (iii) of this paragraph.

9.4 **Arbitrator Qualifications and Powers**. Any arbitration proceeding in which the amount in controversy is $5,000,000.00 or less will be decided by a single arbitrator selected according to the Rules, and who shall not render an award of greater than $5,000,000.00. Any dispute in which the amount in controversy exceeds $5,000,000.00 shall be decided by majority vote of a panel of three arbitrators; provided however, that all three arbitrators must actively participate in all hearings and deliberations. The arbitrator will be a neutral attorney licensed in the State of California or a neutral retired judge of the state or federal judiciary of California, in either case with a minimum of ten years experience in the substantive law applicable to the subject matter of the dispute to be arbitrated. The arbitrator will determine whether or not an issue is arbitratable and will give effect to the statutes of limitation in determining any claim. In any arbitration proceeding the arbitrator will decide (by documents only or with a hearing at the arbitrator's discretion) any pre-hearing motions which are similar to motions to dismiss for failure to state a claim or motions for summary adjudication. The arbitrator shall resolve all disputes in accordance with the substantive law of California and may grant any remedy or relief that a court of such state could order or grant within the scope hereof and such ancillary relief as is necessary to make effective any award. The arbitrator shall also have the power to award recovery of all costs and fees, to impose sanctions and to take such other action as the arbitrator deems necessary to the same extent a judge could pursuant to the Federal Rules of Civil Procedure, the California Rules of Civil Procedure or other applicable law. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction. The institution and maintenance of an action for judicial relief or pursuit of a provisional or ancillary remedy shall not constitute a waiver of the right of any party, including the plaintiff, to submit the controversy or claim to arbitration if any other party contests such action for judicial relief.

9.5 **Discovery**. In any arbitration proceeding discovery will be permitted in accordance with the Rules. All discovery shall be expressly limited to matters directly relevant to the dispute being arbitrated and must be completed no later than 20 days before the hearing date and within 180 days of the filing of the dispute with the AAA. Any requests for an extension of the discovery periods, or any discovery disputes, will be subject to final determination by the arbitrator upon a showing that the request for discovery is essential for the party's presentation and that no alternative means for obtaining information is available.

9.6 **Class Proceedings and Consolidations**. The resolution of any dispute arising pursuant to the terms of this Agreement shall be determined by a separate arbitration proceeding and such dispute shall not be consolidated with other disputes or included in any class proceeding.

9.7 **Payment Of Arbitration Costs And Fees**. The arbitrator shall award all costs and expenses of the arbitration proceeding.

9.8 **Real Property Collateral; Judicial Reference**. Notwithstanding anything herein to the contrary, no dispute shall be submitted to arbitration if the dispute concerns indebtedness secured directly or indirectly, in whole or in part, by any real property unless (i) the holder of the mortgage, lien or security interest specifically elects in writing to proceed with the arbitration, or (ii) all parties to the arbitration waive any rights or benefits that might accrue to them by virtue of the single action rule statute of California, thereby agreeing that all indebtedness and obligations of the parties, and all mortgages, liens and security interests securing such indebtedness and obligations, shall remain fully valid and enforceable. If any such dispute is not submitted to arbitration, the dispute shall be referred to a referee in accordance with California Code of Civil Procedure Section 638 et seq., and this general reference agreement is intended to be specifically enforceable in accordance with said Section 638. A referee with the qualifications required herein for arbitrators shall be selected pursuant to the AAA's selection procedures. Judgment upon the decision rendered by a referee shall be entered in the court in which such proceeding was commenced in accordance with California Code of Civil Procedure Sections 644 and 645.

9.9 **Miscellaneous**. To the maximum extent practicable, the AAA, the arbitrators and the parties shall take all action required to conclude any arbitration proceeding within 180 days of the filing of the dispute with the AAA. No arbitrator or other party to an arbitration proceeding may disclose the existence, content or results thereof, except for disclosures of information by a party required in the ordinary course of its business or by applicable law or regulation. If more than one agreement for arbitration by or between the parties potentially applies to a dispute, the arbitration provision most directly related to the documents between the parties or the subject matter of the dispute shall control. This Agreement may be amended or modified only in writing signed by each party hereto. If any provision of this Agreement shall be held to be prohibited by or invalid under applicable law such provision shall be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or any remaining provisions of this Agreement. This arbitration provision shall survive termination, amendment or expiration of any of the documents or any relationship between the parties.

Borrower and Trade Bank have caused this Agreement to be executed by their duly authorized officers or representatives on the date first written above.

"BORROWER"

ZUMIEZ, INC.

By: ______________________________

Title: ____________________________

Borrower's Address:
6300 Merrill Creek Parkway, Suite B
Everett, WA 98203

"LENDER"

WELLS FARGO HSBC TRADE BANK,
NATIONAL ASSOCIATION

By: ______________________________
Jennifer Wallis
Vice President

Lender's Address:
999 Third Avenue
Seattle, WA 98104

EXHIBIT A

WELLS FARGO HSBC TRADE BANK **ADDENDUM TO CREDIT AGREEMENT**

THIS ADDENDUM IS ATTACHED TO THE CREDIT AGREEMENT ("CREDIT AGREEMENT") BETWEEN WELLS FARGO HSBC TRADE BANK AND THE FOLLOWING BORROWER:

NAME OF BORROWER: ZUMIEZ INC.

ADDITIONAL AFFIRMATIVE COVENANTS

The following covenants are part of Article IV of the Credit Agreement:

REPORTS. Borrower will furnish the following information or deliver the following reports to Trade Bank at the times indicated below:

- **Annual Financial Statements:** Not later than ninety (90) calendar days after and as of the end of each of Borrower's fiscal years, an annual unqualified audited consolidated and consolidating financial statement of Borrower prepared by a certified public accountant acceptable to Trade Bank and prepared in accordance with GAAP, to include balance sheet, income statement and statement of cash flow.

- **Quarterly Financial Statements:** Not later than forty-five (45) calendar days after and as of the end of each of Borrower's fiscal quarters, a consolidated and consolidating financial statement of Borrower prepared by Borrower, to include balance sheet, income statement and statement of cash flow.

  Certificate of Compliance: At the time each financial statement of Borrower required above is delivered to Trade Bank, a certificate of the president or chief financial officer of Borrower that said financial statements are accurate and that there exists no Event of Default under the Agreement nor any condition, act or event which with the giving of notice or the passage of time or both would constitute an Event of Default.

- **Insurance:** Borrower will maintain in full force and effect insurance coverage on all Borrower's property, including, but not limited to, the following types of insurance coverage:
  policies of fire insurance
  business personal property insurance

All the insurance referred to in the preceding sentence must be in form, substance and amounts, and issued by companies, satisfactory to Trade Bank, and cover risks required by Trade Bank and contain loss payable endorsements in favor of Trade Bank.

FINANCIAL COVENANTS. Borrower will maintain the following (if Borrower has any Subsidiaries which must be consolidated under GAAP, the following applies to borrower and the consolidated Subsidiaries):

- **Total Liabilities divided by Tangible Net Worth**. Not greater than 1.15 to 1.0 determined as of each fiscal quarter end. ("Tangible Net Worth" means the aggregate of total shareholders' equity determined in accordance with GAAP *plus* indebtedness which is subordinated to the Obligations to Trade Bank under a subordination agreement in form and substance acceptable to Trade Bank or by subordination language acceptable to Trade Bank in the instrument evidencing such indebtedness *less* (i) all assets which would be classified as intangible assets under GAAP, including, but not limited to, goodwill, licenses, patents, trademarks, trade names, copyrights, capitalized software and organizational costs, licenses and franchises, and (ii) assets which Trade Bank determines in its business judgment would not be available or would be of relatively small value in a liquidation of Borrower's business, including, but not limited to, loans to officers or affiliates and other items, and "Total Liabilities" excludes indebtedness which is subordinated to the Obligations to Trade Bank under a subordination agreement in form and substance acceptable to Trade Bank or by subordination language acceptable to Trade Bank in the instrument evidencing such indebtedness.)

- **Quick Asset Ratio**. Not less than 1.0 to 1.0 determined as of each fiscal quarter end. "**Quick Asset Ratio**" means "Quick Assets" divided by Funded Debt, and "**Quick Assets**" means cash on hand or on deposit in banks, readily marketable securities issued by the United States, readily marketable commercial paper rated "A-1" by Standard & Poor's Corporation (or a similar rating by a similar rating organization), certificates of deposit and banker's acceptances, and accounts receivable (net of allowance for doubtful accounts). "**Funded Debt**" means outstanding amounts under Revolving Credit Facility whether classified as a short or long-term liability on Borrower's financial statement.

- **Net Income After Taxes**. Not less than $1 on a rolling four-quarter basis determined as of each fiscal quarter end, based on the sum of the results of four consecutive quarters consisting of the present quarter and the three preceding quarters.

Borrower shall only be obligated to comply with financial covenants at the time an advance for Funded Debt is requested under the Revolving Facility and shall be obligated to comply with financial covenants at all times any Funded Debt is outstanding under the Revolving Credit Facility.

BY SIGNING HERE BORROWER AGREES TO THE DESIGNATED PROVISIONS IN THIS ADDENDUM:

ZUMIEZ INC.

By: ____________________________

Title: __________________________

EXHIBIT B

WELLS FARGO HSBC TRADE BANK **REVOLVING CREDIT FACILITY SUPPLEMENT**

THIS SUPPLEMENT IS AN INTEGRAL PART OF THE CREDIT AGREEMENT BETWEEN WELLS FARGO HSBC TRADE BANK AND THE FOLLOWING BORROWER:

NAME OF BORROWER: ZUMIEZ INC.

CREDIT LIMIT FOR THIS REVOLVING CREDIT LOAN FACILITY AND SUBLIMITS: Credit Limit: $25,000,000 (subject to dollar limitations in Section 1.2 of Agreement)

CREDIT SUBLIMITS: Subject to the Revolving Credit Facility Credit Limit, the Credit Sublimit for each Subfacility specified below refers to the aggregate amount which may be outstanding at any one time under each such Subfacility.

· Sight Commercial Letters of Credit	$	25,000,000
· Standby Letters of Credit	$	5,000,000

FACILITY DESCRIPTION: Trade Bank will make the Revolving Credit Facility available to finance Borrower's working capital requirements. Subject to the credit sublimits specified above, the Revolving Credit Facility may be supported by (i) a standby letter of credit in favor of Trade Bank, (ii) a guarantee or (iii) accounts receivable, inventory or other collateral. Revolving Credit Loans cannot be used to repay outstanding Revolving Credit Loans or Term Loans that have matured or to repay amounts due under any other Facilities provided to Borrower.

FACILITY DOCUMENTS:

- **Revolving Credit Loans Note:** The term and prepayment conditions of the Loans under Revolving Credit Facility are set forth in Revolving Credit Loans Note.

INTEREST RATES:

- **Loans under Revolving Credit Facility:** All outstanding Loans under Revolving Credit Facility will bear interest at the following rate:

  Prime Rate: The Prime Rate minus .50% per annum.
  Other Rate: LIBOR plus 1.00% per annum.

  Interest Payment Dates: Interest on all outstanding Loans under Revolving Credit Facility will be paid at least once each month on the last day of the month.

FEES:

- **Facilities Fee:** Borrower will pay the following Facilities Fee to Trade Bank before any Facility, including this Facility, is made available to Borrower: $7,500.

- **Sight Commercial Credits:**

  Issuance Fees/Fees For Increasing Credit Amounts or Extending Expiration Dates: (Minimum $125)
  1/8 of 1% per annum of the amount of each Sight Commercial Credit and of any increase in such amount.
  Payable: At the time each Sight Commercial Credit is issued or increased and at the time the expiration date of any Sight Commercial Credit is extended.

  Amendment Fees: (Minimum $100)
  $100 for each amendment, unless the amendment is an increase in the Sight Commercial Credit amount or an extension of the expiration date, in which case the Issuance Fee above will substitute for any Amendment Fee.
  Payable: At the time each amendment is issued.

  Negotiation/Payment/Examination Fees: (Minimum $125)
  1/8 of 1% of the face amount of each drawing under each Sight Commercial Credit.
  Payable: At the time any draft or other documents are negotiated, paid or examined.

- **Standby Credits:**

  Commission Fees/Fees For Increasing Credit Amounts or Extending Expiration Dates: (Minimum $500)
  1.25% of the amount of each Standby Credit and of any increase in such amount.
  Payable: At the time each Standby Credit is issued or increased and at the time the expiration date of any Standby Credit is extended.

  Amendment Fees: (Minimum $130)
  $130 for each amendment, unless the amendment is an increase in the Standby Credit amount or an extension of the expiration date, in which case the Commission Fee above will substitute for any Amendment Fee.
  Payable: At the time each amendment is issued.

  Negotiation/Payment/Examination Fees: (Minimum $250)
  1/8 of 1% of the face amount of each drawing under each Standby Credit.
  Payable: At the time any draft or other documents are negotiated, paid or examined.

COLLATERAL: See Exhibit C - Collateral/Credit Support Document.

SUBFACILITIES DESCRIPTION, PURPOSE, DOCUMENTS, TERM, AND PREPAYMENTS:

- **Sight Commercial Credits:**

  Description And Purpose: Trade Bank will issue sight commercial letters of credit (each a “Sight Commercial Credit”) for the account of Borrower for the purpose or purposes stated below. Subject to the credit sublimits specified above, these Sight Commercial Credits will be transferable or not transferable and have the goods related to them consigned to or not consigned to, or controlled by or not controlled by, Trade Bank. The Sight Commercial Credit Sublimit specified above refers to the aggregate undrawn amount of all Sight Commercial Credits which may be at any one time outstanding under this Facility together with the aggregate amount of all drafts drawn under such Sight Commercial Credits which have not been reimbursed as provided below at such time.

  This Subfacility may only be used for the following purpose: importation of goods.

  Documents:
  Before the first Sight Commercial Credit is issued:

Trade Bank's standard form Commercial Letter of Credit Agreement;

Before each Sight Commercial Credit is issued:
Trade Bank's standard form Application For Commercial Letter of Credit;

Before each Sight Commercial Credit is amended:
Trade Bank's standard form Application For Amendment To Letter of Credit;

Term: No Sight Commercial Credit may expire more than one hundred twenty (120) calendar days after the date it is issued.

· **Standby Credits:**

Description And Purpose: Trade Bank will issue standby letters of credit (each a "Standby Credit") for the account of Borrower the purpose or purposes stated below. Subject to the credit sublimits specified above, these Standby Credits will be issued to support Borrower's open account trade terms, bid and performance bonds, industrial revenue bonds, worker's compensation obligations and or the moving of Borrower as a new customer from another bank to Trade Bank. The Standby Credit Sublimit specified above refers to the aggregate undrawn amount of all Standby Credits which may be at any one time outstanding under this Subfacility together with the aggregate amount of all drafts drawn under such Standby Credits which have not been reimbursed as provided below at such time.

This Subfacility may only be used for the following purpose: to support lease or other obligations.

Documents:
Before the first Standby Credit is issued:
Trade Bank's standard form Standby Letter of Credit Agreement.

Before each Standby Credit is issued:
Trade Bank's standard form Application For Standby Letter of Credit.

Before each Standby Credit is amended:
Trade Bank's standard form Application For Amendment To Letter of Credit.

Term: No Standby Credit will expire more than three hundred sixty-five (365) calendar days after the date it is issued. Standby Credits will be available by sight drafts only.

REIMBURSEMENTS FOR SIGHT COMMERCIAL CREDITS AND STANDBY CREDITS:

The amount of each drawing paid by Trade Bank under a Sight Commercial Credit or Standby Credit will be reimbursed to Trade Bank as follows:

by Trade Bank having Wells Fargo Bank debit any of Borrower's accounts with Wells Fargo Bank and forwarding such amount debited to Trade Bank; or

immediately on demand of Trade Bank; or
by treating such amount drawn as an advance to Borrower under Borrower's Revolving Credit Facility.

DEFAULT INTEREST RATE ON UNREIMBURSED SIGHT COMMERCIAL CREDITS AND STANDBY CREDITS:

Default interest will accrue at a per annum rate equal to the Prime Rate plus five percent (5%) ("Default Interest Rate") and be paid at least once each month as follows:

All drawings (i) under Sight Commercial Credits and (ii) under Standby Credits, not reimbursed on the day they are paid by Trade Bank, will bear interest at the Default Interest Rate from the date they are paid to the date such payment is fully reimbursed.

EXHIBIT C

BY INITIALING HERE BORROWER AGREES TO ALL THE TERMS OF THIS SUPPLEMENT:

WELLS FARGO HSBC TRADE BANK **COLLATERAL/CREDIT SUPPORT DOCUMENT**

· **Personal Property Security From Borrower:**
First priority lien in the following assets of Borrower:
accounts receivable
inventory
equipment
Collateral Documents:
Continuing Security Agreement: Rights to Payment and Inventory
Security Agreement: Equipment and Fixtures

UCC-1 Financing Statement

BY INITIALING HERE BORROWER AGREES TO ALL THE TERMS OF THIS EXHIBIT:

Exhibit 31.1

CERTIFICATION PURSUANT TO

RULE 13a-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Richard M. Brooks, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Zumiez Inc.;

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

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

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

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

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

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

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

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

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

/s/ RICHARD M. BROOKS Dated: December 08, 2006

Richard M. Brooks
Principal Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO

RULE 13a-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Brenda I. Morris, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Zumiez Inc.;

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

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

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

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

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

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

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

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

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

/s/ BRENDA I. MORRIS Dated: December 08, 2006

Brenda I. Morris
Principal Financial Officer

Exhibit 32.1

CERTIFICATIONS PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)

In connection with the Quarterly Report of Zumiez Inc., a Washington corporation (the "Company"), on Form 10-Q for the quarter ending April 29, 2006 as filed with the Securities and Exchange Commission (the "Report"), We, Richard M. Brooks, Principal Executive Officer of the Company, and Brenda I. Morris, Principal Financial Officer of the Company, certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ RICHARD M. BROOKS	/s/ BRENDA I. MORRIS
Richard M. Brooks	Brenda I. Morris
Principal Executive Officer	Principal Financial Officer
December 08, 2006	December 08, 2006

A signed original of this written statement required by Section 906 has been provided to Zumiez Inc. and will be retained by Zumiez Inc. and furnished to the Securities and Exchange Commission or its staff upon request.