Ituran Location & Control Ltd.
Form 20-F
April 28, 2015

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

FORM 20-F

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

For the fiscal year ended December 31, 2014

Commission file no. 001-32618

ITURAN LOCATION AND CONTROL LTD.
(Exact name of Registrant as specified in its charter and
translation of Registrant's name into English)

Israel
(Jurisdiction of incorporation or organization)

3 Hashikma Street, Azour, Israel
(Address of principal executive offices)

Eli Kamer, Chief Financial Officer, 3 Hashikma Street, Azour, Israel, Tel: 972-3-5571314, Facsimile: 972-3-5571327
(Name, Telephone, E-mail and/or Facsimile number and Address of Company contact person)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, par value NIS 0.331/3 per share	Nasdaq Global Select Market

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None
(Title of Class)

Securities for which there is reporting obligation pursuant to Section 15(d) of the Act:

None
(Title of Class)

Indicate the number of outstanding shares of each of the Issuer's classes of capital or common stock as of the

close of the period covered by the annual report:

23,475,431 Ordinary Shares

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act

Yes o No x

If this report is an annual or transition report, indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Yes o No x

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 proceeding 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 has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files).

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 x Non-accelerated filer o

Indicate by check mark which basis of accounting the registrant had used to prepare the financial statements included in this filing:

U.S. GAAP x International Financial Reporting Standards as issued by the International Accounting Standards Board o Other o

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

[APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS]

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes o No o

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USE OF CERTAIN TERMS

As used herein, and unless the context suggests otherwise, the terms “we”, “us”, “our” or “Ituran” refer to Ituran Location and Control Ltd. and its consolidated subsidiaries.

We have prepared our consolidated financial statements in US Dollars. Our consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). All references herein to “dollars” or “$“or “USD” are to United States dollars, and all references to “NIS” are to New Israeli Shekels.

FORWARD LOOKING STATEMENTS

This Annual Report on Form 20-F contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The use of the words “projects,” “believes,” “expects,” “may,” “plans” or “intends,” or words of similar import, identifies a statement as “forward-looking.” The forward-looking statements included herein are based on current expectations that involve a number of risks and uncertainties. These forward-looking statements are based on the assumption that we will not lose a significant customer or customers or experience increased fluctuations of demand or rescheduling of purchase orders, that our markets will continue to grow, that our products will remain accepted within their respective markets and will not be replaced by new technology, that competitive conditions within our markets will not change materially or adversely, that we will retain key technical and management personnel, that our forecasts will accurately anticipate market demand, and that there will be no material adverse change in our operations or business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. In addition, our business and operations are subject to substantial risks which increase the uncertainty inherent in the forward-looking statements. In light of the significant uncertainties inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives or plans will be achieved. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties described in this annual report in Item 3D: Risk Factors. Forward-looking statements speak only as of the date on which they are made, and we undertake no obligation to update any forward-looking statements or other information contained in this report, whether as a result of new information, future events or otherwise. You are advised, however, to consult any additional disclosures we make in our reports on Form 6-K filed with the U.S. Securities and Exchange Commission (“SEC”).

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The selected consolidated financial data below is provided under generally accepted accounting principles in the U.S. (U.S. GAAP). You should read the selected consolidated financial data presented in this Item together with Item 5 – Operating and Financial Review and Prospects and with our consolidated financial statements included elsewhere in this annual report.

Our selected consolidated statements of income data for the years ended December 31, 2012, 2013 and 2014 and our selected consolidated balance sheet data as of December 31, 2013 and 2014 have been derived from our consolidated financial statements included elsewhere in this report. The selected consolidated statements of income data for each of the years ended December 31, 2010 and 2011 and the selected consolidated balance sheet data as of December 31, 2010, 2011 and 2012 are derived from our audited consolidated financial statements not included in this report.

Selected Financial Data Under U.S. GAAP:

Consolidated Statements of Income Data

	Year Ended December 31,				
	2014	2013	2012	2011	2010
	In USD In thousands, except per share amounts				
Revenues:					
Location based services	133,692	126,951	114,565	120,410	108,101
Wireless communications products	48,435	43,216	35,753	39,757	39,724
Total Revenues	182,127	170,167	150,318	160,167	147,825
Cost of Revenues:					
Location based services	46,852	44,850	44,974	49,731	41,272
Wireless communication products	38,142	36,015	29,786	29,758	33,037
Total cost of revenues	84,994	80,865	74,760	79,489	74,309
Gross profit	97,133	89,302	75,558	80,678	73,516
Research and development expenses	2,526	2,414	2,066	1,877	1,346
Selling and marketing expenses	9,264	9,715	8,489	8,543	8,675
General and administrative expenses	38,617	34,483	33,439	34,984	31,671
Other expenses, net	856	4,760	1,617	8,691	1,156
Operating Income	45,870	37,930	29,947	26,583	30,668
Other income (expenses), net	-	(166)	6,755	(819)	(14,745)
Financing income (expenses), net	1,704	238	987	2,100	139
Income before income tax	47,574	38,002	37,689	27,864	16,062
Income tax	(14,246)	(12,447)	(11,690)	(5,655)	(6,286)
Share in losses of affiliated companies, net	(421)	(1)	(39)	(23)	(3)
Net income for the year	32,907	25,554	25,960	22,186	9,773
Less: net income attributable to non-controlling interest	(2,478)	(1,792)	(1,080)	(908)	(1,071)
Net income attributable to Company stockholders	30,429	23,762	24,880	21,278	8,702
Earning per share					
Basic	$1.45	$1.13	$1.19	$1.01	$0.42
Diluted	$1.45	$1.13	$1.19	$1.01	$0.42
Weighted average number of shares outstanding					
Basic	20,968	20,968	20,968	20,968	20,968
Diluted	20,968	20,968	20,968	20,968	20,968

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Consolidated Balance Sheets Data

	Year Ended December 31,				
	2014	2013	2012	2011	2010
	In USD In thousands, except per share amounts				
Cash & Cash Equivalent; deposit in escrow (short and long term) and investment in trading marketable securities	40,780	46,679	34,392	40,226	61,279
Working Capital	56,910	57,259	44,145	48,474	48,594
Total Assets	152,337	160,542	147,339	157,457	188,344
Total Liabilities	57,754	65,057	55,332	52,105	73,181
Retained Earnings	49,067	38,831	32,187	43,185	43,689
Stockholders Equity	90,696	90,918	88,027	101,194	110,771
Dividend declared per share	0.93	0.86	0.81	1.23	1.00

Other Data:

	Year Ended December 31,				
	2014	2013	2012	2011	2010
	(unaudited)				
Subscribers of our location-based services(1)	817,000	741,000	667,000	623,000	604,000
Average monthly churn rate	3 %	2.9 %	3 %	3.2 %	2.8 %

(1) number of subscribers is approximate.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D.RISK FACTORS

Our business, operating results and financial condition could be seriously harmed due to any of the following risks, among others. If we do not successfully address the risks to which we are subject, we could experience a material adverse effect on our business, results of operations and financial condition and our share price may decline, which may result in a loss of all or part of your investment . We cannot assure you that we will successfully address any of these risks. You should carefully consider the following factors as well as the other information contained and incorporated by reference in this annual report before taking any investment decision with respect to our securities. See “Forward Looking Statements” on page iv above.

RISKS RELATED TO OUR BUSINESS

Failure to maintain our existing relationships or establish new relationships with insurance companies could adversely affect our revenues and growth potential.

Revenues from our stolen vehicle recovery services, which we refer to as SVR services, and automatic vehicle location products, which we refer to as AVL products, are primarily dependent on our relationships with insurance companies. In Israel, insurance companies drive demand for our SVR services and AVL products by encouraging and, in some cases, requiring customers to subscribe to vehicle location services and purchase vehicle location products such as ours. In Brazil and Argentina, insurance companies enter into written agreements to subscribe to our services and purchase or lease our products directly. Our inability to maintain our existing relationships or establish new relationships with insurance companies could adversely affect our revenues and growth potential.

Changes in practices of insurance companies in the markets in which we provide our SVR services and sell our AVL products could adversely affect our revenues and growth potential.

We depend on the practices of insurance companies in the markets in which we provide our SVR services and sell our AVL products. In Israel, insurance companies either mandate the use of SVR services and AVL products, or their equivalent, as a prerequisite for providing insurance coverage to owners of certain medium- and high-end vehicles, or provide insurance premium discounts to encourage vehicle owners to subscribe to services and purchase products such as ours. In Brazil and Argentina, insurance companies mainly lease our AVL products directly and subsequently require their customers to subscribe to our SVR services.

Therefore, we rely on insurance companies' continued practice of:

n accepting vehicle location and recovery technology as a preferred security product;
n requiring or providing a premium discount for using location and recovery services and products;
n mandating or encouraging use of our SVR services and AVL products, or similar services and products, for vehicles with the same or similar threshold values and for the same or similar required duration of use; and
n with respect to insurance companies in Brazil and Argentina, deciding to lease SVR services and AVL products from us directly.

If any of these policies or practices change, revenues from sales of our SVR services and AVL products could decline, which could adversely affect our revenues and growth potential.

A reduction in vehicle theft rates may adversely impact demand for our SVR services and AVL products.

Demand for our SVR services and AVL products depends primarily on prevailing or expected vehicle theft rates. Vehicle theft rates may decline as a result of various reasons, such as the availability of improved security systems, implementation of improved or more effective law enforcement measures, or improved economic or political conditions in markets that have high theft rates. If vehicle theft rates in any or all of our existing markets decline, or if insurance companies or our other customers believe that vehicle theft rates have declined or are expected to decline, demand for our SVR services and AVL products may decline.

A decline in sales of new medium and high end cars and commercial vehicles in the markets in which we operate could result in reduced demand for our SVR services and AVL products.

Our SVR services and AVL products are primarily used to protect medium- and high-end cars and commercial vehicles and are often installed before or immediately after their initial sale. Consequently, a reduction in sales of new medium- and high-end vehicles could reduce our addressable market for SVR services and AVL products. New vehicle sales may decline for various reasons, including an increase in new vehicle tariffs, taxes or gas prices. A decline in vehicle production levels or labor disputes affecting the automobile industry in the markets where we operate may also impact the volume of new vehicle sales. A decline in sales of new medium- and high-end vehicles in the markets in which we provide our SVR services or sell our AVL products could result in reduced demand for such services and products.

There is significant competition in the markets in which we offer our services and products and our results of operations could be adversely affected if we fail to compete successfully.

The markets for our services and products are highly competitive. We compete primarily on the basis of the technological innovation, quality and price of our services and products. Our most competitive market is the location-based services market and the related AVL products market, due to the existence of a wide variety of

competing services and products and alternative technologies that offer various levels of protection and tracking capabilities, including global positioning systems, or GPS (although we also provide services based on GPS/GPRS technology), satellite- or network-based cellular systems and direction-finding homing technologies. Some of these competing services and products, such as certain GPS-based products, are installed in new cars by vehicle manufacturers prior to their initial sale, which effectively precludes us from competing for such subscribers in the SVR market. Furthermore, providers of competing services or products may extend their offerings to the locations in which we operate or new competitors may enter the location-based services market. Our AVL products also compete with less sophisticated theft protection devices such as standard car alarms, immobilizers, steering wheel locks and homing devices, some of which may be significantly cheaper. Some of these competing products have greater brand recognition than our AVL products, including LoJack Corporation in the United States.

The development of new or improved competitive products, systems or technologies that compete with our wireless communications products may render our products less competitive or obsolete, which could cause a decline in our revenues and profitability.

We are engaged in businesses characterized by rapid technological change and frequent new product developments and enhancements. The number of companies developing and marketing new wireless communications products has expanded considerably in recent years. The development of new or improved products, systems or technologies that compete with our wireless communications products, for both our SVR and fleet management services, may render our products and services less competitive and we may not be able to enhance our technology in a timely manner. In addition to the competition resulting from new products, systems or technologies, our future product enhancements may not adequately meet the requirements of the marketplace and may not achieve the broad market acceptance necessary to generate significant revenues. Any of the foregoing could cause a decline in our revenues and profitability.

The inability of local law enforcement agencies to timely and effectively recover the stolen vehicles we locate could negatively impact customers' perception of the usefulness of our SVR services and AVL products, adversely affecting our revenues.

Our AVL products identify the location of vehicles in which our products are installed. Following a notification of an unauthorized entry, or if we receive notification of the vehicle's theft from a subscriber, we notify the relevant law enforcement agency of the location of the subscriber's vehicle and generally rely on local law enforcement or governmental agencies to recover the stolen vehicle. We cannot control nor predict the response time of the relevant local law enforcement or other governmental agencies responsible for recovering stolen vehicles, nor that the stolen vehicles, once located, will be recovered at all. In the past, some stolen vehicles in which our AVL products were installed were not recovered and the average stolen vehicle recovery time in the markets in which we operate was 20 minutes from the time an unauthorized entry is confirmed or reported to the time the vehicle is recovered. To the extent that the relevant agencies do not effectively and timely respond to our calls and recover stolen vehicles, our recovery rates would likely diminish, which may, in turn, negatively impact customers' perception of the usefulness of our SVR services and AVL products, adversely affecting our revenues.

The ability to detect, deactivate, disable or otherwise inhibit the effectiveness of our AVL products could adversely affect demand for such products and our revenues.

The effectiveness of our AVL products is dependent, in part, on the inability of unauthorized persons to deactivate or otherwise alter the functioning of our AVL products or the vehicle anti-theft devices that work in conjunction with our AVL products. As sales of our AVL products increase, criminals in the markets in which we operate may become increasingly aware of our AVL products and may develop methods or technologies to detect, deactivate or disable our tracking devices or the vehicle anti-theft devices that work in conjunction with our AVL products. We believe that, as is the case with any product intended to prevent vehicle theft, over time, there may be an increased ability of unauthorized persons to detect, deactivate, disable or otherwise inhibit the effectiveness of our AVL products, although it is difficult to verify this fact. An increase in the ability of unauthorized persons to detect, deactivate, disable or otherwise inhibit the effectiveness of our AVL products could adversely affect demand for our products and our revenues.

We rely on some intellectual property that we license from third parties, the loss of which could preclude us from providing our SVR services or market and sell some of our AVL products, which would adversely affect our revenues.

We license from third parties some of the technology that we need in order to provide our SVR services and market and sell some of our AVL products. In the event that such licenses were to be terminated, or if such licenses were rendered unenforceable or invalid and we would not be able to license similar technology from other parties, it would require us, at a minimum, to obtain rights to a different technology and reconfigure our AVL products accordingly. In addition, some of the licenses we obtained from third parties are non-exclusive, which may enable other entities to obtain identical licenses from such third parties to operate in the places in which we conduct our business resulting in increased competition and could adversely affect our revenues.

We depend on proprietary technology and our failure to protect and enforce our intellectual property rights or our need to defend against infringement claims could result in a significant increase in costs and decline in revenues.

Our business is dependent on the uninterrupted use of proprietary technology, both owned and licensed, from third parties. If we fail to protect, enforce and maintain our intellectual property rights, we may not be able to compete and our business and operating results could be negatively impacted. We seek to protect our intellectual property rights through a combination of patents, trademarks, copyrights, trade secret laws, know-how, confidentiality procedures and licensing arrangements. Even with the intellectual property protection currently in place, we may not be able to protect our technology from misappropriation or infringement and we may lose, or the relevant owners may restrict or lose, our current rights of use of the technology that we license from such owners. Any of our existing intellectual property rights may be invalidated, circumvented, challenged or rendered unenforceable. In addition, the laws of some countries in which we operate or plan to operate, may not protect intellectual property rights to the same extent as the laws of Israel or the United States, increasing the possibility of piracy of our technology and products. It may be necessary for us to litigate in order to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others, which litigation can be time consuming, distracting to management, expensive and difficult to predict..

It is possible that we have or will inadvertently violate the intellectual property rights of other parties and those other parties may choose to assert infringement claims against us. If a court were to determine that our technology infringes on third parties' intellectual property, in addition to exposure to substantial damages, we could be required to expend considerable resources to modify our products, to develop non-infringing technology or to obtain licenses to permit our continued use of the technology that is the subject matter of the litigation.

Our failure to protect and enforce our intellectual property rights, or our need to defend against claims of infringement of intellectual property rights of others or the loss of any such claims, could result in a significant increase in costs and decline in revenues.

Our ability to sell our services and products depends upon the prior receipt and maintenance of various governmental licenses and approvals and our failure to obtain or maintain such licenses and approvals, or third-party use of the same licenses and frequencies, could result in a disruption or curtailment of our operations, a significant increase in costs and a decline in revenues.

We are required to obtain specific licenses and approvals from various governmental authorities in order to conduct our operations. For example, our AVL products use radio frequencies that are licensed and renewed periodically from the Ministry of Communications in Israel and similar agencies worldwide. As we continue to expand into additional markets, we will be required to obtain new permits and approvals from relevant governmental authorities. Furthermore, once our AVL infrastructure is deployed and our AVL end-units are sold to subscribers, a

change in radio frequencies would require us to recalibrate all of our antennas and replace or modify all end-units held by subscribers, which would be costly and may result in delays in the provision of our SVR services. In addition, some of the governmental licenses for radio frequencies that we currently use may be preempted by third parties. In Israel, our license is designated as a “joint” license, allowing the government to grant third parties a license to use the same frequencies, and in Brazil our license is designated as a “secondary”, non-exclusive license, which allows the government to grant a third party a primary license to use such frequencies, which third-party use could adversely affect, disrupt or curtail our operations. Our inability to maintain necessary governmental licenses and frequency approvals, or third-party use of or interference with the same licenses or frequencies, could result in a significant increase in costs and decline in revenues.

Our SVR services business model is based on the existence of certain conditions, the loss or lack of which in existing or potential markets could adversely affect our revenues generated in existing markets or our growth potential.

Our SVR services business model and, consequently, our ability to provide our SVR services and sell our AVL products, relies on our ability to successfully identify markets in which:

- the rate of car theft or consumer concern over vehicle safety is high;
- satisfactory radio frequencies are available to us that allow us to operate our business in an uninterrupted manner; and
- insurance companies or owners of cars believe that the value of cars justifies incurring the expense associated with the deployment of SVR services.

The absence of such conditions, our inability to locate markets in which such conditions exist or the loss of any one of the above conditions in markets we currently serve could adversely affect our revenues generated in existing markets or our growth potential.

Some of our agreements restrict our ability to expand into new markets for our SVR services, which could adversely affect our growth potential.

In 2008, we entered into an agreement with Telematics, pursuant to which Ituran and Telematics designated parts of the world as their exclusive territories for selling their AVL products and SVR services using any RF location technology compatible to the RF vehicle location systems. This agreement restricts our ability to expand our business and operations and sell our products and services in certain markets, which could adversely affect our growth potential.

The loss of key personnel could adversely affect our business and prospects for growth.

Our success depends upon the efforts and abilities of key management personnel, including our President and our Co-Chief Executive Officers. Loss of the services of one or more of such key personnel could adversely affect our ability to execute our business plan. In addition, we believe that our future success depends in part upon our ability to attract, retain and motivate qualified personnel necessary for the development of our business. If one or more members of our management team or other key technical personnel become unable or unwilling to continue in their present positions, and if additional key personnel cannot be hired and retained as needed, our business and prospects for growth could be adversely affected.

We rely on third parties to manufacture our wireless communications products, which could affect our ability to provide such products in a timely and cost-effective manner, adversely impacting our revenues and profit margins.

We outsource the manufacturing of most of our wireless communications products to third parties. Furthermore, we use one manufacturer for production of a significant portion of our wireless communications products and we do not maintain significant levels of inventories to support us in the event of an unexpected interruption in its manufacturing process. If our principal manufacturer or any of our other manufacturers is unable to or fails to manufacture our products in a timely manner, we may not be able to secure alternative manufacturing facilities without experiencing an interruption in the supply of our products or an increase in production costs. Any such interruption or increase in production costs could affect our ability to provide our wireless communications products in a timely and cost-effective manner, adversely impacting our revenues and profit margins.

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We rely on Telematics Wireless Ltd. (previously owned by us) to supply us with various products and services as single supplier of such products and services. Termination of our agreement with Telematics in respect of such products and services could adversely affect our revenues and operations.

Following the sale of our subsidiary, Telematics Wireless Ltd. in 2007 to a third party and the execution of a 10-year supply agreement with Telematics as a result of such sale, we rely on Telematics as a single supplier of products and services. Termination of our relations with Telematics would adversely affect our operations and revenues.

We depend on the use of specialized quality assurance testing equipment for the production of our wireless communications products, the loss or unavailability of which could adversely affect our results of operations.

We and our third-party manufacturers use specialized quality assurance testing equipment in the production of our products. The replacement of any such equipment as a result of its failure or loss could result in a disruption of our production process or an increase in costs, which could adversely affect our results of operations.

The adoption of industry standards that do not incorporate the technology we use may decrease or eliminate the demand for our services or products and could harm our results of operations.

There are no established industry standards in all of the businesses in which we sell our wireless communications products. For example, vehicle location devices may operate by employing various technologies, including network triangulation, GPS, satellite-based or network-based cellular or direction-finding homing systems. The development of industry standards that do not incorporate the technology we use may decrease or eliminate the demand for our services or products and we may not be able to develop new services and products that are in compliance with such new industry standards on a cost-effective basis. If industry standards develop and such standards do not incorporate our wireless communications products and we are unable to effectively adapt to such new standards, such development could harm our results of operations.

Expansion of our operations to new markets involves risks and our failure to manage such risks may delay or preclude our ability to generate anticipated revenues and may impede our overall growth strategy.

We anticipate future growth to be attributable to our business activities in new markets, particularly in developing countries, where we may encounter additional risks and challenges, such as longer payment cycles, potentially adverse tax consequences, potential difficulties in collecting receivables and potential difficulties in enforcing agreements or other rights in foreign legal systems. The challenges and risks of entering a new market may delay or preclude our ability to generate anticipated revenues and may impede our overall growth strategy.

Part of our services rely on GPS/GPRS-based technology owned and controlled by others, the loss, impairment or increased expense of which could negatively impact our immediate and future revenues from, or growth of, our services and adversely affect our results of operations.

Part of our business relies on signals from GPS/GPRS satellites built and maintained by third parties. If GPS/GPRS satellites become unavailable to us, or if the costs associated with using GPS/GPRS technology increase such that it is no longer feasible or cost-effective for us to use such technology, we will not be able to adequately provide our fleet management services. In addition, if one or more GPS/GPRS satellites malfunction, there could be a substantial delay before such satellites are repaired or replaced, if at all. The occurrence of any of the foregoing events could negatively impact our immediate and future revenues from, or growth of, our fleet management services and adversely affect our results of operations.

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Due to the already high penetration of SVR services and AVL products in Israel and moderate overall growth of the addressable market in Israel, our prospects for growth in such market may be limited.

Our AVL products are primarily installed in medium- and high-end cars and commercial vehicles. Therefore, our ability to increase demand for our SVR services and revenues from sales of our AVL products is limited by the number of potential vehicles in which our products can be installed in each relevant market. We estimate that our AVL products are installed in a significant portion of the medium- and high-end cars and commercial vehicles in Israel. We anticipate that revenues from sales of our SVR services and AVL products in Israel will not increase significantly due to the already high penetration of SVR services and AVL products in Israel and moderate overall growth of the addressable market in Israel, which could adversely affect our prospects for growth in such markets.

Some of our employees in our subsidiaries in Brazil and Argentina are members of labor unions and a dispute between us and any such labor union could result in a labor strike that could delay or preclude altogether our ability to generate revenues in the markets where such employees are located.

Some of our employees in our subsidiaries in Brazil and Argentina are members of labor unions. If a labor dispute were to develop between us and our unionized employees, such employees could go on strike and we could suffer work stoppage for a significant period of time. A labor dispute can be difficult to resolve and may require us to seek arbitration for resolution, which arbitration can be time consuming, distracting to management, expensive and difficult to predict. The occurrence of a labor dispute with our unionized employees could delay or preclude altogether our ability to generate revenues in the markets where such employees are located.

We are subject to litigation that could result in significant costs to us.

On July 13, 2010 the State Revenue Services of São Paulo issued a tax deficiency notice against our subsidiary in Brazil, Ituran Sistemas de Monitoramento Ltda., claiming that the vehicle tracking and monitoring services provided by our subsidiary should be classified as telecommunication services and therefore subject to the imposition of State Value Added Tax – ICMS, resulting in an imposition of 25% state value added tax on all revenues of our subsidiary during the period between August 2005 and December 2007. At the time the notice was served to us, the tax deficiency notice was in the amount of R$36,499,984 (approximately US$22.1 million at the time) plus interest in the amount of R$30,282,420 (approximately US$18.2 million at the time) and penalties in the amount of R$66,143,446 (approximately US$40.0 million at the time). On March 2, 2012 the Administrative Court of the State of São Paulo dismissed the State Revenue Services of São Paulo's claims and resolved in our favor. The State of São Paulo filed an administrative appeal to the full bench session at the Administrative Court which has been dismissed and such a decision is non-appealable .

Furthermore, it is noted that the effect of aforesaid decision is limited to the period of August 2005 up to December 2007. It is possible that the State of São Paulo may issue us additional tax deficiency notices regarding the past 5 year period. However, we maintain our position, based among other things on the results of the aforesaid legal proceedings, that if such tax deficiency notices are issued in future, our chances of success in defending its position are overwhelmingly favorable.

For information concerning additional litigation proceedings, please refer to Item 8.A – “Consolidated Statements and other Financial Information” under the caption “Material Legal Proceedings” below.

We have not obtained nor applied for several of the permits required for the operation of some of our base sites. To the extent enforcement is sought, the breadth, quality and capacity of our network coverage could be materially affected.

The provision of our SVR services depends upon adequate network coverage for accurate tracking information. In Israel, we have installed 103 base sites that provide complete communications coverage in Israel. Similarly, we have established complete communications coverage in Sao Paulo and Rio, Brazil and Buenos Aires, Argentina. The installation and operation of most of our base sites require building permits from local or regional zoning authorities as well as a number of additional permits from governmental and regulatory authorities.

Currently most of our base sites in Israel and Brazil and some of our base sites in Argentina operate without local building permits or the equivalent. Although relevant authorities in Israel, Brazil and Argentina have not historically enforced penalties for non-compliance with certain permit regulations, following ongoing press coverage and actions by various public interest groups, relevant Israeli and Argentine authorities have begun seeking enforcement of permit regulations, especially with respect to antennas constructed for cellular phone operators. Some possible enforcement measures include the closure or demolition of existing base sites or the imposition of limitation on erection of new base stations. Should these enforcement measures be imposed upon us in Israel or Argentina, the extent, quality and capacity of our network coverage and, as a result, our ability to provide SVR services, may be adversely affected.

Currency fluctuations may result in valuation adjustments in our assets and liabilities and could cause our results of operations to decline.

The valuation of our assets and liabilities, our revenues received and the related expenses incurred are not always denominated in the same currency. This lack of correlation between revenues and expenses exposes us to risks resulting from currency fluctuations. These currency fluctuations could have an adverse effect on our results of operations. In addition, fluctuations in currencies may result in valuation adjustments in our assets and liabilities which could cause our results of operations to decline.

RISKS RELATED TO OUR OPERATIONS IN ISRAEL

We are headquartered in Israel and therefore our results of operations may be adversely affected by political, economic and military instability in Israel.

Our headquarters and sole research and development facilities are located in Israel and our key employees, officers and directors are residents of Israel. Accordingly, security, political and economic conditions in Israel directly affect our business. Over the past several decades, a number of armed conflicts have taken place between Israel and its Arab neighbors. During July-August 2014 and November 2012, Israel was engaged in an armed conflict with a militant group and political party who control the Gaza Strip, and during the summer of 2006, Israel was engaged in an armed conflict with Hezbollah, a Lebanese Islamist Shiite militant group and political party. These conflicts involved missile strikes against civilian targets in various parts of Israel, including areas in which our employees and some of our consultants are located, and negatively affected business conditions in Israel. Continued or increased hostilities, future armed conflicts, political developments in other states in the region or continued or increased terrorism could make it more difficult for us to conduct our operations in Israel, which could increase our costs and adversely affect our financial results.

Israel has experienced in recent years, unionized general strikes in connection with the legislation of new economic reforms. A prolonged general strike in Israel would affect our ability to provide our wireless communications products that are manufactured in Israel and would negatively impact our operations. Furthermore, there are a number of countries, primarily in the Middle East, that still restrict business with Israel or Israeli companies and as a result our company is precluded from marketing its products in these countries. Restrictive laws or policies directed toward Israel or Israeli businesses could have an adverse affect on our ability to grow our business and our results of operations.

Under Israeli law, we are considered a “monopoly” and therefore subject to certain restrictions that may negatively impact our ability to grow our business in Israel.

We have been declared a monopoly under the Israeli Restrictive Trade Practices Law, 1988 (the "Israeli Antitrust Law"), in the market for the provision of systems for the location of vehicles. Under Israeli law, a monopoly is prohibited from taking certain actions, such as predatory pricing and the provision of loyalty discounts, which prohibitions do not apply to other companies. The Israeli antitrust authority may further declare that we have abused our position in the market. Any such declaration in any suit in which it is claimed that we engage in anti-competitive conduct would serve as prima facie evidence that we are a monopoly or that we have engaged in anti-competitive behavior. Furthermore, we may be ordered to take or refrain from taking certain actions, such as set maximum prices, in order to protect against unfair competition. If we breach certain provisions of the Israeli Antitrust Law, including as a monopoly, the Israeli antitrust authority may also impose on us in an administrative procedure, financial sanctions in an amount of up to the lower of NIS 24 million or 8% of our annual revenues for the last financial year prior to such breach. Restraints on our operations as a result of being considered a “monopoly” in Israel could adversely affect our ability to grow our business in Israel.

It may be difficult and costly to enforce a judgment issued in the United States against us, our executive officers and directors, or to assert United States securities laws claims in Israel or serve process on our officers and directors.

We are incorporated and headquartered in Israel. As a result, our executive officers and directors are non-residents of the United States and a substantial portion of our assets and the assets of these persons are located outside of the United States. Therefore, service of process upon any of these officers or directors may be difficult to effect in the United States. Furthermore, it may be difficult to enforce a judgment issued against us in the United States against us or any of such persons in both United States courts and other courts abroad.

Additionally, there is doubt as to the enforceability of civil liabilities under United States federal securities laws in actions originally instituted in Israel or in actions for the enforcement of a judgment obtained in the United States on the basis of civil liabilities in Israel.

Provisions of Israeli corporate and tax law may delay, prevent or otherwise encumber a merger with, or an acquisition of, our company, which could prevent a change of control, even when the terms of such transaction are favorable to us and our shareholders.

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. In addition, our articles of association contain, among other things, provisions that may make it more difficult to acquire our company, such as classified board provisions and certain restrictions on the members of our board pursuant to regulatory requirements of the Israeli Ministry of Communication. Furthermore, Israeli tax considerations may make potential transaction structures involving the acquisition of our company unappealing to us or to some of our shareholders. See Item 10.B. – "Memorandum and Articles of Association" - “Our Corporate Practices under the Israeli Companies Law” under the caption “Approval of Transactions under Israeli law” and Item 10.E. – “Taxation” under the caption “Israeli Tax Considerations” for additional discussion of some anti-takeover effects of Israeli law. These provisions of Israeli law and our articles of association may delay, prevent or otherwise encumber a merger with, or an acquisition of, our company or any of our assets, which could have the effect of delaying or preventing a change in control of our company, even when the terms of such a transaction could be favorable to our shareholders.

The rights and responsibilities of our shareholders will be governed by Israeli law and may differ in some respects from the rights and responsibilities of shareholders under United States law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical US-based corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith toward the company and other shareholders and to refrain from abusing his, her or its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli corporate law has undergone extensive revisions in the recent years and, as a result, there is little case law available to assist in understanding the implications of these provisions that govern shareholders' actions, which may be interpreted to impose additional obligations on holders of our ordinary shares that are typically not imposed on shareholders of US-based corporations.

RISKS RELATED TO OUR ORDINARY SHARES AND THE ECONOMY

Future sales of our ordinary shares could reduce the market price of our ordinary shares.

If we or our shareholders sell substantial amounts of our ordinary shares, either on the Tel Aviv Stock Exchange or the Nasdaq Global Select Market, the market price of our ordinary shares may decline.

The market price of our ordinary shares is subject to fluctuation, which could result in substantial losses for our investors.

The stock market in general, and the market price of our ordinary shares in particular, are subject to fluctuation, and changes in our share price may be unrelated to our operating performance. The market price of our ordinary shares has fluctuated in the past, and we expect it will continue to do so, as a result of a number of factors, including:

- the gain or loss of significant orders or customers;
- recruitment or departure of key personnel;
- the announcement of new products or service enhancements by us or our competitors;
- quarterly variations in our or our competitors' results of operations;
- announcements related to litigation;
- changes in earnings estimates, investors' perceptions, recommendations by securities analysts or our failure to achieve analysts' earning estimates;
- developments in our industry; and
- general market conditions and other factors unrelated to our operating performance or the operating performance of our competitors.

These factors and price fluctuations may materially and adversely affect the market price of our ordinary shares and result in substantial losses to our investors.

A significant portion of our ordinary shares are held by a small number of existing shareholders and you may not agree with some or all of the decisions taken by such shareholders.

Moked Ituran Ltd., currently beneficially owns approximately 19.44% of our outstanding ordinary shares (not including treasury stock held by us). The amount of shares owned by Moked Ituran Ltd, was significantly reduced on September 16, 2014, by 6.82% (from 26.26%), due to Moked Ituran Ltd Shareholder, F.K. Generators and Equipment Ltd. sale of 1,431,000 of our ordinary shares through Moked Ituran Ltd. For additional information concerning the transaction, see Item 6.A "Shareholders Agreement and Articles of Association of Moked Ituran

Ltd.". Other than applicable regulatory requirements under applicable law, Moked Ituran Ltd., is not prohibited from selling a controlling interest in our company to a third party. This shareholder could exercise significant influence over our operations and business strategy and may use its voting power to influence all matters requiring approval by our shareholders, including the ability to elect or remove directors, to approve or reject mergers or other business combination transactions, the decision to raise additional capital and the amendment of our articles of association that govern the rights attached to our ordinary shares. In addition, this concentration of ownership may delay, prevent or deter a change in control, or deprive our shareholders of a possible premium for ordinary shares as part of a sale of our company. For additional information concerning our major shareholders, see Item 7.A- "Major Shareholders" and Item 6.A. –Directors and Senior Management under the caption "Shareholders Agreement and Articles of Association of Moked Ituran Ltd.".

U.S. investors in our company could suffer adverse tax consequences if we are characterized as a passive foreign investment company.

If, for any taxable year, our passive income or our assets that produce passive income exceed levels provided by law, we may be characterized as a passive foreign investment company, which we refer to as PFIC, for US federal income tax purposes. This characterization could result in adverse US tax consequences to our shareholders who are U.S. Holders. See Item 10.E. – “Taxation” under the caption “United States Tax Considerations” below, for more information about which shareholders may qualify as U.S. Holders. If we were classified as a PFIC, a U.S. Holder could be subject to increased tax liability upon the sale or other disposition of our ordinary shares or upon the receipt of amounts treated as “excess distributions.” Under such rules, the excess distribution and any gain would be allocated ratably over the U.S. Holder’s holding period for the ordinary shares and the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a PFIC would be taxed as ordinary income. The amount allocated to each of the other taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such other taxable years. In addition, holders of shares in a PFIC may not receive a “step-up” in basis on shares acquired from a decedent. U.S. shareholders should consult with their own U.S. tax advisors with respect to the United States tax consequences of investing in our ordinary shares as well as the specific application of the “excess distribution” and other rules discussed in this paragraph. For a discussion of how we might be characterized as a PFIC and related tax consequences, please see Item 10.E. – “Taxation” under the caption “United States Tax Considerations–Passive foreign investment company considerations”.

Our ordinary shares are traded on more than one market and this may result in price variations.

Our ordinary shares are traded on the Nasdaq Global Select Market and the Tel Aviv Stock Exchange. Trading in our ordinary shares on these markets takes place in different currencies (dollars on the Nasdaq Global Select Market and NIS on the Tel Aviv Stock Exchange), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). The trading prices of our ordinary shares on these two markets may differ due to these and other factors. Any decrease in the trading price of our ordinary shares on one of these markets could cause a decrease in the trading price of our ordinary shares on the other market.

Securities we issue to fund our operations or in connection with acquisitions could dilute our shareholders ownership or impact the value of our ordinary shares.

We may decide to raise additional funds through a public or private debt or equity financing to fund our operations or finance acquisitions. If we issue additional equity securities, the percentage of ownership of our shareholders will be reduced and the new equity securities may have rights superior to those of our ordinary shares, which may, in turn, adversely affect the value of our ordinary shares.

Global and local economic downturns could reduce the level of consumer spending and available credit within the automobile industry, which could adversely affect demand for our products and services and negatively impact our financial results.

Current and future economic conditions could adversely affect consumer spending in the automobile industry, as such spending is often discretionary and may decline during economic downturns when consumers have less disposable income. Consequently, changes in general economic conditions resulting in a significant decrease in dealer automobile sales or in a tightening of credit in financial markets, such as the 2007 U.S. subprime mortgage crisis and resulting credit crunch, could adversely impact our future revenue and earnings. Such decreases could also affect the financial security of the automobile dealers with whom we do business. The delayed payment from or closure of our larger dealer groups could affect our ability to collect on our receivables. Similar effects could result from local

economic downturns in either one of our main markets of operations, i.e. Israel, Brazil and Argentina. Given the volatile nature of the current market disruption, we may not timely anticipate or manage such existing or new risks. Our failure to do so could materially and adversely affect our business, financial condition, results of operations and prospects.

ITEM 4. INFORMATION ON THE COMPANY

A.HISTORY AND DEVELOPMENT OF THE COMPANY

Our History

We are mainly engaged in the area of location-based services, consisting of stolen vehicle recovery, fleet management services and other tracking services. We also provide wireless communication products used in connection with our location-based services and various other applications. We currently primarily provide our services as well as sell and lease our products in Israel, Brazil, Argentina and the United States.

Ituran was initially incorporated in February 1994 in Israel as a subsidiary of Tadiran Ltd., an Israeli-based designer and manufacturer of telecommunications equipment, software and defense electronic systems, whose original business purpose was to adapt military-grade technologies for the civilian market. In July 1995, Moked Ituran Ltd. purchased us and the assets used in connection with our operations from Tadiran and Tadiran Public Offerings Ltd. The AVL infrastructure and AVL end-units for the operation of our SVR services were originally developed by an independent division of Tadiran Communications and Systems Group. These operations were later transferred to a Tadiran subsidiary, Tadiran Telematics Ltd. In November 1999, we purchased Tadiran Telematics from Tadiran and in 2002, we changed its name to Telematics Wireless.

In May 1998, we completed the initial public offering of our ordinary shares in Israel and our ordinary shares began trading on the Tel-Aviv Stock Exchange. In September 2005, we publicly offered our ordinary shares in the United States and our ordinary shares are currently quoted on both the Tel-Aviv Stock Exchange and on Nasdaq under the symbol “ITRN”. The address of our principal executive office is 3 Hashikma Street, Azour 58001, Israel. Our telephone number is 972-3-557-1333. Our agent for service of process in the United States is Ituran USA Inc.1700 NW 64th ST. SUITE 100 Fort Lauderdale, Florida 33309.

In 2006 we acquired control of E.R.M. Electronic Systems Limited (“ERM”), a developer, manufacturer, and marketer of innovative vehicle security, tracking, and management GSM based communication solutions for the international market. Since such acquisition, we have been developing our fleet management services and products, which now constitute a material portion of our operations.

In 2007, we purchased the entire issued share capital of Mapa Group from its shareholders for US$9.9 million. In addition, we invested an additional sum of approximately US$3.1 million in Mapa Group, which was used by Mapa Group to repay shareholders’ loans. Mapa Group is a provider of geographic information (GIS) in Israel and owner of geographic information database for navigation in Israel.

On December 31, 2007, we completed the sale of our subsidiary, Telematics Wireless Ltd., to ST (Infocomm). Pursuant to the sale transaction, we sold our entire shareholdings, constituting 93.93%, of Telematics Wireless to ST (Infocomm), for an enterprise value of US$90 million (following repurchase of our shares in Telematics for the aggregate sum of US$5 million). Pursuant to an adjustment mechanism as detailed in the agreement and following arbitration proceedings with ST, the purchase price was adjusted by US$4.4 Million. For details regarding the recent conclusion of arbitration proceedings related to the sale of Telematics to ST (Infocomm), please refer to Item 8.A. – “Consolidated Statements and other Financial Information” under the caption “Material Legal Proceedings” below.

In January 2008, we entered into a 10 year Frame Product and Service Purchase Agreement with Telematics, pursuant to which the Company and Telematics shall purchase from each other certain products and services as detailed in the agreement for a price and other conditions as detailed in the agreement. In addition, each of Ituran and Telematics undertook toward one another not to compete in each other's exclusive markets in the area of RF vehicle location and tracking RF technology or similar RF terrestrial location systems and technology. The agreement is for a term of 10 years, following which it shall be renewed automatically for additional consecutive 12 months periods, unless non-renewal notice is provided by one of the parties to the other. Pursuant to the agreement, each of Telematics and Ituran granted the other party a license to use certain technology in connection with the products and services purchased from each other, which license shall survive the termination or expiration of the agreement.

In 2010 we launched a new line of AVL products (IturanSave), which is based on our SMART products and tailored to be installed in medium-end vehicles, a market which was not previously targeted by us, offering our customers an affordable tracking device solution. This new line of products led to an increase in our sales since then.

On April 9, 2012, we entered into an agreement with General Motors Brazil ("GMB") through a Brazilian company controlled by us. According to the agreement, GMB will offer its customers immobilization, location and Telematics services for the Chevrolet range of vehicles it sells in Brazil through Ituran's Brazilian company. The sale and the installation of the anti-theft device will not be carried out by us. For the purposes of this agreement, we incorporated a new Brazilian subsidiary, Ituran Road Truck Ltda. in which we own 50% of the issued share capital. As of the date hereof, this Brazilian subsidiary has not yet commenced operations.

In December 2013 we invested $1.4 million in Bringg delivery technologies Ltd. (formerly Overvyoo Ltd.), an Israeli start-up company developing solutions for the management of mobile/field workforce. According to the agreement with Bringg, we have invested by January 2015 an additional amount of $1.1 million and we now hold 40.8% of its share capital.

Capital Expenditures and Divestitures

We had capital expenditures of $15.2 million in 2014, $14 million in 2013 and $10 million in 2012. We have financed our capital expenditures with cash generated from our operations.

Our capital expenditures in 2014, 2013 and 2012 consisted primarily of acquisition of operational equipment for $11.2 million, $10.2 million and $5.6 million, respectively.

We did not have any material capital divestitures during the last three fiscal years and until the date of this report.

B.BUSINESS OVERVIEW

Overview

We believe we are a leading provider of location-based services, consisting predominantly of stolen vehicle recovery, fleet management services and other tracking services. We also provide wireless communications products used in connection with our location-based services. We currently primarily provide our services and sell and lease our products in Israel, Brazil, Argentina and the United States. We utilize technologies that enable precise and secure high-speed data transmission and analysis. Some of the technology underlying our products was originally developed for the Israeli Defense Forces in order to locate downed pilots.

We generate our revenues from subscription fees paid for our location-based services and from the sale and lease of our wireless communications products.

We describe below the principal markets in which we compete. For a breakdown of total revenues by category of activity and geographic market for each of the last three financial years, please see Item 5.A - Operating Results under the caption "Revenues".

Location-Based Services

In 2014, 73.4% of our revenues were attributable to our location-based services. As of December 31, 2014, we primarily provided our services in Israel, Brazil, Argentina and the United States to approximately 340,000, 298,000, 158,000 and 21,000subscribers, respectively.

Stolen vehicle recovery services

Our stolen vehicle recovery and tracking services, which we refer to as SVR services, enable us to locate, track and recover stolen vehicles for our subscribers. Our customers include both individual vehicle owners who subscribe to our services directly and insurance companies that either require their customers to install a security system or offer their customers financial incentives to subscribe to SVR services such as ours. In certain countries, insurance companies directly subscribe to our SVR services and purchase automatic vehicle location products supporting these SVR services from us on behalf of their customers.

Fleet management services

Our fleet management services enable corporate and individual customers to track and manage their vehicles in real time. Our services improve appointment scheduling, route management and fleet usage tracking, thereby increasing efficiency and reducing operating costs for our customers. We market and sell our services to a broad range of vehicle fleet operators and individual vehicle owners in different geographic locations and industries. As of December 31, 2014, we provided our services to approximately 122,000 end-users through 28,000 corporate customers in Israel, Brazil, Argentina and the United States. We are currently exploring collaborations with local entities in other regions of the world for the marketing of our fleet management services and products in such regions.

Value-added services

The personal locator services that we offer allow customers to protect valuable merchandise and equipment. We currently provide personal locator services in Israel, Brazil and Argentina and, as of December 31, 2014, we had approximately 8,000 subscribers to this service. In addition, through a call center, we provide 24-hour on-demand navigation guidance, information and assistance to our customers. Such services include the provision of traffic reports, help with directions and information on the location gas stations, car repair shops, post offices, hospitals and other facilities. We provide our concierge services to our subscribers in Israel, Argentina and Brazil. As of December 31, 2014, we had approximately 160,000 subscribers to our concierge service.

Wireless Communications Products

In 2014, 26.6% of our revenues were attributable to the sale of our wireless communications products. Our wireless communications products employ short- and medium-range communication between two-way wireless modems and are used for various applications, including automatic vehicle location, which we refer to as AVL.

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Our AVL products enable the location and tracking of vehicles, as well as assets and persons, and are used by us primarily to provide SVR and fleet management services to our customers. Each subscriber to our SVR services has our AVL end-unit installed in his or her vehicle. Subscribers to services for locating equipment and merchandise will use our SMART products. As part of our expansion into additional markets, in 2006 we acquired control of E.R.M. Electronic Systems Limited ("ERM"), a developer, manufacturer, and marketer of innovative vehicle security, tracking, and management GSM based communication solutions for the international market. Subscribers to our fleet management services use ERM hardware and our proprietary software

Industry Overview

While we believe that the statistical data, industry data forecasts and market research discussed below are reliable, we have not independently verified the data, and we do not make any representation as to the accuracy of the information

(a) Location-based services

Stolen vehicle recovery

The demand for vehicle security products and services is driven by vehicle theft rates, increasing security awareness among customers and insurance companies' efforts to reduce incidents of loss. In addition, in Brazil, which is one of our primary markets, a regulation was adopted pursuant to which new vehicles (cars, motorcycles, trucks etc.), manufactured in Brazil or imported into the country may only be sold when equipped with a blocking (immobilizing) and GPS location system or tracking system (such as our products). However the implementation date of this regulation was delayed to June 31, 2016. This regulation may not enter in force on such date and may be subject to further delays, to amendments or to cancelation. In some of our markets, demand for SVR services has been enhanced by incidents of carjacking and car-related kidnappings that have increased consumers' perceived crime risk. Additionally, theft of trucks carrying valuable or hazardous cargo (e.g., microchips and chemicals) represents a threat to commercial, industrial, public and personal safety and security.

A wide range of vehicle security products, with varying degrees of sophistication and pricing, are available to vehicle owners today. These products can be divided roughly into two categories:

1) Traditional products, such as locks, alarms and traditional immobilizers. These devices are limited in their effectiveness as most can be disarmed easily and typically require the driver to activate the device upon leaving the vehicle. Also, unmonitored alarms that set off sirens are routinely ignored by people as the incidence of false alarms has been historically high. Furthermore, these products can only help in preventing theft and not in recovering the vehicle once it is stolen.

2) More sophisticated products that include some form of remote monitoring and communication. This category can be further separated into devices that simply provide information on the general direction of the vehicle and those that enable the location, tracking and recovery of the vehicle in real time.

AVL technology is typically used to report stolen vehicles to police, provide real-time location and tracking information and immobilize the vehicle if necessary. The application of AVL technology has proven to be effective in increasing the recovery rates of stolen vehicles. As a result, many insurance companies in countries such as Israel, Brazil and Argentina either offer discounts between 10% and 20% on insurance premiums for vehicles equipped with AVL systems or require customers to install such AVL systems in vehicles above a pre-determined value.

Fleet management

The market for fleet management services ranges from very large fleets of thousands of vehicles to very small fleets of five vehicles or less, with smaller fleets constituting a significant portion of the market given the large number of companies that maintain a fleet today. Fleet management services allow fleet operators and individuals to locate, monitor and communicate with their vehicles and employees in the field in real time. This helps them to better track loads, predict arrival times, schedule customer appointments, reduce fuel usage and manage vehicles' maintenance schedules. By increasing efficiency and reducing costs, fleet management can provide a quantifiable return on investment for fleet operators, as well as improve customer satisfaction. In addition, fleet management services can enhance driver security and can notify the fleet operator if a vehicle leaves a prescribed geographic region, reducing theft-related liabilities.

A principal factor supporting fleet management industry growth is the presence of millions of vehicles that are in commercial use but which are not yet equipped with fleet management systems.

(b) Wireless communications products

Automatic vehicle location

AVL is one of the many possible applications for wireless location technology and is an umbrella term used for communication equipment and services that facilitate wireless tracking of vehicles, as well as assets and persons.

Typical AVL applications include:

Security	Transportation	Telecommunication services	Government
Vehicle tracking	Fleet management	Maintenance vehicle tracking	Government vehicle tracking
Driver Behavior and Accident Notification	Parcel tracking		
Personal tracking	Public transit		
Asset tracking			

Currently, the main underlying technologies available for wireless location and tracking in the AVL industry are terrestrial network triangulation, GPS (in combination with wireless communication), network-based cellular communication and radio frequency-based homing.

- Terrestrial network triangulation uses the wireless signals transmitted by an end-unit in the vehicle and received by a network of land-based wireless antennas (base stations) installed in the relevant coverage region in order to determine the precise location of the transmitter.

- GPS-based systems utilize specially designed GPS devices in the vehicle that receive data from three or more satellites in order to determine the location of the device. Once located, GPS-based systems require a cellular or another wireless network to communicate with a remote control center.

- Network-based cellular systems utilize signals between the wireless device and the cellular operator's network of land-based antennas in order to triangulate the location of the relevant device. These systems require two-way communication between the device and antennas and, therefore, both a transmitter and receiver need to be installed in the vehicle.

- RF-based homing systems utilize direction-finding technology based on a tracking signal transmitted by the end-unit in the vehicle, which is activated by a unique radio signal from the tracking unit once the vehicle is reported stolen.

Our Services and Products

Location-based services

Stolen vehicle recovery

Our stolen vehicle recovery system is based on three main components: an AVL end-unit that is installed in the vehicle, a network of base stations and a 24-hour manned control center. Once the control center receives indication of an unauthorized entry into a vehicle equipped with our AVL end-unit, our operators decide whether it is a false alarm or an actual unauthorized entry. If it is determined to be an unauthorized entry, or if a notification of the vehicle’s theft is received directly from the vehicle operator, our operators transmit a signal that activates the transmitter installed in the vehicle. We then pinpoint the location of the transmitter with terrestrial network triangulation technology or GPRS technology and notify the relevant law enforcement agency. In Israel, Brazil and Argentina, we also maintain private enforcement units, which work together with local police to recover the vehicle. In addition, we have the capability to immobilize vehicles remotely from our control centers.

Fleet management

We offer our customers the ability to use a comprehensive application for fleet management both by using an Internet site and workstations. Our system allows our customers 24-hour access to information on their fleets through our active control center and we are able to tailor our system to our customers' specific needs.

Our solutions allow our subscribers to effectively manage and control their fleet, and thereby to reduce their operating costs, optimize work hours and appointment scheduling and improve their services and operations. Our system includes the following features:

- the ability to locate the fleet's vehicles;
- continuous data communication with the fleet's vehicles;
- real-time vehicle status indicators: speed, distance driven, direction of travel, driver name, motion start/stop, engine start/stop, speeding, diagnostic alerts, driver behavior and more;
- recording of determined events and analysis of data over time to improve driving and vehicle use;
- remote monitoring and processing of data, such as temperature control in refrigerated or chilled compartments, time stamp, tire pressure and heat and other complementary data;
- connection to standard organization systems;
- accident notification;
- driver's behavior; and
- task management optimization.

Value-added services

Locator services. Our services allow consumers to protect valuable merchandise and equipment. We provide our locator services in Israel, Brazil and Argentina.

Concierge services. Through a call center, we provide 24-hour on-demand navigation guidance, information and assistance to our customers. Such services include the provision of traffic reports, help with directions and information on the location of gas stations, car repair shops, post offices, hospitals and other facilities. We provide our concierge services to subscribers mainly in Israel.

Wireless communications products

Our wireless communications products are used for various applications in the AVL markets and primarily in connection with our location-based services described above.

Our AVL products enable the location and tracking of vehicles, as well as assets or persons, and are primarily used by us in providing our SVR and fleet management services. Each subscriber to our SVR services has one of our end-units installed in his or her vehicle. Subscribers to services for locating persons or valuables will use our SMART products. Our key wireless communications products for AVL applications include:

- Base Site: a radio receiver, which includes a processor and a data computation unit to collect and send data to and from transponders and send that data to control centers as part of the terrestrial infrastructure of the location system;

- Control Center: a center consisting of software used to collect data from various base sites, conduct location calculations and transmit location data to various customers and law enforcement agencies;

- GPS/GPRS-based products: navigation and tracking devices installed in vehicles; and

- SMART: a portable transmitter installed in vehicles (including motorcycles) that sends a signal to the base site, enabling the location of vehicles, equipment or an individual;

Geographical Information

The following table lists the key services and products that we currently sell or lease in different regions of the world:

Country	Services offered	Products sold
Israel	SVR Fleet Management Value-added services	AVL
Brazil	SVR Fleet Management Value-added services	AVL
Argentina	SVR Fleet Management	AVL
United States	SVR Fleet Management Value-added services Asset protection to Auto Lenders	AVL

In each of the above countries we maintain a control center, which is operated 24 hours a day, 365 days a year. The following is a short description of key operating statistics about our location-based services in the countries in which we operate:

- Israel: We commenced operations in Israel in 1995 and we had approximately 340,000 subscribers as of December 31, 2014. We maintain 103base stations in Israel, which provide complete coverage within the country. We also operate throughout Israel in providing fleet management services through GPS/GPRS based products and services.

- Brazil: We commenced operations in Brazil in 2000 and we had approximately 298,000 subscribers as of December 31, 2014. We currently provide RF based products and services only in the metropolitan areas of Sao Paulo, Campinas, Americans and Rio de Janeiro, where we maintain 137 base stations; however we operate throughout Brazil in providing GPS/GPRS based products and services.

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Argentina: We commenced operations in Argentina in 2002 and we had approximately 158,000 subscribers as of December 31, 2014. We currently provide RF based products and services only in the metropolitan area of Buenos Aires, where we maintain 43 base sites; however, we also operate throughout Argentina in providing GPS/GPRS based products and services for fleet management.

- United States: We commenced operations in the United States in 2000. We provide GPS/GPRS products and services throughout the United States. As of December 31, 2014, we had approximately 21,000 subscribers for our location-based services in the United States.

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Customers, Marketing and Sales

We market and sell our products and services to a broad range of customers that vary in size, geographic location and industry. In 2012, 2013 and 2014 no single customer or group of related customers comprised more than 10% of our total annual revenues.

Our selling and marketing objective is to achieve broad market penetration through targeted marketing and sales activities. As of December 31, 2014, our selling and marketing team consisted of 127 employees.

(A) Location-based services

Stolen vehicle recovery

Our marketing and sales efforts are principally focused on five target groups: insurance companies and agents, car manufacturers, dealers and importers, cooperative sales channels (mostly vehicle fleet operators and owners) and private subscribers.

We maintain marketing and sales departments in each geographical market in which we operate. Each department is responsible for maintaining our relationships with our principal target groups. These responsibilities also include advertising and branding, sales promotions and sweepstakes.

In Israel, Brazil and Argentina, we focus our marketing efforts on insurance companies and private customers; while in Brazil, our primary focus has shifted to the retail market during recent years. In the United States, we believe that insurance companies do not constitute a material influence in the marketing of SVR services or AVL products. Most of our sales in the United States are made through car dealerships and dealers for new or used cars. Our customers in the SVR market include insurance companies as well as individual vehicle owners. As of December 31, 2014, we had a total of approximately 817,000 subscribers for our SVR services.

Fleet management

Vehicle fleet management systems are primarily marketed through vehicle fleets' departments, which form a part of our regional marketing departments. We conduct in-depth research to identify companies that will gain efficiency and cost savings through the implementation of our products and services, and conduct targeted marketing campaigns to these companies. In addition, we participate in professional conventions and advertise in professional publications and journals designed for our target customers. Our customers in the fleet management market include small-, mid- and large-size enterprises and individuals. As of December 31, 2014, we provided our services to approximately 122,000 end users through 28,000 corporate customers and individuals in Israel, Brazil, Argentina and the United States. We are currently exploring collaborations with local entities in other regions of the world for the marketing of our fleet management services and products in such regions.

Value-added services

Our concierge services are provided to existing SVR customers. As of December 31, 2014, we had approximately 160,000 subscribers to our concierge service in Israel, Argentina and Brazil and approximately 8,000 of our SMART devices were installed in valuable merchandise and equipment.

(B) Wireless communications products

Our AVL end-units are primarily used by us in providing our location-based services, including fleet management and value-added services, in Israel, Brazil, Argentina and the United States.

Competition

We face strong competition for our services and products in each market in which we operate. We compete primarily on technology edge, functionality, ease of use, quality, price, service availability, geographic coverage, track record of recovery rates and response times and financial strength.

(A) Location-based services

We compete with a variety of companies in each of our markets. The three major technologies utilized by our competitors are GPS/cellular, network-based cellular and radio frequency-based homing systems. In addition, new competitors utilizing other technologies may continue to enter the market.

Stolen vehicle recovery

- Israel. Our primary competitors in Israel are Eden Telecom Ltd. (Pointer) and Skylock Ltd.

- Brazil. Brazil is a highly fragmented market with many companies selling competing products and services (including immobilizers and other less-sophisticated vehicle security systems). Our main competitors in Brazil are Sascar, LoJack Corporation and Car System.

- Argentina. Argentina is also a highly fragmented market with many companies selling competing products and services (including immobilizers and other less-sophisticated vehicle security systems). Our main competitors in Argentina are LoJack Corporation and Megatrans S.A..

- United States. In the United States, there are several major companies offering various theft protection and recovery products that compete with our product and service offerings, including LoJack Corporation, OnStar Corporation, Sky Link Corporation, Spireon (which also includes SysLocate and GoldStar), PassTime, Guide Point, Sky Patrol, Sky Guard, I-Metrik SVR and Position Plus.

We believe that we are a leading provider of location-based services in Israel, as we are deemed a monopoly in this field; however, we are unable to provide specific market share information in the markets of our operations for various reasons, including the broad range of services and products that compete in these markets, the non-existence of trade publications with respect to the products and services we offer in such markets and the lack of meaningful or accurate market research or data available to us.

Fleet Management

The vehicle fleet management market is highly fragmented with many corporations offering location products and services. Our major competitors in Israel are Pointer, ISR, Traffilog and Skylock; our major competitors in the United States are GPS Insight, Trimble, Network Fleet, Street Eagle, FleetMatics, Navtrack, Teletrac, Trim Track, FleetBoss, PassTime and Spireon; our major competitors in Brazil are Sascar, Onixsat, Autotrac and Omnilink; and our major competitors in Argentina are LoJack Corporation, Megatrans SA., G4S, Sitrac S.A., American Tracer, Ubicar S.A. and Sky Cop.

(B) Wireless communications products

Our AVL system for automatic vehicle location is based on terrestrial network triangulation technology and primarily competes with companies that use one of three main technologies: GPS/GPRS (in combination with wireless communication), network-based cellular communication and radio frequency-based homing.

Although AVL products based on GPS, network-based cellular and homing technologies do not require the construction of a separate infrastructure of base stations as with terrestrial network triangulation systems such as ours, such solutions have certain drawbacks. GPS receivers require line of sight to at least three satellites, which reduces their effectiveness in areas where the satellite signals are subject to interference and "noise" (such as urban areas, buildings or parking garages, forests and other enclosed or underground spaces). GPS and network-based cellular systems are also prone to jamming since the tracking signal receivers are located in the vehicle and can be easily tampered with. In addition, the satellites utilized by GPS devices are managed by the United States Department of Defense and can be subject to forced temporary outages. The main disadvantage of homing systems is that they provide only the general direction and not the precise location of the end-unit. In addition, homing systems require that the vehicle be reported stolen before the tracking signal can be activated, which may result in a delay between vehicle theft and recovery.

Terrestrial network triangulation systems have succeeded in overcoming some of the challenges faced by systems based on other technologies. Terrestrial network triangulation technology does not require line of sight and the signals are not easily interrupted in densely populated or obstructed areas. Also, the signals are transmitted from the end-unit in the vehicle to a network of base stations. Therefore, in order to jam the system, receivers in each individual base station within range of the end-unit would have to be jammed, which is difficult to accomplish. Additionally, since the primary application of terrestrial network triangulation systems in the AVL industry is vehicle location and not continuous two-way communication, short bursts of data are sufficient for tracking purposes, which enable the network of base stations to be deployed at a much lower density in the coverage area than traditional network-based cellular base stations. Terrestrial network triangulation systems are capable of determining the precise location, and not just the general direction, of a vehicle at any moment in time. Furthermore, when connected with the existing theft protection system in the vehicle, terrestrial network triangulation systems automatically alert the control center when a vehicle is stolen and do not require that the vehicle be reported stolen, which can potentially reduce stolen vehicle recovery times to a few minutes. The main disadvantage of terrestrial network triangulation systems is the necessity to deploy a physical infrastructure, including the construction, development and deployment of a network of base stations and a control center and the need to address the various financial, legal and practical issues associated with such deployment. Any such deployment entails an investment of a sizable amount of money prior to the receipt of any revenues.

Since our AVL end-units are primarily used by us in providing our location-based services, the information provided above concerning our competition in this market is applicable to the competition in the wireless communications products' market as well.

Manufacturing Operations and Suppliers

Our wireless communications products are manufactured and assembled by a limited number of manufacturers in Israel (including our subsidiary ERM). We engage with our manufacturers on a full turn-key basis, where we supply detailed production files and materials list and receive a final product that we sell directly to our clients. Other than our dependency on Telematics, as described in Item 3, "Risk Factors" above, we do not depend on a single manufacturer for the production of our products. Our main manufacturers and assemblers are Telematics and E.R.M Electronic Systems Limited (our subsidiary). For further details of our agreement with Telematics concerning the supply of products and services see Item 4.A – History and Development of our Company under the caption "Our History" above.

Our quality assurance and testing operations are performed by our manufacturers at their facilities, while using our quality assurance and testing equipment and in accordance with the test procedures designated by us. We monitor quality with respect to key stages of the production process, including the selection of components and subassembly suppliers, warehouse procedures, assembly of goods, final testing, packaging and shipping. We are ISO 9001 certified. We believe that our quality assurance procedures have been instrumental in achieving the high degree of reliability of

our products.

Several components and subassemblies included in our products are presently obtainable from a single source or a limited group of suppliers and subcontractors. We maintain strong relationships with our manufacturers and suppliers to ensure that we receive an adequate supply of products, components and raw materials at favorable prices and to access their latest technologies and product specifications.

Proprietary Rights

We seek to protect our intellectual property through patents, trademarks, contractual rights, trade secrets, know-how, technical measures and confidentiality, non-disclosure and assignment of inventions agreements and other appropriate protective measures to protect our proprietary rights in the primary markets in which we operate. The continued use of some licenses granted by third parties to use their intellectual property is material to our business. Please refer to Item 3.D – Risk Factors, under the caption "We rely on some intellectual property that we license from third parties, the loss of which could preclude us from providing our SVR services or market and sell some of our AVL products, which would adversely affect our revenues" above.

We typically enter into non-disclosure and confidentiality agreements with our employees and consultants. We also seek these protective agreements from some of our suppliers and subcontractors who have access to sensitive information regarding our intellectual property. These agreements provide that confidential information developed or made known during the course of a relationship with us is to be kept confidential and not disclosed to third parties, except in specific circumstances.

Our stolen vehicle recovery system is based on three main components: (i) an AVL end-unit that is installed in the vehicle, (ii) (for RF technology based AVL units) a network of base stations that relay information between the vehicle location units and the control center, certain components of which were developed by third parties and are currently licensed to us and (iii) a 24-hour manned control center consisting of software used to manage communications and the exchange of information among the hardware components of the AVL system, certain components of which were developed by third parties and licensed to us. For details concerning the non-exclusive license granted by Telematics to us in respect of the RF technology incorporated in some of our products, please refer to Item 4.A. – History and Development of our Company under the caption “Our History” above.

“Ituran”, “Mr. Big”, “Mapa” and the related logos are our trademarks, which have been registered in Israel. This report also refers to brand names, trademarks, service marks and trade names of other companies and organizations, each of which is the property of its respective holder.

Regulatory Environment

In order to provide our SVR services in the locations where we currently operate, we need to obtain four primary types of licenses and permits: (i) for our products utilizing the RF technology - a license that allows us to use designated frequencies for broadcasting, transmission or reception of signals and information and to provide telecommunication services to our customers, (ii) for our products utilizing the RF technology - a building permit, which permits us to erect our base sites and transmit therefrom, (iii) product specific licenses (commonly known as type approvals), which enable us to use the equipment necessary for our services, and (iv) a general commerce license, which allows us to offer our services to the public.

The telecommunication services and frequency license and general commerce licenses we require are granted by the applicable national agency regulating communications in the markets in which we operate, specifically, the Ministry of Communication, in Israel, Anatel – Agencia Nacional de Telecomunicatoes, in Brazil, the Comision Nacional de Comunicaciones, in Argentina, and the Federal Communications Commission, in the United States. The product specific licenses we require are granted in Israel by the Ministry of Communication, in Brazil by IBRACE (the Instituto Brasileiro de Certificatao de Productos para Telecominicatoes), in Argentina by the National Institute of Industrial Technology of Argentina and in the United States by the Federal Communications Commission.

In Brazil, the general commerce licenses, such as the city permits, are granted by the local municipalities and other specific entities, depending on the licenses required.

Our frequency licenses in all of the locations where we operate are “secondary” or “joint”, which means that the government may grant another person or persons, typically a cellular operator, a primary license to the same frequencies and, to the extent our operations interfere with the operations of the other person, we would have to modify our operations to accommodate the joint use of the frequencies. All of these licenses are also subject to revocation, alteration or limitation by the respective authority granting them. While any events that would cause us to change frequencies or to modify our operations could have a material adverse effect on us, we do not believe that this is a likely event in any of the locations where we provide our SVR services.

Our frequency license in Israel was renewed for a term of five (5) years until July 31, 2017. Our frequency licenses in Brazil expire in 2019. Except in Brazil, where a request for a new license may have to be filed upon expiration of the license in 2019, we have options to extend all of our frequency licenses for periods ranging from three- to ten-years. In Argentina,the SECOM (Secretary of Communication), on July 15, 1999, granted us a license to provide services and the authorization to use frequencies. These authorizations do not have any expired date.

In Israel and Brazil, like our competitors and most cellular operators, we are not in compliance with all relevant laws and regulations in connection with the erection of transmission antennas (our base sites). As of the date hereof, most of our base sites in Israel and Brazil are operating without local building permits. Currently, there is heightened awareness of this issue in Israel, particularly in connection with base sites of cellular providers, and possible sanctions could include fines and even the closure or demolition of these base sites. In Brazil, Brazilian authorities enforce permit requirements and impose penalties for non-compliance with such requirements. However, we do not believe this is likely. Obtaining such required permits may involve additional fees as well as payments to the Land Administration Authority.

In Israel the required permits and approvals for the erection of the base sites include:

n erection and operating permits from the Israeli Ministry of the Environment;

n permits from the Israeli Civil Aviation Authority, in certain cases;

n permits from the Israeli Defense Forces;

n approval from Israel's Land Administration and/or from Civil Administration in the Territories, which usually also involves payment for the land use rights; and

n building permits from local or regional zoning authorities in Israel and Brazil.

We are continuously in the process of obtaining the relevant permits required for the construction of our base sites in Israel, however, to date, we have been issued only 28 of these permits (13 of them have expired). With respect to the general permit from Israel’s Land Administration, in 2005 we entered into an agreement with the Israel’s Land Administration, pursuant to which the general permit has been issued to us against an annual consideration based on the date of approval of our base sites. The agreement had expired on December 31, 2010. In the event that the Israel Land Administration claims consideration for the erection of the base sites without a permit, we may be subject to penalties and payment of annual consideration for the years of use of those base sites.

In Brazil, very few providers of wireless telecommunications services obtain the required permits for the erection of transmission antennas due to the nature of the approval process. Currently we do not have such permits (except Anatel permits). In Brazil, we try to minimize our risk by locating most of our equipment in sub-leased sites which are already used by other telecommunication service providers, such as cellular operators. In Brazil the required permits for the erection of our base sites include:

- a permit from Anatel (National Agency for Telecommunication)
- a permit from IBAMA (Environment national agency) and/or state EPAs
- Municipal permits
- a permit from the fire department.
- and a permit from COMAR (Aviation authorities)

ANATEL permits are required only for sites where we have transmission equipment and we have obtained all the permits required with this agency. Special IBAMA permits need to be obtained only for ground sites which are located in certain preservation areas. We have few sites of this kind, most of them are collocated sites where we pay for the right of use and permits are undertaken by the landowner. Fire Department permits are required only for equipment rooms and we have not applied for any as of this date. COMAR permits are needed only for a very few of our sites, most of which are collocated.

We have been declared a monopoly under the Israeli Restrictive Trade Practices Law, 1988, in the provision of systems for the location of vehicles in Israel. This law prohibits a monopoly from abusing its market position in a manner that might reduce competition in the market or negatively affect the public. For instance, a monopoly is prohibited from engaging in predatory pricing and providing loyalty discounts, which prohibitions do not apply to other companies. The law empowers the Commissioner of Restrictive Trade Practices to instruct a monopoly abusing its market power to perform certain acts or to refrain from taking certain acts in order to prevent the abuse. Additionally, any declaration by the Israeli antitrust authority that a monopoly has abused its position in the market may serve in any suit in which it is claimed that such a monopoly engages in anti-competitive conduct, as prima facie evidence that it has engaged in anti-competitive behavior. Our declaration as a monopoly in the market of “provision of systems for the location of vehicles in Israel” was not accompanied with any instructions or special restrictions beyond the provisions of the Restrictive Trade Practices Law. Although we may be ordered to take or refrain from taking certain actions, to date we have not been subject to such restrictions.

C.ORGANIZATIONAL STRUCTURE

We were initially incorporated as a subsidiary of Tadiran, an Israeli-based designer and manufacturer of telecommunications equipment, software and defense electronic systems, whose original business purpose was to adapt military-grade technologies for the civilian market. In July 1995, Moked Ituran Ltd. purchased our company and the assets used in connection with its operations from Tadiran and Tadiran Public Offerings Ltd. The AVL infrastructure and AVL end-units for the operation of our SVR services were originally developed by an independent division of Tadiran Communications and Systems Group. These operations were later transferred to a Tadiran subsidiary, Tadiran Telematics Ltd. In November 1999, we purchased Tadiran Telematics from Tadiran and in 2002, we changed its name to Telematics Wireless. In December 2007 we sold our subsidiary Telematics – for further information please refer to Item 4.A. – “History and Development of the Company” under the caption “Our History” above.

List of Significant Subsidiaries

Name of Subsidiary	Country of Incorporation	Proportion of Ownership Interest
Ituran USA Holdings Inc.	USA	100%
Ituran USA Inc.	USA	88.5%*
Ituran de Argentina S.A.	Argentina	100%
Ituran Sistemas de Monitoramento Ltda.	Brazil	98%**
Ituran Instalacoes Ltda.	Brazil	98%
Teleran Holding Ltda.	Brazil	99.99%
Ituran servicos Ltda.	Brazil	98%
Ituran Road Truck Ltda.	Brazil	50%
E.R.M. Electronic Systems Limited	Israel	51%

Mapa Internet Ltd.	Israel	100%
Mapa Mapping & Publishing Ltd.	Israel	100%

* 88.5% of the shares are held by Ituran U.S.A. Holding Inc., which is our wholly owned subsidiary; and the remaining shares are held by employees of Ituran USA Inc.
** we indirectly hold 98% of the shares (out of which one share is being held by Mr. Avner Kurz, the President of Teleran Holding Ltda.)
*** we indirectly hold 98% of the shares.

D.PROPERTY, PLANTS AND EQUIPMENT

As of the date of this report, and other than an office building of 8 floors in the area of approximately 5,356 sqm (57,651 square feet), which was purchased by our subsidiary Ituran Sistemas de Monitoramento Ltda (Ituran Brazil) in Sao Paulo, Brazil, and was later, on December 3, 2014 sold to us, we do not own any real estate.

Other than the property in Brazil, all of our offices, headquarters, control centers and facilities are leased in accordance with our specific needs in the areas in which we operate. Additionally, we lease space for our base sites, in order to operate the reception and transmission stations of the system, in each area in which we provide our SVR services.

In 2014 we leased an aggregate of approximately 43,153 square feet of office space in Azour and Holon, Israel. In 2014, the annual lease payments for these facilities were approximately $684,000. The initial term of the primary lease (in Azour) expired on March 31, 2013; and we renewed the lease until 2020. These premises include our executive offices and the administrative and operational centers for our operations as well as our customer service, value-added services and technical support centers for the Israeli market.

In Buenos Aires, Argentina, we lease approximately 8,793 square feet of office space for approximately $ 83,470 annually, approximately 720 square feet for our control center for approximately $ 6,841 annually, approximately 5,253 square feet for our installation center for approximately $ 84,122 annually, approximately 2,121 square feet for our warehouse for approximately $14,877 annually, and approximately 862 square feet for our third warehouse for approximately $8,425 annually.

We lease approximately 7,460 square feet for our offices and control center in Florida for a monthly rate of $9,636. This lease commenced in October 2014 and is expected to end in September 2015. We are planning on extending our lease for additional 12 months commencing October 2015.

In 2014, we leased approximately 1050 Sq. m (11,020 square feet) of office space and warehouse in Brazil for approximately $133,000 annually.

We believe that our facilities are suitable and adequate for our operations as currently conducted. In the event that additional facilities will be required, we believe that we could obtain such facilities at commercially reasonable rates.

The size of our base station sites varies from approximately 11 to 44 square feet. In Israel, we have 103 base stations and we rent most base station sites independently for a monthly rate ranging from $200 to $2,000 per site depending on the location, size and other factors; for certain sites we do not pay any rent. The typical duration of a lease agreement for our base stations in Israel is five years and we generally have a right to renew the term of the lease agreements for a period ranging between two and five years. In Brazil, we have 137 base station sites, of which 23 sites are leased from the same entity under a 15 years-contract,(commencing from 2012) for a monthly rate ranging from $500 to $3,400 per site . The remaining 114 sites are leased independently for an annual rate ranging from $200 to $800 depending on the location, size and other factors, and the typical duration for these leases is five years. In Argentina, we have 43 base station sites, all of which are leased from three entities for a monthly rate ranging from $300 to $1,250 per site. The duration of the lease ranges from one to two years.

We do not believe that we have a legal retirement obligation associated with the operating leases for our base sites pursuant to the relevant accounting standards, since we do not own any real property. However, we are obligated pursuant to certain of the operating leases for our base sites, mainly for base sites in Israel, Brazil and Argentina, to restore facilities or remove equipment at the end of the lease term. Since the restoration is limited to any construction or property installed on the property, which in our case is only the installed antennas, we do not believe that these obligations, individually or in the aggregate, will result in us incurring a material expense.

ITEM 4.A. UNRESOLVED STAFF COMMENTS

Not applicable

ITEM 5: OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A.OPERATING RESULTS

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this report.

Introduction

We believe we are a leading provider of location-based services, consisting predominantly of stolen vehicle recovery, which we refer to as SVR, and tracking services. We also provide wireless communications products used in connection with our SVR services and for various other applications. We currently provide our services and sell and lease our products in Israel, Brazil, Argentina and the United States.

Our operations consist of two segments: location-based services and wireless communication products.

Our location-based services segment consists of our SVR, fleet management and value-added services. We currently operate stolen vehicle recovery services throughout Israel, in Brazil, Buenos Aires, Argentina and in the United States.

Our wireless communications products segment consists of our short- and medium-range two-way wireless communications products that are used for various applications, including AVL. We sell our AVL end-units to customers that subscribe to our SVR services.

Outlook

We have historically experienced significant growth in the markets in which we provide our location-based services. These markets are generally characterized by high car theft rates and insurance companies that are seeking solutions to limit their actual losses resulting from car theft, and hence the Brazilian market continues to represent growth potential for our location-based services. The growth in subscribers within our location-based services segment also has a direct impact on the sale or lease of our AVL products, as they are an integral component of our location-based services and are installed in each subscriber's vehicle. In Israel, improvements in the economy in 2010 have led to increased car sales which positively affected our sales as compared with previous years.

As of December 31, 2014, we had approximately 298,000 subscribers in Brazil. We estimate that the total addressable market in Brazil several million vehicles, and therefore we have a significant opportunity to grow our subscriber base and increase sales of our AVL products.

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We expect growth over the next 12 months in our location-based services segment to be driven by increased demand for our services in Brazil and in Israel, as a result of our strong operating results and our customers' increased familiarity with and confidence in our services; additional insurance companies who could seek to establish relationships with us; increased direct sales of SVR services to individual subscribers in Brazil who, due to prevailing high insurance costs, are self-insured and represent an additional market opportunity for our SVR services and AVL products; and increased sales of our fleet management systems and services. In connection with such potential markets and additional growth opportunities, we constantly look to enhance our brand recognition through continuous advertising efforts.

Our services and products, including our line of AVL products, which is based on our SMART products and tailored for vehicles which are considered medium to high end vehicles, have contributed to an increase in our customer base and sales in Israel, and we expect it to continue to contribute to such increase.

Please refer to Item 3.D. – Risk Factors above in respect of factors that could negatively impact our business.

Geographical breakdown

Location-based services' subscriber base

The following table sets forth the geographic breakdown of subscribers to our location-based services as of the dates indicated:

	As of December 31,		
	2014	2013	2012
Israel	340,000	310,000	276,000
Brazil	298,000	262,000	238,000
Argentina	158,000	145,000	131,000
United States	21,000	24,000	22,000
Total(1)	817,000	741,000	667,000

(1) All numbers provided are rounded, and therefore totals may be slightly different than the results obtained by adding the numbers provided.

Revenues

The following table sets forth the geographic breakdown of our revenues for each of our business segments for the relevant periods indicated.

	Year ended December 31,					
	2014		2013		2012	
	In USD, in Millions					
	Location based services	Wireless communications products	Location based services	Wireless communications products	Location based services	Wireless communications products
Israel	56	33.5	51.5	31.8	45.2	25.4
Brazil	63.6	2.9	60.3	3.2	55.4	2.8
Argentina	12.5	1.3	13.6	1.6	12.3	1.1
United States	1.6	6	1.6	3.3	1.7	3.2
Others	-	4.7	-	3.3	-	3.2
Total(1)	$ 133.7	$ 48.4	$ 127.0	$ 43.2	$ 114.6	$ 35.7

(1) We attribute revenues to countries based on the location of the customer.

Location-based services segment

We generate revenues from sales and leases of our SVR, fleet management and value-added services. A majority of our revenues represent subscription fees paid to us by our customers, predominately subscribers in Israel, Brazil and the United States, and insurance companies in Brazil and Argentina. We recognize revenues from subscription fees on a monthly basis. Our customers are free to terminate their subscription at any time. In the absence of such termination, the subscription term continues automatically. We also generate subscription fees from our fleet management services. Assuming no additional growth in our subscriber base and based on our historical average churn rates of 2.5% per month in this segment, we can anticipate that at least 90% of our subscription fees generated in a prior quarter will

recur in the following quarter.

Wireless communications products segment

We generate revenues from the sale of our AVL products to customers in Israel, Brazil, Argentina, and the United States. We currently sell or lease our AVL end-units in each of the above regions. Growth in our subscriber base is the principal driver for the sale of our AVL products. We recognize revenues from sales of our wireless communications products upon delivery.

Cost of revenues

Location-based services segment

The cost of revenues in our location-based services segment consists primarily of staffing, maintenance and operation of our control centers and base stations, costs associated with our staff and costs incurred for private enforcement, licenses, permits and royalties, as well as communication costs and costs due to depreciation of leased products and installation fees. Cost of revenues for sales of our fleet management services also includes payments to a third party who markets our services.

Wireless communications products segment

The cost of revenues in our wireless communications products segment consists primarily of production costs of our third-party manufacturers and costs associated with installation fees.

Operating expenses

Research and development

Our research and development expenses consist of salaries, costs of materials and other overhead expenses, primarily in connection with the design and development of our wireless communications products. We expense all of our research and development costs as incurred.

Selling and marketing

Our selling and marketing expenses consist primarily of advertising, salaries, commissions and other employee expenses related to our selling and marketing team and promotional and public relations expenses.

General and administrative

Our general and administrative expenses consist primarily of salaries, bonuses, accounting and other general corporate expenses.

Operating Income

Location-based services segment

Operating income in our location-based services segment is primarily affected by increases in our subscriber base and our ability to increase the resulting revenues without a commensurate increase in our corresponding costs.

Wireless communications products segment

Operating income in our wireless communications products segment is primarily affected by our ability to increase sales of our AVL products.

Financing expenses (income), net

Financing expenses (income), net, include, inter alia, short- and long-term interest expenses, financial commissions, and gains and losses from currency fluctuations from the conversion of monetary balance sheet items denominated in currencies other than the functional currency of each entity in the group, gains in respect of marketable securities and interest related tax positions.

Taxes on income

Income earned from our services and product sales is subject to tax in the country in which we provide our services or from which we sell our products.

Critical Accounting Policies and Estimates

Our critical accounting policies are more fully described in Note 1 to our consolidated financial statements appearing elsewhere in this report. However, certain of our accounting policies require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. We evaluate our estimates on a periodic basis. We base our estimates on historical experience, industry trends, authoritative pronouncements and various other assumptions that we believe to be reasonable under the circumstances. Such assumptions and estimates are subject to an inherent degree of uncertainty.

The following are our critical accounting policies and the significant judgments and estimates affecting the application of those policies in our consolidated financial statements. See Note 1 to our consolidated financial statements included elsewhere in this report.

Revenue recognition

Revenues are recognized when delivery has occurred and, where applicable, after installation has been completed, there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection of the related receivable is reasonably assured and no further obligations exist. In cases where delivery has occurred but the required installation has not been performed, we do not recognize the revenues until the installation is completed.

Revenues are recognized as follows:

- Revenues from sales of wireless communications product are recognized when title and risk of loss of the product pass to the customer (usually upon delivery).

- Revenues from SVR services subscription fees and installation services which have been determined not to have value on the stand-alone basis to the customers, in accordance with ASC Topic 605-25 "Multiple Elements Arrangements" are recognized ratably on a straight-line basis over the subscription period.

- Deferred revenues which include unearned amounts received from customers (mostly for the provision of installation and subscription services) but not yet recognized as revenues, are recognized and described in the above paragraph.

- Revenues from extended warranty which are provided for a monthly fee and are sold separately are recognized over the duration of the warranty period.

Accounting for income taxes

As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process requires us to estimate our actual current tax exposure and make an assessment of 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 our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely (i.e., less than "more likely than not"), we establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the consolidated statement of income. Significant management judgment is required in determining our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. In the event that we generate taxable income in the jurisdictions in which we operate and in which we have net operating loss carry-forwards, we may be required to adjust our valuation allowance.

We follow the provisions of ASC Topic 740-10, "Income Taxes" which clarify the accounting for uncertainty in tax positions. ASC Topic 740-10 requires that we recognize in our financial statements the impact of a tax position, if that position will more likely than not be sustained upon examination, based on the technical merits of the position, without regard the likelihood that the tax position may be challenged. If an uncertain tax position meets the "more-likely-than-not" threshold, the largest amount of tax benefit that is greater than 50% likely to be recognized upon ultimate settlement with the taxing authority is recorded.

We recognize interest as interest expenses (among financing expenses) and penalties, if any, related to unrecognized tax benefits within the provision for income tax.

Goodwill and other Intangible Assets Impairment Test

Goodwill acquired in a business combination is deemed to have indefinite life and is not to be amortized but rather tested at least annually for impairment. As required by ASC Topic 350, as amended by ASU No. 2011-08, “Testing for Impairment”, we are required to choose either to perform a qualitative assessment wheatear the two-step goodwill impairment test is necessary or to proceed directly to the two-step goodwill impairment test. Such determination is made for each reporting unit on a stand-alone basis. The qualitative assessment includes various factors such as macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, earning multiples, gross margin and cash flows from operating activities and other relevant factors.

When we choose to perform a qualitative assessment and determine that it is more likely than not (a more than 50 percent likelihood) that the fair value of the reporting unit is less than its carrying value, then we proceed to the two-step goodwill impairment test. If we determine otherwise, no further evaluation is necessary.

When we decide or are required to perform the two step goodwill impairment test, we implement the following process: firstly, we compare the fair value of each reporting unit to its carrying value ("step 1"). If the fair value exceeds the carrying value of the reporting unit net assets, goodwill is considered not to be impaired, and no further testing is required. If the carrying value exceeds the fair value of the reporting unit, then the implied fair value of goodwill is determined by subtracting the fair value of all the identifiable net assets from the fair value of the reporting unit. An impairment loss is recorded for the excess, if any, of the carrying value of the goodwill allocated to the reporting unit over its implied fair value ("step 2").

There are a number of generally accepted methods used for valuing a reporting unit:

The ̵adding-Top:0.75pt;padding-Bottom:0pt;width:1%; border-top:solid 0.75pt #000000;white-space:nowrap;">

Net cash used for operating activities

—

(6,805

)

Net cash used for investing activities

—

—

Net cash used for financing activities

—

—

Effect of exchange rates changes on cash

—

—

Net cash used for discontinued operations

—

(6,805

)

Net increase (decrease) in cash and cash equivalents

31,600

(47,580

)

Cash and cash equivalents - beginning of period

260,067

410,696

Cash and cash equivalents - end of period

$

291,667

$

363,116

Supplemental disclosure of cash flow information:

Cash paid during the period for income taxes

$

77,562

$

81,797

Cash paid during the period for interest

$

881

$

892

Refer to Notes to Consolidated Financial Statements

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AMERICAN EAGLE OUTFITTERS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Interim Financial Statements

The accompanying Consolidated Financial Statements of American Eagle Outfitters, Inc. (the "Company") at October 29, 2016 and October 31, 2015 and for the 13 week and 39 week periods ended October 29, 2016 and October 31, 2015 have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Certain notes and other information have been condensed or omitted from the interim Consolidated Financial Statements presented in this Quarterly Report on Form 10-Q. Therefore, these Consolidated Financial Statements should be read in conjunction with the Company's Fiscal 2015 Annual Report. In the opinion of the Company's management, all adjustments (consisting of normal recurring adjustments and those described in the footnotes that follow) considered necessary for a fair presentation have been included. The existence of subsequent events has been evaluated through the filing date of this Quarterly Report on Form 10-Q.

As used in this report, all references to "we," "our" and the "Company" refer to American Eagle Outfitters, Inc. and its wholly owned subsidiaries. "American Eagle Outfitters," "American Eagle," "AEO" and the "AE Brand" refer to our American Eagle Outfitters stores. "Aerie" refers to our Aerie® by American Eagle® stores. "AEO Direct" refers to our e-commerce operations, ae.com and aerie.com. "Tailgate" refers to the Tailgate Clothing Company that was acquired in Fiscal 2015. Tailgate owns and operates the Tailgate and Todd Snyder New York brands.

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

2. Summary of Significant Accounting Policies

Principles of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. At October 29, 2016, the Company operated in one reportable segment.

Fiscal Year

The Company's financial year is a 52/53 week year that ends on the Saturday nearest to January 31. As used herein, "Fiscal 2016" refers to the 52 week period ending January 28, 2017. "Fiscal 2015" refers to the 52 week period ended January 30, 2016.

Estimates

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

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Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standard Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). ASU 2014-09 is a comprehensive new revenue recognition model that expands disclosure requirements and requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. Originally, ASU 2014-09 was effective for annual reporting periods beginning after December 15, 2016. In July 2015, the FASB voted to approve amendments deferring the effective date by one year to be effective for annual reporting periods beginning after December 15, 2017. Accordingly, the Company will adopt ASU 2014-09 on February 4, 2018. The Company does not expect a material impact of the adoption of this guidance to its Consolidated Financial Statements.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes ("ASU 2015-17"), which requires entities to present deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. ASU 2015-17, may be applied prospectively or retrospectively. The Company adopted ASU 2015-17 on January 30, 2016, applied retrospectively.

In February 2016, the FASB issued ASU No. 2016-02, Leases ("ASU 2016–02") which replaces the existing guidance in ASC 840, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years and requires retrospective application. The Company will adopt in Fiscal 2019 and is currently evaluating the impact of ASU 2016-02 to its Consolidated Financial Statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718) ("ASU 2016-09"). ASU 2016-09 makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016. The Company will adopt in Fiscal 2017 and does not expect a material impact to its Consolidated Financial Statements.

Foreign Currency Translation

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

Revenue Recognition

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

Revenue is recorded net of estimated and actual sales returns and deductions for coupon redemptions and other promotions. The Company records the impact of adjustments to its sales return reserve quarterly within total net

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

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

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

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

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

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

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

Selling, General and Administrative Expenses

Selling, general and administrative (“SG&A”) expenses consist of compensation and employee benefit expenses, including salaries, incentives and related benefits associated with our stores and corporate headquarters. Selling, general and administrative expenses also include advertising costs, supplies for our stores and home office, communication costs, travel and entertainment, leasing costs and services purchased. Selling, general and administrative expenses do not include compensation, employee benefit expenses and travel for our design, sourcing and importing teams, our buyers and our distribution centers as these amounts are recorded in cost of sales.

Other Income, Net

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

Cash and Cash Equivalents and Investments

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

As of October 29, 2016 and October 31, 2015, the Company held no short or long term investments.

Refer to Note 3 to the Consolidated Financial Statements for information regarding cash and cash equivalents.

Merchandise Inventory

Merchandise inventory is valued at the lower of average cost or market, utilizing the retail method. Average cost includes merchandise design and sourcing costs and related expenses. The Company records merchandise receipts when both title and risk of loss for the merchandise have transferred to the Company.

The Company reviews its inventory levels to identify slow-moving merchandise and generally uses markdowns to clear merchandise. Additionally, the Company estimates a markdown reserve for future planned permanent

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

Income Taxes

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

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

The calculation of the deferred tax assets and liabilities, as well as the decision to recognize a tax benefit from an uncertain position and to establish a valuation allowance, require management to make estimates and assumptions. The Company believes that its assumptions and estimates are reasonable, although actual results may have a positive or negative material impact on the balances of deferred tax assets and liabilities, valuation allowances or net income.

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

Property and Equipment

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

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

In accordance with ASC 360, Property, Plant, and Equipment (“ASC 360”), the Company evaluates long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified. Impairment losses are recorded on long-lived assets used in operations when events and circumstances indicate that the assets are impaired and the undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. When events such as these occur, the impaired assets are adjusted to their estimated fair value and an impairment loss is recorded. No long-lived asset impairment charges were recorded during the 13 weeks or 39 weeks ended October 29, 2016 or October 31, 2015.

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

Goodwill

The Company's goodwill is related to the acquisition of its importing operations, Canada, Hong Kong and China businesses and the recent acquisition of Tailgate Clothing Co. in Fiscal 2015. In accordance with ASC 350, Intangibles – Goodwill and Other ("ASC 350"), the Company evaluates goodwill for possible impairment on at least an annual basis and last performed an annual impairment test as of January 30, 2016. As a result of the Company's annual goodwill impairment test, the Company concluded that its goodwill was not impaired. The change in goodwill in the 13 weeks ended October 29, 2016 is due to the fluctuation in the foreign exchange spot rate at which the foreign goodwill balances are translated.

Intangible Assets

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

The Company evaluates intangible assets for impairment in accordance with ASC 350 when events or circumstances indicate that the carrying value of the asset may not be recoverable. Such an evaluation includes the estimation of undiscounted future cash flows to be generated by those assets. If the sum of the estimated future undiscounted cash flows are less than the carrying amounts of the assets, then the assets are impaired and are adjusted to their estimated fair value. No intangible asset impairment charges were recorded during the 13 or 39 weeks ended October 29, 2016 or October 31, 2015.

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

Gift Cards

The value of a gift card is recorded as a current liability upon issuance, and revenue is recognized when the gift card is redeemed for merchandise. The Company estimates gift card breakage and recognizes revenue in proportion to actual gift card redemptions as a component of total net revenue. The Company determines an estimated gift card breakage rate by continuously evaluating historical redemption data and the time when there is a remote likelihood that a gift card will be redeemed. The Company recorded $1.5 million and $1.4 million of revenue related to gift card breakage during the 13 weeks ended October 29, 2016 and October 31, 2015, respectively. During the 39 weeks ended October 29, 2016 and October 31, 2015, the Company recorded $5.3 million and $4.6 million, respectively, of revenue related to gift card breakage.

Deferred Lease Credits

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

Co-branded Credit Card and Customer Loyalty Program

The Company offers a co-branded credit card (the "AEO Visa Card") and a private label credit card (the "AEO Credit Card") under the AEO and Aerie brands. These credit cards are issued by a third-party bank (the "Bank") in accordance with a credit card agreement ("the Agreement"). The Company has no liability to the Bank for bad debt expense, provided that purchases are made in accordance with the Bank's procedures. We receive additional funding from the Bank based on the Agreement and card activity. We recognize revenue for the additional funding when the amounts are fixed or determinable and collectability is reasonably assured. This revenue is recorded as a component of total net revenue.

Once a customer is approved to receive the AEO Visa Card or the AEO Credit Card and the card is activated, the customer is eligible to participate in the credit card rewards program. Customers who make purchases at AEO and Aerie earn discounts in the form of savings certificates when certain purchase levels are reached. Also, AEO Visa Card customers who make purchases at other retailers where the card is accepted earn additional discounts. Savings certificates are valid for 90 days from issuance.

Points earned under the credit card rewards program on purchases at AEO and Aerie are accounted for by analogy to ASC 605-25, Revenue Recognition, Multiple Element Arrangements ("ASC 605-25"). The Company believes that points earned under its point and loyalty programs represent deliverables in a multiple element arrangement rather than a rebate or refund of cash. Accordingly, the portion of the sales revenue attributed to the award points is deferred and recognized when the award is redeemed or when the points expire. Additionally, credit card reward points earned on non-AEO or Aerie purchases are accounted for in accordance with ASC 605-25. As the points are earned, a current liability is recorded for the estimated cost of the award, and the impact of adjustments is recorded in cost of sales.

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The Company offers its customers the AEREWARDS® loyalty program (the "Program"). Under the Program, customers accumulate points based on purchase activity and earn rewards by reaching certain point thresholds during three-month earning periods. Rewards earned during these periods are valid through the stated expiration date, which is approximately one month from the mailing date of the reward. These rewards can be redeemed for a discount on a purchase of merchandise. Rewards not redeemed during the one-month redemption period are forfeited. The Company determined that rewards earned using the Program should be accounted for in accordance with ASC 605-25. Accordingly, the portion of the sales revenue attributed to the award credits is deferred and recognized when the awards are redeemed or expire.

Segment Information

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

3. Cash and Cash Equivalents and Investments

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

	October 29,	January 30,	October 31,
(In thousands)	2016	2016	2015
Cash and cash equivalents:			
Cash	$209,581	$205,359	$283,035
Interest Bearing Deposits and Money Market Funds	82,086	54,708	80,081
Total cash and cash equivalents	$291,667	$260,067	$363,116

4. Fair Value Measurements

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

Financial Instruments

Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. In addition, ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 — Unobservable inputs (i.e., projections, estimates, interpretations, etc.) that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of October 29, 2016 and October 31, 2015, the Company held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents.

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In accordance with ASC 820, the following table represents the Company's fair value hierarchy for its financial assets (cash equivalents) measured at fair value on a recurring basis at October 29, 2016 and October 31, 2015:

	Fair Value Measurements at October 29, 2016			
(In thousands)	Carrying Amount	Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents:				
Cash	$ 209,581	$ 209,581	—	—
Interest Bearing Deposits	82,086	82,086	—	—
Total cash and cash equivalents	$ 291,667	$ 291,667	—	—

	Fair Value Measurements at October 31, 2015			
(In thousands)	Carrying Amount	Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents:				
Cash	$283,035	$ 283,035	—	—
Interest Bearing Deposits and Money Market Funds	80,081	80,081	—	—
Total cash and cash equivalents	$363,116	$ 363,116	—	—

In the event the Company holds Level 3 investments, a discounted cash flow model is used to value those investments. There were no Level 3 investments at October 29, 2016 or October 31, 2015.

Non-Financial Assets

The Company's non-financial assets, which include goodwill, intangible assets and property and equipment, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur, or if an annual impairment test is required, and the Company is required to evaluate the non-financial instrument for impairment, a

resulting asset impairment would require that the non-financial asset be recorded at the estimated fair value.

5. Earnings per Share

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

	13 Weeks Ended		39 Weeks Ended	
(In thousands)	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
Weighted average common shares outstanding:				
Basic number of common shares outstanding	181,819	195,215	181,196	195,308
Dilutive effect of stock options and non-vested restricted stock	2,796	2,263	2,455	1,709
Diluted number of common shares outstanding	184,615	197,478	183,651	197,017

Stock option awards to purchase 1.4 million shares of common stock during both the 13 and 39 weeks ended October 29, 2016, respectively, and approximately 13,000 shares of common stock during both the 13 and 29 weeks ended October 31, 2015 were outstanding, but were not included in the computation of weighted average diluted common share amounts as the effect of doing so would be anti-dilutive.

Additionally, approximately 0.1 million shares of restricted stock units for the 13 and 39 weeks ended October 29, 2016, respectively, were not included in the computation of weighted average diluted common share amounts because the number of shares ultimately issued is contingent on the Company’s performance compared to pre-established annual performance goals.

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

6. Property and Equipment

Property and equipment consists of the following:

(In thousands)	October 29, 2016	January 30, 2016	October 31, 2015
Property and equipment, at cost	$1,858,863	$1,792,382	$1,784,862
Less: Accumulated depreciation	(1,150,375)	(1,088,796)	(1,075,601)
Property and equipment, net	$708,488	$703,586	$709,261

7. Intangible Assets

Intangible assets consist of the following:

(In thousands)	October 29, 2016	January 30, 2016	October 31, 2015
Trademarks and other intangibles, at cost	$68,611	$67,398	$61,543
Less: Accumulated amortization	(18,618)	(15,566)	(14,787)
Intangible assets, net	$49,993	$51,832	$46,756

8. Other Credit Arrangements

The Company currently participates in a Credit Agreement (“Credit Agreement”) consisting of five-year, syndicated, asset-based revolving credit facilities (the “Credit Facilities”). The Credit Agreement provides senior secured revolving credit for loans and letters of credit up to $400 million, subject to customary borrowing base limitations. The Credit Facilities provide increased financial flexibility and take advantage of a favorable credit environment.

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

As of October 29, 2016, the Company was in compliance with the terms of the Credit Agreement and had $8.0 million outstanding in stand-by letters of credit. No loans were outstanding under the Credit Agreement as of October 29, 2016.

Additionally, the Company has a borrowing agreement with one financial institution under which it may borrow an aggregate of $5.0 million USD for the purposes of trade letter of credit issuances. The availability of any future borrowings under the trade letter of credit facilities is subject to acceptance by the financial institution.

As of October 29, 2016, the Company had no outstanding trade letters of credit.

9. Share-Based Compensation

The Company accounts for share-based compensation under the provisions of ASC 718, Compensation - Stock Compensation ("ASC 718"), which requires companies to measure and recognize compensation expense for all share-based payments at fair value. Total share-based compensation expense included in the Consolidated Statements of Operations for the 13 weeks and 39 weeks ended October 29, 2016 was $6.3 million ($4.0 million, net of tax) and $23.0 million ($14.6 million, net of tax), respectively, and for the 13 and 39 weeks ended October 31, 2015 was $10.5 million ($6.5 million, net of tax) and $32.5 million ($20.0 million, net of tax), respectively.

Stock Option Grants

The Company grants both time-based and performance-based stock options. A summary of the Company's stock option activity for the 39 weeks ended October 29, 2016 follows:

	Options (In thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding - January 30, 2016	1,213	$ 14.83		
Granted	2,211	$ 15.35		
Exercised (1)	(1,068)	$ 14.83		
Cancelled	(42)	$ 14.50		
Outstanding - October 29, 2016	2,314	$ 15.33	6.3	3,640
Vested and expected to vest - October 29, 2016	2,133	$ 15.33	6.3	3,361
Exercisable - October 29, 2016 (2)	90	$ 14.22	0.6	240

(1) Options exercised during the 39 weeks ended October 29, 2016 had exercise prices ranging from $11.51 to $15.81.
(2) Options exercisable represent "in-the-money" vested options based upon the weighted-average exercise price of vested options compared to the Company's stock price at October 29, 2016.

Cash received from the exercise of stock options was $16.2 million for the 39 weeks ended October 29, 2016 and $6.3 million for the 39 weeks ended October 31, 2015. The actual tax detriment realized from stock option exercises totaled ($0.2) million for the 39 weeks ended October 29, 2016 and ($0.6) million for the 39 weeks ended October 31, 2015.

The fair value of stock options was estimated based on the closing market price of the Company's common stock on the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

Black-Scholes Option Valuation Assumptions	39 Weeks Ended October 29, 2016
Risk-free interest rate (1)	1.3 %
Dividend yield	3.0 %
Volatility factor (2)	35.4 %
Weighted-average expected term (3)	4.4 years
Expected forfeiture rate (4)	8.0 %

(1) Based on the U.S. Treasury yield curve in effect at the time of grant with a term consistent with the expected life of our stock options.

(2) Based on a combination of historical volatility of the Company’s common stock and implied volatility.

(3) Represents the period of time options are expected to be outstanding, based on historical experience.

(4) Based upon historical experience.

As of October 29, 2016 there was $6.6 million of unrecognized compensation expense related to non-vested time-based stock option awards that is expected to be recognized over a weighted average period of 2.9 years.

Restricted Stock Grants

Time-based restricted stock awards are comprised of time-based restricted stock units. These awards vest over three years. Time-based restricted stock units receive dividend equivalents in the form of additional time-based restricted stock units, which are subject to the same restrictions and forfeiture provisions as the original award.

Performance-based restricted stock awards include performance-based restricted stock units. These awards cliff vest at the end of a three year period based upon the Company’s achievement of pre-established goals throughout the term of the award. Performance-based restricted stock units receive dividend equivalents in the form of additional performance-based restricted stock units, which are subject to the same restrictions and forfeiture provisions as the original award.

The grant date fair value of all restricted stock awards is based on the closing market price of the Company's common stock on the date of grant.

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

	Time-Based Restricted Stock Units 39 Weeks Ended October 29, 2016		Performance-Based Restricted Stock Units 39 Weeks Ended October 29, 2016	
(Shares in thousands)	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Nonvested - January 30, 2016	1,935	$ 15.17	2,609	$ 16.02
Granted	966	$ 16.04	1,082	$ 15.71
Vested	(889)	$ 16.11	(195)	$ 14.82
Cancelled	(83)	$ 12.75	(701)	$ 19.73
Nonvested - October 29, 2016	1,929	$ 15.28	2,795	$ 15.05

As of October 29, 2016, there was $23.4 million of unrecognized compensation expense related to non-vested, time-based restricted stock unit awards that is expected to be recognized over a weighted-average period of 2.1 years. Based on current probable performance, $10.8 million of unrecognized compensation expense related to performance-based restricted stock unit awards which will be recognized as achievement of performance goals is probable over a one to three year period.

As of October 29, 2016, the Company had 3.5 million shares available for all equity grants.

10. Income Taxes

The provision for income taxes is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for discrete quarterly events. The effective income tax rate for the 13 weeks ended October 29, 2016 was 36.3% compared to 36.8% for the 13 weeks ended October 31, 2015. The effective income tax rate for the 39 weeks ended October 29, 2016 was 36.4% compared to 36.9% for the 39 weeks ended October 31, 2015. The decrease in the effective income tax rate for the 13 weeks and 39 weeks ended October 29, 2016 was primarily due to a decrease to the valuation allowance on foreign deferred tax assets.

The Company records accrued interest and penalties related to unrecognized tax benefits in income tax expense. The Company recognizes income tax liabilities related to unrecognized tax benefits in accordance with ASC 740 and adjusts these liabilities when its judgment changes as the result of the evaluation of new information not previously available. Unrecognized tax benefits did not change significantly during the 13 weeks ended October 29, 2016. Over the next twelve months, the Company believes that it is reasonably possible that unrecognized tax benefits may decrease by approximately $3.8 million due to settlements, expiration of statute of limitations or other changes in unrecognized tax benefits.

11. Legal Proceedings

The Company is subject to certain legal proceedings and claims arising out of the conduct of its business. In accordance with ASC 450, Contingencies (“ASC 450”), management records a reserve for estimated losses when the loss is probable and the amount can be reasonably estimated. If a range of possible loss exists and no anticipated loss within the range is more likely than any other anticipated loss, the Company records a reserve at the low end of the range, in accordance with ASC 450. As the Company believes that it has provided adequate reserves, it anticipates that the ultimate outcome of any matter currently pending against the Company will not materially affect the consolidated financial position or results of the operations of the Company.

12. Discontinued Operations

In Fiscal 2012, the Company exited the 77kids business. In connection with the exit of the 77kids business, the Company became secondarily liable for obligations under lease agreements for 21 store leases assumed by the third party purchaser. In Fiscal 2014, the third party purchaser did not fulfill its obligations under the leases, resulting in the Company becoming primarily liable. The Company was required to make rental and lease termination payments and received reimbursement from the $11.5 million stand-by letter of credit provided by the third party purchaser. The cash outflow for the remaining lease termination costs was paid in Fiscal 2015.

In accordance with ASC 460, Guarantees ("ASC 460"), as the Company became primarily liable under the leases upon the third party purchaser's default, the estimated remaining amounts to terminate the lease agreements were accrued in our Consolidated Financial Statements related to these guarantees.

A rollforward of the liabilities recognized in the Consolidated Balance Sheets is as follows:

(In thousands)	
Accrued liability as of January 31, 2015	14,636
Add: Costs incurred	—
Less: Cash payments	(6,805)
Less: Adjustments (1)	(7,831)
Accrued liability as of October 31, 2015	—

(1) Adjustments resulting from favorably settling lease termination obligations during the 13 weeks ended October 31, 2015.

The table below presents the significant components of 77kids' results included in Gain from Discontinued Operations on the Consolidated Statements of Operations for the 13 and 39 weeks ended October 31, 2015. During the 13 and 39 weeks ended October 29, 2016, there were no costs associated with discontinued operations incurred on the Consolidated Statement of Operations.

(In thousands)	13 Weeks Ended October 31, 2015	39 Weeks Ended October 31, 2015
Total net revenue	$ —	$ —
Gain from discontinued operations, before income	7,831	7,831

taxes				
Income tax expense		(2,984)		(2,984)
Gain from discontinued operations, net of tax	$	4,847	$	4,847
Gain per common share from discontinued operations:				
Basic	$	0.03	$	0.02
Diluted	$	0.03	$	0.02

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Review by Independent Registered Public Accounting Firm

Ernst & Young LLP, our independent registered public accounting firm, has performed a limited review of the unaudited Consolidated Financial Statements for the thirteen and thirty-nine week periods ended October 29, 2016 and October 31, 2015, as indicated in their report on the limited review included below. Since they did not perform an audit, they express no opinion on the unaudited Consolidated Financial Statements referred to above.

Review Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

American Eagle Outfitters, Inc.

We have reviewed the consolidated balance sheets of American Eagle Outfitters, Inc. (the Company) as of October 29, 2016 and October 31, 2015, and the related consolidated statements of operations and retained earnings and comprehensive income for the thirteen and thirty-nine week periods ended October 29, 2016 and October 31, 2015 and the consolidated statements of cash flows for the thirty-nine week periods ended October 29, 2016 and October 31, 2015. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of American Eagle Outfitters, Inc. as of January 30, 2016, and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for the year then ended (not presented herein) and we expressed an unqualified audit opinion on those consolidated financial statements in our report dated March 10, 2016. In our opinion, the accompanying consolidated balance sheet of American Eagle Outfitters, Inc. as of January 30, 2016, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Pittsburgh, Pennsylvania

December 2, 2016

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with our Fiscal 2015 Management's Discussion and Analysis of Financial Condition and Results of Operations which can be found in our Fiscal 2015 Annual Report on Form 10-K.

In addition, the following discussion and analysis of financial condition and results of operations are based upon our Consolidated Financial Statements and should be read in conjunction with these statements and notes thereto.

This report contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which represent our expectations or beliefs concerning future events, including the following:

- the planned opening of approximately 10 to 20 AEO stores, 10 to 15 Aerie stores, 3 Tailgate stores and conversion of 20 to 25 stores to Aerie side-by-side format in North America and continued international expansion during Fiscal 2016;
- the success of our efforts to expand internationally, engage in future franchise/license agreements, and/or growth through acquisitions or joint ventures;
- the selection of approximately 55 to 65 American Eagle Outfitters stores in the United States and Canada for remodeling and refurbishing during Fiscal 2016;
- the potential closure of approximately 10 to 15 American Eagle Outfitters and 8 to 10 Aerie stores in the United States and Canada during Fiscal 2016;
- the planned opening of approximately 40 new international third party operated American Eagle Outfitters stores during Fiscal 2016;
- the success of our core American Eagle Outfitters and Aerie brands through our omni-channel outlets within North America and internationally;
- the expected payment of a dividend in future periods;
- the possibility that our credit facilities may not be available for future borrowings;
- the possibility that rising prices of raw materials, labor, energy and other inputs to our manufacturing process, if unmitigated, will have a significant impact to our profitability; and
- the possibility that we may be required to take additional store impairment charges related to underperforming stores.

We caution that these forward-looking statements, and those described elsewhere in this report, involve material risks and uncertainties and are subject to change based on factors beyond our control as discussed within Item 1A of this Quarterly Report on Form 10-Q and Item 1A of our Fiscal 2015 Annual Report on Form 10-K. Accordingly, our future performance and financial results may differ materially from those expressed or implied in any such forward-looking statements.

Key Performance Indicators

Our management evaluates the following items, which are considered key performance indicators, in assessing our performance:

Comparable sales - Comparable sales provide a measure of sales growth for stores open at least one year over the comparable prior year period, as well as the AEO Direct business. In fiscal years following those with 53 weeks, the prior year period is shifted by one week to compare similar calendar weeks. A store is included in comparable sales in the thirteenth month of operation. However, stores that have a gross square footage increase of 25% or greater due to a remodel are removed from the comparable sales base, but are included in total sales. These stores are returned to the comparable sales base in the thirteenth month following the remodel. Sales from American Eagle Outfitters and Aerie stores, as well as sales from AEO Direct, are included in total comparable sales. Sales from franchise stores are not included in comparable sales. Individual American Eagle Outfitters and Aerie brand comparable sales disclosures

represent sales from stores and AEO Direct.

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

- Our approach to customer engagement is "omni-channel", which provides a seamless customer experience through both traditional and non-traditional channels, including four wall store locations, web, mobile/tablet devices, social networks, email, in-store displays and kiosks;
- Shopping behavior has continued to evolve across multiple channels that work in tandem to meet all customer needs. Management believes that presenting a brand level performance metric that includes all channels (i.e., stores and AEO Direct) to be the most appropriate, given customer behavior.

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

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

Buying, occupancy and warehousing costs consist of: compensation, employee benefit expenses and travel for our buyers and certain senior merchandising executives; rent and utilities related to our stores, corporate headquarters, distribution centers and other office space; freight from our distribution centers to the stores; compensation and supplies for our distribution centers, including purchasing, receiving and inspection costs; and shipping and handling costs related to our e-commerce operation. The inability to obtain acceptable levels of sales, initial markups or any significant increase in our use of markdowns could have an adverse effect on our gross profit and results of operations.

Operating income - Our management views operating income as a key indicator of our success. The key drivers of operating income are comparable sales, gross profit, our ability to control selling, general and administrative expenses, and our level of capital expenditures. Management also uses earnings before interest and taxes as an indicator of successful operating results.

Return on invested capital - Our management uses return on invested capital, calculated as a ratio of net income to average debt and equity, as a key measure to assess our efficiency at allocating capital to profitable investments. This measure is critical in determining which strategic alternatives to pursue.

Sales productivity - Sales productivity, including total net revenue per average square foot, sales per productive hour, average unit retail price ("AUR"), store & e-commerce conversion rate, the number of transactions, the number of units sold and the number of units per transaction, is evaluated by our management in assessing our operational performance.

Inventory turnover - Our management evaluates inventory turnover as a measure of how productively inventory is bought and sold. Inventory turnover is important as it can signal slow moving inventory. This can be critical in determining the need to take markdowns on merchandise.

Cash flow and liquidity - Our management evaluates cash flow from operations, investing and financing in determining the sufficiency of our cash position. Cash flow from operations has historically been sufficient to cover our uses of cash. Our management believes that cash flow from operations will be sufficient to fund anticipated capital expenditures and working capital requirements. Additionally, for increased financial flexibility, we have Credit Facilities which allow us to borrow up to $400 million.

Our management's goals are to drive improvements to our gross profit performance, bring greater consistency to our results and to deliver profitable growth over the long term. To meet these goals, our priorities are focused on delivering innovative and quality product, strengthening our brand experience, growing the Aerie brand, leveraging our omni-channel capabilities and expanding our global presence through our third party licensed stores.

Results of Operations

Overview

We continued our trend of earnings growth in the third quarter, marking our ninth consecutive quarter of profit improvement. We achieved record sales and earnings growth over last year. Third quarter revenue grew 2% with earnings of $0.41 per diluted share, a 17% increase from earnings from continuing operations of $0.35 per diluted share last year. Strong financial disciplines, combined with a positive customer response to our brands and merchandise were key drivers. Comparable sales were positive for both the AE and Aerie brands. Gross margin expansion and leverage of operating expenses led to an increase in our operating margin. We ended the quarter in solid financial condition, with $291.7 million in cash and no debt.

Total net revenue increased 2% to $940.6 million and consolidated comparable sales, including AEO Direct, increased 2%, following a 9% increase last year. By brand, American Eagle Outfitters comparable sales were up slightly while Aerie increased 21%.

Gross profit rose 3% to $377.8 million compared to $367.5 million last year and increased 20 basis points as a percent to total net revenue. The change was the result of lower costs and higher realized selling prices.

Operating income for the third quarter was $118.3 million compared to $109.1 million last year. Operating income improved 70 basis points as a rate to total net revenue, driven by 20 basis points of gross profit improvement and 60 basis points of SG&A expenses leverage. Net income for the quarter was $75.8 million, or $0.41 per diluted share, compared to income from continuing operations of $69.3 million, or $0.35 per diluted share, last year.

We had $291.7 million in cash and cash equivalents as of October 29, 2016. Merchandise inventory at the end of the third quarter was $492.6 million, an increase of 3% to last year.

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

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

	13 Weeks Ended		39 Weeks Ended	
	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
Total net revenue	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales, including certain buying, occupancy and warehousing expenses	59.8	60.0	61.1	62.1
Gross profit	40.2	40.0	38.9	37.9
Selling, general and administrative expenses	23.4	24.0	24.5	24.9
Depreciation and amortization expense	4.2	4.1	4.6	4.5
Operating income	12.6	11.9	9.8	8.5
Other income	—	—	0.1	0.1
Income before income taxes	12.6	11.9	9.9	8.6

Provision for income taxes	4.6		4.4		3.6		3.2	
Income from continuing operations	8.0		7.5		6.3		5.4	
Gain from discontinued operations, net of tax	—		0.5		—		0.2	
Net income	8.0	%	8.0	%	6.3	%	5.6	%

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The following table shows our consolidated store data:

	13 Weeks Ended		39 Weeks Ended	
	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
Number of stores:				
Beginning of period	1,044	1,057	1,047	1,056
Opened	11	12	19	22
Closed	(3)	(1)	(14)	(10)
End of period	1,052	1,068	1,052	1,068
Total gross square feet at end of period	6,638,008	6,721,312	6,638,008	6,721,312
International licensed/franchise stores at end of period (1)	163	126	163	126

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

Our operations are conducted in one reportable segment, which includes 952 American Eagle Outfitters retail stores, 97 Aerie stand-alone retail stores, 3 Tailgate Clothing Co. retail stores, and AEO Direct.

Comparison of the 13 weeks ended October 29, 2016 to the 13 weeks ended October 31, 2015

Total net revenue

Total net revenue increased 2% to $940.6 million compared to $919.1 million last year. The increase resulted primarily from a consolidated comparable sales increase of 2% for the period. By brand, including the respective AEO Direct sales, American Eagle Outfitters brand comparable sales were up slightly, or $3.4 million, and Aerie brand comparable sales increased 21%, or $12.4 million.

The sales increase was driven by strength in our digital business as we continue to see greater on-line shopping. On a consolidated basis, although transactions declined, we saw improvement in average transaction size, AUR and units per transaction.

Gross Profit

Gross profit increased 3% to $377.8 million compared to $367.5 million last year. As a rate to total net revenue, gross profit leveraged 20 basis points to 40.2%. 20 basis points of leverage was primarily the result of lower costs and higher realized selling prices. Buying, occupancy and warehousing costs were flat as a rate to sales.

There was $3.1 million and $6.8 million of share-based payment expense included in gross profit for the periods ended October 29, 2016 and October 31, 2015, respectively, comprised of both time and performance-based awards.

Our gross profit may not be comparable to that of other retailers, as some retailers include all costs related to their distribution network as well as design costs in cost of sales and others may exclude a portion of these costs from cost of sales, including them in a line item such as selling, general and administrative expenses. Refer to Note 2 to the Consolidated Financial Statements for a description of our accounting policy regarding cost of sales, including certain buying, occupancy and warehousing expenses.

Selling, General and Administrative Expenses

SG&A expenses decreased slightly to $219.9 million from $220.8 million last year. As a rate to total net revenue, SG&A expenses leveraged 60 basis points to 23.4%. Planned investments in advertising were offset by disciplined expense management.

There was $3.2 million and $3.7 million of share-based payment expense included in SG&A expenses for the periods ended October 29, 2016 and October 31, 2015, respectively, comprised of both time and performance-based awards.

Depreciation and Amortization Expense

Depreciation and amortization expense increased to $39.6 million, compared to $37.6 million last year. As a rate to total net revenue, depreciation and amortization expense was 4.2% this year as compared to 4.1% last year. The increase was driven by omni-channel and IT technology investments.

Other Income, Net

Other expense of $0.6 million this year and $0.5 million last year was comprised primarily of currency losses on cash held in Canadian dollars.

Provision for Income Taxes

The provision for income taxes is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for quarterly events. The effective income tax rate for the 13 weeks ended October 29, 2016 was 36.3% compared to 36.8% for the 13 weeks ended October 31, 2015. The decrease in the effective income tax rate this year is primarily due to a decrease to the valuation allowance on foreign deferred tax assets.

Income from Continuing Operations

Income from continuing operations for the 13 weeks ended October 29, 2016 was $75.8 million, or $0.41 per diluted share. Income from continuing operations for the 13 weeks ended October 31, 2015 was $69.3 million, or $0.35 per diluted share.

Gain from Discontinued Operations

In Fiscal 2012, we exited the 77kids business and sold the stores and related e-commerce operations to a third party purchaser. In Fiscal 2014, we became primarily liable for 21 store leases as the third party purchaser did not fulfill its obligations and incurred $13.7 million in pre-tax expense to terminate store leases. During the 13 weeks ended October 31, 2015, we recorded a $7.8 million pre-tax gain ($4.8 million net of tax) as a result of favorably settling lease termination obligations.

Refer to Note 12 to the Consolidated Financial Statements for additional information regarding the discontinued operations of 77kids.

Net Income

Net income increased to $75.8 million, or 8.0% as a percent to total net revenue, from $74.1 million, or 8.0% as a percent to total net revenue last year. Net income per diluted share increased to $0.41 per diluted share from $0.38 per diluted share in the prior year. The change in net income is attributable to the factors noted above.

Comparison of the 39 weeks ended October 29, 2016 to the 39 weeks ended October 31, 2015

Total net revenue

Total net revenue increased 4% to $2.513 billion compared to $2.416 billion last year. The increase resulted primarily from a consolidated comparable sales increase of 4% for the period. By brand, including the respective AEO Direct sales, American Eagle Outfitters brand comparable sales increased 2%, or $38.2 million, and Aerie brand comparable sales increased 25%, or $40.9 million.

The sales increase was driven by strength in our digital business as we continue to see greater on-line shopping. On a consolidated basis, although transactions declined, we saw improvement in average transaction size, AUR and units per transaction.

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Gross Profit

Gross profit increased 7% to $978.4 million compared to $914.8 million last year. As a rate to total net revenue, gross profit leveraged 100 basis points to 38.9%. 90 basis points of improvement was primarily the result of favorable product costs. Additionally, the remaining 10 basis points of improvement was the result of buying, occupancy, and warehousing costs leverage of occupany costs on the 4% comparable sales increase.

There was $12.1 million and $19.8 million of share-based payment expense included in gross profit for the periods ended October 29, 2016 and October 31, 2015, respectively, comprised of both time and performance-based awards.

Our gross profit may not be comparable to that of other retailers, as some retailers include all costs related to their distribution network as well as design costs in cost of sales and others may exclude a portion of these costs from cost of sales, including them in a line item such as selling, general and administrative expenses. Refer to Note 2 to the Consolidated Financial Statements for a description of our accounting policy regarding cost of sales, including certain buying, occupancy and warehousing expenses.

Selling, General and Administrative Expenses

SG&A expenses increased 2% to $615.5 million from $601.7 million last year. As a rate to total net revenue, SG&A expenses improved 50 basis points to 24.4%. SG&A expense increased due to investments in brand advertising and variable selling expenses, partially offset by well controlled expenses.

There was $10.9 million and $12.7 million of share-based payment expense included in SG&A expenses for the periods ended October 29, 2016 and October 31, 2015, respectively, comprised of both time and performance-based awards.

Depreciation and Amortization Expense

Depreciation and amortization expense increased to $117.3 million, compared to $108.9 million last year. As a rate to total net revenue, depreciation and amortization expense was 4.7% this year as compared to 4.5% last year. The increase was driven by omni-channel and IT technology investments.

Other Income, Net

Other income of $2.4 million this year and $4.3 million last year was comprised primarily of net currency gains on cash held in Canadian dollars.

Provision for Income Taxes

The provision for income taxes is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for quarterly events. The effective income tax rate for the 39 weeks ended October 29, 2016 was 36.4% compared to 36.9% for the 39 weeks ended October 31, 2015. The decrease in the effective income tax rate this year is primarily due to decrease to the valuation allowance on foreign deferred tax assets.

Income from Continuing Operations

Income from continuing operations for the 39 weeks ended October 29, 2016 was $157.8 million, or $0.86 per diluted share. Income from continuing operations for the 39 weeks ended October 31, 2015 was $131.6 million, or $0.67 per diluted share.

Gain from Discontinued Operations

In Fiscal 2012, we exited the 77kids business and sold the stores and related e-commerce operations to a third party purchaser. In Fiscal 2014, we became primarily liable for 21 store leases as the third party purchaser did not fulfill its obligations and incurred $13.7 million in pre-tax expense to terminate store leases. In the 39 weeks ended October 31, 2015, we recorded a $7.8 million pre-tax gain ($4.8 million net of tax) as a result of favorably settling lease termination obligations.

Refer to Note 12 to the Consolidated Financial Statements for additional information regarding the discontinued operations of 77kids.

Net Income

Net income increased to $157.8 million, or 6.3% as a percent to total net revenue, from $136.4 million, or 5.6% as a percent to total net revenue last year. Net income per diluted share increased to $0.86 from $0.69 in the prior year driven by a lower share count as the result of the 15.6 million shares repurchased in Fiscal 2015 and higher net income this year.

International Operations

We have agreements with multiple third party operators to expand our brands internationally. Through these agreements, a series of franchised, licensed or other brand-dedicated American Eagle Outfitters stores have opened and will continue to open in areas including Eastern Europe, the Middle East, Central and South America, Northern Africa and parts of Asia. These agreements do not involve a significant capital investment or operational involvement from the Company. We continue to increase the number of countries in which we enter into these types of arrangements as part of our strategy to expand internationally. As of October 29, 2016, we had 163 stores operated by our third party operators in 23 countries. International third party operated stores are not included in the consolidated store data or the total gross square feet calculation.

As of October 29, 2016, we had 101 company-operated stores in Canada, 26 in Mexico, 6 in Hong Kong, 10 in China, 6 in Puerto Rico, and 3 in the United Kingdom. We continue to evaluate further opportunities to expand internationally, which may include additional company-operated stores as well as stores operated by third party operators under license, franchise and/or joint venture agreements.

Fair Value Measurements

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

Financial Instruments

Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. In addition, ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 — Unobservable inputs (i.e., projections, estimates, interpretations, etc.) that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of October 29, 2016, we held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents.

In accordance with ASC 820, the following table represents the fair value hierarchy of our financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of October 29, 2016:

	Fair Value Measurements at October 29, 2016			
(In thousands)	Carrying Amount	Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents:				
Cash	$ 209,581	$ 209,581	—	—
Interest Bearing Deposits	82,086	82,086	—	—
Total cash and cash equivalents	$ 291,667	$ 291,667	—	—

Liquidity and Capital Resources

Our uses of cash are generally for working capital, the construction of new stores and remodeling of existing stores, information technology upgrades, distribution center improvements and expansion and the return of value to shareholders through the repurchase of common stock and the payment of dividends. Historically, these uses of cash have been funded with cash flow from operations and existing cash on hand. Additionally, our uses of cash include the development of the Aerie brand and our international expansion efforts. We expect to be able to fund our future cash requirements through current cash holdings as well as cash generated from operations. In the future, we expect that our uses of cash will also include further expansion of our brands internationally.

Our growth strategy includes fortifying our brands and further international expansion or acquisitions. We periodically consider and evaluate these options to support future growth. In the event we do pursue such options, we could require additional equity or debt financing. There can be no assurance that we would be successful in closing any potential transaction, or that any endeavor we undertake would increase our profitability.

The following sets forth certain measures of our liquidity:

	October 29, 2016	January 30, 2016	October 31, 2015
Working Capital (in thousands)	$373,970	$259,693	$406,568
Current Ratio	1.66	1.56	1.70

Working capital increased $114.2 million compared to January 30, 2016 and decreased $32.6 million compared to last year. Our operating cash flows have been sufficient to fund our use of cash for financing and investing activities

including capital expenditures and the distribution of cash to shareholders through the payment of dividends and share repurchases. Additionally, for increased financial flexibility, we have Credit Facilities which allow us to borrow up to $400 million.

Cash Flows from Operating Activities of Continuing Operations

Net cash provided by operating activities from continuing totaled $202.9 million and $162.9 million for the 39 weeks ended October 29, 2016 and October 31, 2015, respectively. For both periods, our major source of cash from operations was merchandise sales and our primary outflow of cash for operations was for the payment of operational costs. The year-over-year increase in cash flows from operations was primarily driven by increased earnings levels resulting from positive sales results and margin growth.

Cash Flows from Investing Activities of Continuing Operations

Investing activities from continuing operations for the 39 weeks ended October 29, 2016 and October 31, 2015 primarily consisted of $107.6 million and $108.7 million, respectively, of capital expenditures for property and equipment.

Cash Flows from Financing Activities of Continuing Operations

Cash used for financing activities from continuing operations for the 39 weeks ended October 29, 2016 consisted primarily of $67.9 million for cash dividends paid at a quarterly rate of $0.125 per share, $6.9 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payment and $5.6 million for the payments on capital leases, partially offset by $16.1 million of net proceeds from stock option exercises. There were no purchases of common stock from publically announced programs this year.

Cash used for financing activities for the 39 weeks ended October 31, 2015 consisted primarily of $73.1 million for cash dividends paid at a quarterly rate of $0.125 per share, $5.2 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payment and $5.3 million for the payments on capital leases, partially offset by $6.3 million of net proceeds from stock option exercises. There were $15.5 million purchases of common stock from publically announced programs.

Credit Facilities

We currently participate in a Credit Agreement (“Credit Agreement”) consisting of five-year, syndicated, asset-based revolving credit facilities (the “Credit Facilities”). The Credit Agreement provides senior secured revolving credit for loans and letters of credit up to $400 million, subject to customary borrowing base limitations. The Credit Facilities provide increased financial flexibility and take advantage of a favorable credit environment.

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

As of October 29, 2016, we were in compliance with the terms of the Credit Agreement and had $8.0 million outstanding in stand-by letters of credit. No loans were outstanding under the Credit Agreement on October 29, 2016.

Additionally, we have a borrowing agreement with one financial institution under which we may borrow an aggregate of $5.0 million for the purposes of trade letter of credit issuances. The availability of any future borrowings under the trade letter of credit facilities is subject to acceptance by the respective financial institutions.

As of October 29, 2016, we had no outstanding trade letters of credit.

Capital Expenditures for Property and Equipment

Capital expenditures for the 13 weeks ended October 29, 2016 were $107.6 million and included $54.4 million related to investments in our stores, including 11 new AE stores and 21 remodels. Additionally, we continued to support our infrastructure growth by investing in information technology initiatives ($15.6 million), other home office projects ($9.4 million), the improvement of our distribution centers ($5.2 million) and investments in e-commerce ($23.0 million).

For Fiscal 2016, we expect capital expenditures to be approximately $160 million related to the continued support of our expansion efforts, stores, information technology upgrades to support growth and investments in e-commerce.

Stock Repurchases

During the 39 weeks ended October 29, 2016, there were no share repurchases as a part of our publicly announced repurchase programs. As of October 29, 2016, we had 2.8 million shares remaining authorized for repurchase under the program authorized by our Board in January 2013. During the 39 weeks ended October 31, 2016, our Board

authorized the repurchase of 25.0 million shares under a new share repurchase program which expires on January 30, 2021, bringing our total repurchase authorization to 27.8 million.

During the 39 weeks ended October 29, 2016, and October 31, 2015, we repurchased approximately 1,600 and 0.3 million shares, respectively, from certain employees at market prices totaling $30,000 and $5.2 million, respectively. These shares were repurchased for the payment of taxes, not in excess of the minimum statutory withholding requirements, in connection with the vesting of share-based payments, as permitted under our equity incentive plans. The aforementioned shares repurchased have been recorded as treasury stock.

Dividends

During the 13 weeks ended October 29, 2016, our Board declared a quarterly cash dividend of $0.125 per share, which was paid on October 21, 2016. The payment of future dividends is at the discretion of our Board and is based on future earnings, cash flow, financial condition, capital requirements, changes in U.S. taxation and other relevant factors. It is anticipated that any future dividends paid will be declared on a quarterly basis.

Critical Accounting Policies

Our critical accounting policies are described in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and in the notes to our Consolidated Financial Statements for the year ended January 30, 2016 contained in our Fiscal 2015 Annual Report on Form 10-K. Any new accounting policies or updates to existing accounting policies as a result of new accounting pronouncements have been discussed in the notes to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q. The application of our critical accounting policies may require our management to make judgments and estimates about the amounts reflected in the Consolidated Financial Statements. Our management uses historical experience and all available information to make these estimates and judgments, and different amounts could be reported using different assumptions and estimates.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

There were no material changes in our exposure to market risk from January 30, 2016. Our market risk profile as of January 30, 2016 is disclosed in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our Fiscal 2015 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management including our Principal Executive Officer and our Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

In connection with the preparation of this Quarterly Report on Form 10-Q, as of October 29, 2016, an evaluation was performed under the supervision and with the participation of our management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon that evaluation, our Principal Executive Officer and our Principal Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this Quarterly Report on Form 10-Q.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the 13 weeks ended October 29, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1A. RISK FACTORS.

Risk factors that affect our business and financial results are discussed within Item 1A of our Fiscal 2015 Annual Report on Form 10-K. There have been no material changes to the disclosures relating to this item from those set forth in our Fiscal 2015 Annual Report on Form 10-K.

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

Issuer Purchases of Equity Securities

The following table provides information regarding our repurchases of our common stock during the 13 weeks ended October 29, 2016.

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Program (1) (3)
Month #1 (July 31, 2016 through August 27, 2016)	—	$ —	—	27,837,016
Month #2 (August 28, 2016 through October 1, 2016)	1,410	$ 18.10	—	27,837,016
Month #3 (October 2, 2016 through October 29, 2016)	212	$ 16.89	—	27,837,016
Total	1,622	$ 17.94	—	27,837,016

(1) During the 13 weeks ended October 29, 2016 there were no shares repurchased as part of our publicly announced share repurchase program and there were 1,622 shares repurchased for the payment of taxes in connection with the vesting of share-based payments.
(2) Average price paid per share excludes any broker commissions paid.
(3) In January 2013, our Board authorized the repurchase of 20.0 million shares of our common stock. The authorization of the remaining 2.8 million shares that may yet be purchased expires on January 28, 2017. During the 26 weeks ended July 30, 2016, our Board authorized 25.0 million shares under a new share repurchase program which expires on January 30, 2021, bringing our total repurchase authorization outstanding to 27.8 million.

ITEM 6. EXHIBITS.

* Exhibit 15	Acknowledgement of Independent Registered Public Accounting Firm
* Exhibit 31.1	Certification by Jay L. Schottenstein pursuant to Rule 13a-14(a) or Rule 15d-14(a)
* Exhibit 31.2	Certification by Robert L. Madore pursuant to Rule 13a-14(a) or Rule 15d-14(a)
** Exhibit 32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
** Exhibit 32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
* Exhibit 101	Interactive Data File

*Filed with this report.
**Furnished with this report.

SIGNATURES

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

Dated: December 2, 2016

American Eagle Outfitters, Inc.

(Registrant)

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

By: /s/ Scott M. Hurd
Scott M. Hurd
Senior Vice President, Chief Accounting Officer

(Chief Accounting Officer)