Bluestem Brands, Inc.

Consolidated Financial Statements as of and for the
Years ended January 31, 2014 and February 1, 2013,
and Independent Auditors' Report

BLUESTEM BRANDS, INC.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Bluestem Brands, Inc.
Eden Prairie, Minnesota

We have audited the accompanying consolidated financial statements of Bluestem Brands, Inc. and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of January 31, 2014 and February 1, 2013, and the related consolidated statements of operations, cash flows, and shareholders' deficit for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

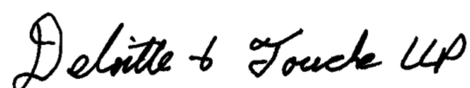
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bluestem Brands, Inc. and its subsidiaries as of January 31, 2014 and February 1, 2013, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



April 17, 2014

Member of
Deloitte Touche Tohmatsu

BLUESTEM BRANDS, INC.

CONSOLIDATED BALANCE SHEETS
AS OF JANUARY 31, 2014 AND FEBRUARY 1, 2013
(In thousands, except share information)

	January 31, 2014	February 1, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 132,388	$ 349
Restricted cash	7,065	22,085
Customer accounts receivable — net of allowance of $37,101 and $164,449, respectively	36,406	720,078
Merchandise inventories	68,151	51,835
Promotional material inventories	15,362	13,852
Deferred income taxes	5,847	12,963
Prepaid expenses and other assets	22,751	12,145
Total current assets	287,970	833,307
PROPERTY AND EQUIPMENT — Net	37,063	26,995
DEFERRED CHARGES (Note 1)	8,776	-
OTHER ASSETS	27	15
TOTAL ASSETS	$ 333,836	$ 860,317
LIABILITIES, MEZZANINE EQUITY, AND SHAREHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Accounts payable	$ 71,572	$ 106,191
Current income taxes payable	18,876	6,141
Accrued costs and other liabilities	54,021	28,648
Derivative liabilities in our own equity	-	85,992
Short-term debt	27,979	443,484
Total current liabilities	172,448	670,456
LONG-TERM DEBT	198,280	1,617
OTHER LONG-TERM LIABILITIES	8,653	10,438
COMMITMENTS AND CONTINGENCIES (Note 10)		
MEZZANINE EQUITY:		
Series B convertible preferred stock, par value $0.00001 — 753,523,962 shares authorized; 753,256,768 shares issued and outstanding at February 1, 2013	-	73,454
Series A convertible preferred stock, par value $0.00001 — 791,738,012 shares authorized; 749,995,554 shares issued and outstanding at February 1, 2013	-	154,947
SHAREHOLDERS' DEFICIT:		
Series B convertible preferred stock, par value $0.00001 — 753,523,962 shares authorized; 753,256,768 shares issued and outstanding at January 31, 2014	469	-
Series A convertible preferred stock, par value $0.00001 — 791,738,012 shares authorized; 794,738,012 shares issued and outstanding at January 31, 2014	872	-
Common stock, par value $0.00001 — 2,592,550,586 shares authorized; 6,416,291 and 3,878,288 shares issued and outstanding, respectively	-	-
Additional paid-in capital	142,086	-
Accumulated deficit	(188,972)	(50,595)
Total shareholders' deficit	(45,545)	(50,595)
TOTAL LIABILITIES, MEZZANINE EQUITY, AND SHAREHOLDERS' DEFICIT	$ 333,836	$ 860,317

See notes to consolidated financial statements.

BLUESTEM BRANDS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED JANUARY 31, 2014 AND FEBRUARY 1, 2013
(In thousands)

	January 31, 2014	February 1, 2013
Net sales	$ 838,937	$ 700,099
Cost of sales	493,461	390,567
Gross profit	345,476	309,532
Sales and marketing expenses	170,530	158,182
Net credit expense (income)	(62,865)	(46,015)
General and administrative expenses	133,320	101,706
Loss from derivatives in our own equity (Note 1)	177,289	1,988
Loss on early extinguishment of debt (Note 4)	8,258	3,121
Interest expense, net	19,772	33,158
(Loss) income before income taxes	(100,828)	57,392
Income tax expense	26,017	21,243
Net (loss) income	$ (126,845)	$ 36,149

See notes to consolidated financial statements.

BLUESTEM BRANDS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JANUARY 31, 2014 AND FEBRUARY 1, 2013
(In thousands)

	January 31, 2014	February 1, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (126,845)	$ 36,149
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	13,929	12,923
Amortization of deferred charges and original issue discount	5,569	5,031
Loss from derivatives in our own equity	177,289	1,988
Noncash component of loss on early extinguishment of debt	1,300	871
Loss (gain) on disposal of assets	44	(25)
Provision for doubtful accounts	74,562	129,080
Provision for merchandise returns	22,955	18,247
Deferred income taxes	5,395	(3,541)
Stock-based compensation	2,666	1,118
Other noncash items affecting income	26,818	19,452
Changes in operating assets and liabilities:		
Customer accounts receivable	140,386	(291,625)
Merchandise inventories	(10,529)	11,171
Promotional material inventories	(1,510)	(2,795)
Prepaid expenses and other current assets	(4,414)	(2,761)
Current income taxes payable	12,735	2,908
Accounts payable and other liabilities	(14,216)	36,956
Net cash provided by (used in) operating activities	326,134	(24,853)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of accounts receivable	(761,266)	-
Proceeds from sale of accounts receivable	1,176,658	-
Purchases of fixed assets — including internal-use software and website development	(19,847)	(13,906)
Proceeds from sales of assets	90	25
Decrease (increase) in restricted cash — net	15,020	(7,436)
Net cash provided by (used in) investing activities	410,655	(21,317)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on revolving credit facilities	952,880	979,916
Repayments on revolving credit facilities	(1,410,644)	(933,713)
Borrowings on term loan, net of financing fees	213,503	-
Common stock dividend paid, including related fees	(254,854)	-
Preferred stock accrued dividend paid, including related fees	(108,290)	-
Issuance of Series A convertible preferred stock	417	-
Issuance of common stock	2,238	6
Net cash (used in) provided by financing activities	(604,750)	46,209
NET INCREASE IN CASH AND CASH EQUIVALENTS	132,039	39
CASH AND CASH EQUIVALENTS — Beginning of year	349	310
CASH AND CASH EQUIVALENTS — End of year	$ 132,388	$ 349
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 14,747	$ 28,185
Income and franchise taxes paid	9,189	22,065
SIGNIFICANT NON-CASH TRANSACTIONS:		
Purchases of property and equipment on account	$ 705	$ 344
Capital lease obligation incurred	3,023	1,273
Series B convertible preferred stock accretion	4,267	4,167
Series A convertible preferred stock accretion	11,496	11,420

See notes to consolidated financial statements.

BLUESTEM BRANDS, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS’ DEFICIT
FOR THE YEARS ENDED JANUARY 31, 2014 AND FEBRUARY 1, 2013
(In thousands, except share information)

	Series B Convertible Preferred Stock		Series A Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Shareholders’ Deficit
	Shares	Amount	Shares	Amount	Shares	Amount			
BALANCE — February 3, 2012					3,564,267	$ -	$ -	$ (74,666)	$ (74,666)
Exercise of common stock options					6,889		6		6
Exercise of common stock warrants (Note 6)					307,132			2,385	2,385
Stock-based compensation							1,118		1,118
Series B convertible preferred stock accretion								(4,167)	(4,167)
Series A convertible preferred stock accretion							(1,124)	(10,296)	(11,420)
Net income								36,149	36,149
BALANCE — February 1, 2013					3,878,288	$ -	-	(50,595)	(50,595)
Issuance of restricted common stock					238,100				-
Exercise of common stock options					17,804		76		76
Exercise of common stock warrants (Note 6)					2,282,099		2,160		2,160
Exercise of preferred stock warrants (Note 6)			41,742,458				417		417
Stock-based compensation							2,666		2,666
Series B convertible preferred stock accretion		461					(625)	(3,642)	(3,806)
Series A convertible preferred stock accretion				864			(3,606)	(7,890)	(10,632)
Reclassification of convertible preferred stock from mezzanine equity	753,256,768	21,569	749,995,554	86,737			134,535		242,841
Reclassification of common stock warrants from derivative liabilities in our own equity							34,008		- 34,008
Reclassification of preferred stock warrants from derivative liabilities in our own equity							12,773		12,773
Reclassification of convertible preferred stock conversion feature from derivative liabilities in our own equity							216,500		- 216,500
Common stock dividend declared, including related costs							(256,818)		(256,818)
Preferred stock accrued dividend paid		(21,561)		(86,729)					(108,290)
Net loss								(126,845)	(126,845)
BALANCE — January 31, 2014	753,256,768	$ 469	791,738,012	$ 872	6,416,291	$ -	$ 142,086	$ (188,972)	$ (45,545)

See notes to consolidated financial statements.

1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business — Bluestem Brands, Inc. (the "Company") is a national multi-brand online retailer serving low to middle income consumers by offering products with customized payment plans through three brands: Fingerhut, Gettington.com and PayCheck Direct. Fingerhut generally targets consumers with FICO scores less than 670 and household income less than $50,000 and offers consumers a brand assortment of merchandise with the ability to pay via monthly payments and allowing access to a revolving credit line. Additionally, Fingerhut offers the FreshStart program, which provides the option of purchasing merchandise on installment credit terms after first making a down payment. Gettington.com targets consumers with a FICO score greater than 610 and household income of $55,000 to $100,000 and offers payment plans similar to Fingerhut. PayCheck Direct is an employee benefit program that is offered directly through employers or organizations as a voluntary benefit to employees and members, which allows consumers to purchase products with the convenience of payment for their purchases over time through payroll deductions or automatic bank withdrawals. The brands offer a large selection of name-brand, private label, and non-branded merchandise through catalog and Internet websites to customers in the United States. The Company primarily sells consumer electronics, domestics, housewares, home furnishings, children's merchandise, and apparel. By combining its proprietary marketing and credit decision-making technologies, the Company is able to tailor merchandise and credit offers to prospective as well as existing customers.

Prior to July 1, 2012, qualifying Fingerhut and Gettington.com brand customers were offered revolving credit accounts by MetaBank and WebBank (the "Credit Issuers"), respectively. Effective July 1, 2012, MetaBank was replaced by WebBank as the originating bank for Fingerhut customer revolving credit accounts and Fingerhut FreshStart installment credit accounts. The Company purchases all receivables resulting from the extension of credit to its customers by the Credit Issuers and assumes the servicing of the accounts. The revolving credit account can only be used to purchase merchandise from Fingerhut, Gettington.com and from certain third parties that market their products and services to the Company's customers. See Note 3 *Customer Accounts Receivable*. Approximately 95% of sales are on these revolving and installment credit accounts.

On April 19, 2013, the Company entered into a series of transactions with WebBank and Santander Consumer USA Inc. ("SCUSA") related to Fingerhut and Gettington.com customer accounts receivables. The following are the primary agreements executed by the Company related to these transactions and the counterparties to each transaction (collectively the "A/R Program Agreements").

Agreement	Counterparty
Receivables Sale Agreement	WebBank
Standard Receivables Sale Agreement	SCUSA

Program Agreement	WebBank and SCUSA

The Company sells all new receivables originated in revolving credit accounts to SCUSA on the same day those receivables are purchased by the Company from WebBank, and if the Fingerhut or Gettington.com customer whose purchase of goods triggered the origination of that new receivable also had an existing receivable balance on his or her revolving credit account, that existing balance is also required to be sold to SCUSA. All new and existing receivables originated in revolving credit accounts are referred to as "Standard Receivables." All new and existing receivables generated in credit accounts other than revolving credit accounts, including Fingerhut FreshStart credit accounts and PayCheck Direct accounts, are referred to as "Nonstandard Receivables." The Company retains all Nonstandard Receivables purchased from WebBank. SCUSA bears risk of loss due to uncollectibility of the Standard Receivables purchased by SCUSA. The Company bears risk of loss due to uncollectibility on Nonstandard Receivables and any existing Standard Receivables not purchased by SCUSA.

The Company services the credit accounts and related receivables as WebBank's and/or SCUSA's agent. In consideration of the Company's servicing of the Standard Receivable portfolio owned by SCUSA, SCUSA pays a servicing fee to and shares a portion of the profits of the portfolio with the Company. See Note 2 *Transfers and Servicing of Financial Assets.*

Principles of Consolidation — The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All intercompany balances and transactions have been eliminated in the consolidated financial statements.

Fiscal Year — The Company's fiscal year is 52 or 53 weeks ending on the Friday closest to January 31. Fiscal year 2013 and 2012 included 52 weeks and ended on January 31, 2014 and February 1, 2013, respectively. References to years relate to fiscal years or fiscal year ends rather than calendar years.

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of 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. Significant estimates in the consolidated financial statements include revenue recognition, the allowance for doubtful accounts, reserves for excess and obsolete merchandise inventories, allowances for merchandise returns and customer allowances, promotional material inventories, income taxes, and valuation of stock-based awards, common stock and derivatives in our own equity.

Cash and Cash Equivalents — Cash and cash equivalents include liquid investments with original maturities of three months or less. All cash and cash equivalents are carried at amounts that approximate fair value.

Restricted Cash — The Company has restricted depository accounts related to its agreement with the Credit Issuers to originate customer revolving credit accounts. Under the agreements with WebBank, as amended, the Company is required to maintain a segregated deposit account at WebBank in an amount equivalent to a minimum of $0.5 million plus 100% of the average of the previous calendar month's daily outstanding principal balance held by WebBank during the contractual holding period. At January 31, 2014 and February 1, 2013, restricted cash included $2.7

million and $3.2 million, respectively, related to WebBank's origination of customer revolving and installment credit accounts.

The Company has restricted accumulated customer cash receipts related to the A/R Program Agreement as of January 31, 2014. Under the A/R Program Agreements, payments on customer accounts receivable received are accumulated in restricted accounts and, subsequently, are released to the Company. Prior to April 2013, the Company funded the majority of its customer accounts receivable with borrowings under its Secured Credit Facility ("A/R Credit Facility") and had restricted accumulated customer cash receipts related to the A/R Credit Facility. Under the A/R Credit Facility, payments on customer accounts receivable were accumulated in restricted accounts and released to the Company on a semi-monthly basis. The Company paid off its A/R Credit Facility on April 19, 2013. As of January 31, 2014 and February 1, 2013, $4.4 million and $18.9 million of accumulated customer cash receipts, respectively, was reported as a component of restricted cash in the Company's consolidated balance sheets.

In addition to payments on customer accounts receivable, cash collateral ranging from 0% to 12% of outstanding borrowings under the A/R Credit Facility was held in a restricted account. The amount of cash collateral varied based on the performance of the A/R Credit Facility's eligible underlying receivables. As of February 1, 2013, no cash collateral was included in restricted cash in the consolidated balance sheets.

Allowance for Doubtful Accounts — The Company maintains an allowance for doubtful accounts at a level intended to absorb estimated probable losses inherent in customer accounts receivable, including accrued finance charges and fees as of the balance sheet date. The Company uses its judgment to evaluate the adequacy of the allowance for doubtful accounts based on a variety of quantitative and qualitative risk considerations. Quantitative factors include, among other things, customer credit risk and aging of accounts receivable. Qualitative factors include, among other things, economic factors that have historically been leading indicators of future delinquency and losses such as national unemployment rates, changing trends in the financial obligations ratio published by the Federal Reserve, and changes in the consumer price index. The Company segments customer accounts receivable into vintage pools based on date of account origination. Each vintage is further segmented into pools based on delinquency status as of the balance sheet date and risk profile. Estimate of future losses are based on historical losses on receivables with a similar vintage, delinquency status, and risk profile, adjusted for current trends and changes in underwriting. Customer receivables are written off as of the statement cycle date following the passage of 180 days (120 days for FreshStart installment accounts) without receiving a qualifying payment. Accounts receivable relating to bankrupt or deceased account holders are written off as of the statement cycle date following the passage of 60 days after receipt of formal notification regardless of delinquency status. Recoveries of receivables previously written off are recorded when received.

Merchandise Inventories — Merchandise inventories are valued at the lower of weighted-average cost or market value. The Company writes down inventory considered obsolete based on management's best estimate of the amount of inventory that is subject to obsolescence. The estimates are subject to change in the near term, depending on changes in economic conditions and other factors, which may affect the ending inventory valuation as well as gross margin. Merchandise inventories were $68.2 million and $51.8 million net of write-downs for excess and obsolete merchandise of $8.4 million and $7.1 million at January 31, 2014 and February 1, 2013, respectively. Cash discounts and trade rebates from vendors are recorded as a reduction to merchandise inventories.

Promotional Material Inventories — Promotional material inventories includes raw materials, work in process, and costs associated with catalog direct response advertising and premium (free gift) inventory. Production of catalog direct response advertising includes costs associated with photography, page design, development, separations, payroll and benefit costs for employees involved in the creation of catalogs, as well as costs of paper, printing, and postage. Catalog direct response advertising costs are deferred and amortized to sales and marketing expense over the period during which the sales are expected to occur, generally over three to five months following a mailing. Premiums are expensed when shipped to the customer along with the product order. Catalog direct response advertising expense for the years ended January 31, 2014 and February 1, 2013, was $111.5 million and $110.1 million, respectively.

Promotional material inventories as of January 31, 2014 and February 1, 2013, consist of the following (in thousands):

	January 31, 2014	February 1, 2013
Premium inventory	$ 1,143	$ 1,447
Catalog advertising work in process	5,132	2,615
Deferred promotional costs	9,087	9,790
Promotional material inventories	$ 15,362	$ 13,852

Property and Equipment – net — Property and equipment includes purchased and internally-developed software, computer hardware, machinery and equipment used in the Company's distribution center, office furniture, property under capital lease, and leasehold improvements with estimated useful lives ranging from three to five years. Property under capital lease is comprised of computer hardware used for corporate data storage and software. Property and equipment is recorded at cost and is depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are depreciated over the shorter of the estimated useful lives of the assets or the contractual term of the lease, with consideration of lease renewal options if renewal appears probable. Purchased and internally-developed software are amortized over the estimated useful lives of the assets not to exceed five years. The Company has pledged unencumbered property and equipment as additional collateral for the Term Loan, with the Inventory Line of Credit in a secondary position. See Note 3 *Financing* for further information on the Term Loan and Inventory Line of Credit.

Property and equipment — net as of January 31, 2014 and February 1, 2013, consists of the following (in thousands):

	January 31, 2014	February 1, 2013
Software	$ 70,282	$ 56,812
Computer hardware	5,982	7,611
Machinery, equipment, and furniture	4,312	4,794
Property under capital lease	3,251	1,273
Leasehold improvements	6,482	4,638
	90,309	75,128
Less accumulated depreciation and amortization	(53,246)	(48,133)
Property and equipment — net	$ 37,063	$ 26,995

Depreciation of fixed assets and internal-use software and website development amortization expense for the years ended January 31, 2014 and February 1, 2013, was $13.4 million and $12.9 million, respectively, of which $12.6 million and $12.2 million were reported in general and administrative expenses for the years ended January 31, 2014 and February 1, 2013, respectively. The remaining $0.8 million and $0.7 million of depreciation and amortization expense were reported in cost of sales for years ended January 31, 2014 and February 1, 2013, respectively. Routine maintenance and repair costs, reported in general and administrative expenses, were $5.1 million and $4.8 million for the years ended January 31, 2014 and February 1, 2013, respectively.

Deferred Charges — Costs incurred to secure financing are capitalized and amortized as interest expense over the term of the related debt using the straight-line method which approximates the effective interest method. Transaction cost related to the A/R Program Agreements are capitalized and amortized as net credit expense (income) over the initial term of the agreements. Amortization of financing costs was $5.0 million and $4.4 million for the years ended January 31, 2014 and February 1, 2013, respectively. Amortization of transaction costs related to the A/R Program Agreements was $0.5 million for the year ended January 31, 2014.

Derivative Liabilities in Our Own Equity — Accounting Standards Codification (“ASC”) 815-40 (ASC 815-40), formerly EITF 07-5, “*Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock*” requires an analysis as to whether or not the Company’s common and preferred stock warrants and conversion features embedded in its Series A convertible preferred stock (“Series A Preferred Stock”) and Series B convertible preferred stock (“Series B Preferred Stock”) are indexed to its own equity, a condition that is required to attain equity accounting and classification. The Series A Preferred Stock and Series B Preferred Stock are collectively referred to as “Preferred Stock.”

The Company’s Series A Preferred Stock and Series B Preferred Stock each contained an embedded conversion feature that contained non-standard anti-dilution provisions. See Note 5 *Fair Value Measurements and Fair Value of Financial Instruments* for further information. The embedded conversion feature was not considered to be clearly and closely related to the host instrument because the Preferred Stock was redeemable outside of the control of the Company. Under ASC 815-40, the embedded conversion feature was required to be bifurcated and accounted for as a freestanding derivative.

The Company also had derivative liabilities relating to certain of its common stock warrants, preferred stock warrants, and a contingent fee agreement. These derivative liabilities were recorded at their estimated fair value. Changes in fair value were reflected in the consolidated statement of operations as gains or losses from derivatives in our own equity. Effective December 6, 2013, the Company had no derivative liabilities in our own equity. See Note 3 *Financing* and Note 5 *Fair Value Measurements and Fair Value of Financial Instruments* for further information.

Operating Leases — The Company rents office and distribution center space under operating leases which, in addition to the minimum lease payments, require payment of a proportionate share of the real estate taxes and certain building operating expenses.

Rent expense is recognized on a straight-line basis over the lease term, after consideration of rent escalations and rent holidays. The Company records any difference between the straight-line rent amounts and amounts payable under the leases as deferred rent, in other current liabilities or other long-term liabilities, as appropriate. The lease term for purposes of the calculation begins on the earlier of the lease commencement date or the date the Company takes possession of the property. Leasehold improvements that are funded by landlord incentives or allowances under an operating lease are recorded as deferred rent in accrued costs and other current liabilities or other long-term liabilities, as appropriate, and amortized as reductions to rent expense over the lease term. As of both January 31, 2014 and February 1, 2013, deferred rent included in accrued costs and other current liabilities in the consolidated balance sheets was $0.5 million. Deferred rent included in other long-term liabilities in the consolidated balance sheets was $4.9 million and $5.2 million as of January 31, 2014 and February 1, 2013, respectively.

Capital Leases — Assets held under capital leases are included in property and equipment. Capital lease obligations are included in current and long-term debt, as appropriate. See Note 4 *Financing*.

Revenue Recognition — Net sales consists of sales of merchandise, shipping and handling revenue, and commissions earned from third parties that market their products to the Company's customers. Merchandise sales and shipping and handling revenue are recorded at the estimated time of delivery to the customer. Net sales is reported net of discounts and estimated sales returns, and excludes sales taxes.

Net sales for the years ended January 31, 2014 and February 1, 2013, consist of the following (in thousands):

	January 31, 2014	February 1, 2013
Sales by merchandise category:		
Home	$ 351,389	$ 311,127
Entertainment	387,413	303,112
Fashion	140,229	112,739
Total merchandise sales	879,031	726,978
Returns and allowances	(56,059)	(41,673)
Commissions	15,965	14,794
Net sales	$ 838,937	$ 700,099

Cost of Sales — Cost of sales includes the cost of merchandise sold (net of vendor rebates, purchase discounts and estimated returns), shipping and handling costs, inbound freight costs, payroll and benefits for distribution center employees, depreciation of distribution center assets, and estimates of product obsolescence costs. Distribution center occupancy costs are not included in cost of sales.

Sales and Marketing Expenses — Sales and marketing expenses include e-commerce advertising, catalog production and postage costs, premium (i.e., free gift with purchase) expense, interchange fee, order entry, and customer service costs. Catalog production and postage costs are deferred and amortized over the period during which the future benefits of the mailing are expected to be received.

Net Credit Expense (Income) — The Company recognizes finance charge and fee income on customer accounts receivable according to the contractual provisions of its customer account agreements. Finance charge income is accrued on all accounts receivable until the account balance is paid off or charged off. A late fee is imposed if the customer does not pay at least the minimum payment by the payment due date. The Company ceases to charge a late fee when an account is 90 or more days past due. The Company's estimate of uncollectible finance charge and fee income is included in the allowance for doubtful accounts.

The Company receives a servicing fee and shares a portion of the profits, as defined in the A/R Program Agreements, of the SCUSA owned portfolio of Standard Receivables. The SCUSA owned portfolio profits are based on finance charge, fees and other revenues, less write-offs of uncollectable receivables, servicing fees, an agreed upon cost of funds and a merchant fee, as applicable. Servicing fee income and portfolio profit sharing income is recognized according to the contractual provisions in the A/R Program Agreements.

The Company records a provision for doubtful accounts to maintain the allowance for doubtful accounts at a level intended to absorb probable losses in customer accounts receivable as of the consolidated balance sheet date.

Credit management costs include statement and payment processing, collections, origination fees paid to the Credit Issuers, new account application and credit bureau processing costs, as well as direct customer service costs. Net credit expense (income) for the years ended January 31, 2014 and February 1, 2013, is as follows (in thousands):

	January 31, 2014	February 1, 2013
Finance charge and fee income	$ (96,835)	$ (219,968)
Servicing fee income and portfolio profit sharing	(91,192)	-
Provision for doubtful accounts	74,562	129,080
Credit management costs	50,600	44,873
Net credit expense (income)	$ (62,865)	$ (46,015)

General and Administrative Expenses — General and administrative expenses include payroll and benefit costs for corporate and administrative employees, including information technology, legal, human resources, finance, merchandising, credit supervision, sales and marketing management; occupancy costs of corporate and distribution center facilities; depreciation related to corporate assets; insurance; software amortization; maintenance; and other overhead costs.

Transfer and Servicing of Financial Assets – A Standard Receivable eligible to be sold under the A/R Program Agreements is recorded at the lower of cost or fair value at the date of eligibility. At that time, any reduction in the Standard Receivable's value is reflected as a charge to provision for doubtful accounts expense with a corresponding addition in the allowance for doubtful accounts. The Standard Receivable is then reclassified as held-for-sale and the Company records a charge-off for any reduction below par on the Standard Receivable with a corresponding reduction in the allowance for doubtful accounts. The Company derecognizes the Standard Receivable upon the sale and any servicing asset or liability is recognized at fair value. During the year ended January 31, 2014, compensation received for the services approximated adequate compensation and, therefore, there was no servicing asset or liability. For the year ended January 31, 2014, the Company recorded $29.2 million charge to provision for doubtful accounts and recorded $72.2 million of charge-offs related to the sale of Standard Receivables.

Impairment of Long-lived Assets — The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset, plus net proceeds expected from disposition of the asset (if any). When an impairment loss is recognized, the carrying amount of the asset is reduced to estimated fair value based on discounted cash flows, quoted market prices, or other valuation techniques. Assets to be disposed of are reported at the lower of the carrying amount of the asset or fair value less costs to sell. There were no impairment losses recognized for each of the years ended January 31, 2014 and February 1, 2013.

Stock-Based Compensation — Stock-based compensation expense is recognized in an amount equal to the fair value on the date of the grant. Compensation expense is recognized over the period the employees are required to provide services in exchange for the stock-based awards. See Note 7 *Stock-Based Compensation* for a discussion of the Company's stock-based compensation plans.

Comprehensive Income — During the years ended January 31, 2014 and February 1, 2013, there were no other comprehensive income. Accordingly, net income equals comprehensive income for all periods presented.

2. TRANSFERS AND SERVICING OF FINANCIAL ASSETS

On April 19, 2013, the Company entered into the A/R Program Agreements with WebBank and SCUSA related to revolving Fingerhut and Gettington.com customer accounts receivables. The agreements have an original term of seven years with two successive two-year automatic renewals.

WebBank continues to originate, and the Company continues to market, revolving credit accounts and installment credit accounts to qualifying customers identified by the Company. The credit accounts may only be used to purchase goods and services from Fingerhut, Gettington.com, and certain third parties that market their goods and services to the Company's customers. The Company purchases all receivables resulting from the extension of credit to its customers by WebBank, after a contractual holding period by WebBank. The purchase price of the receivables from WebBank is par value, and the Company pays applicable interchange fees, origination fees, and other products fees along with applicable customer finance charges earned by WebBank during the contractual hold period.

The Company is obligated to sell to SCUSA all new Standard Receivables on the same day those receivables are purchased by the Company from WebBank, and if the Fingerhut or Gettington.com customer whose purchase of goods triggered the origination of that new receivable also had an

existing receivable balance on his or her revolving credit account, that existing balance is also required to be sold to SCUSA. The purchase price for the first $650 million of Standard Receivables, including any accrued finance charges, was 88.9% of par value. All Standard Receivables sold subsequent to the first $650 million are purchased at par value. SCUSA also reimburses the Company for the fees paid to WebBank except for the applicable interchange fees.

The Company is responsible for servicing the credit accounts and related receivables as WebBank's and/or SCUSA's agent, as applicable, including account transaction authorization, preparation and mailing of account statements, undertaking collections, providing customer service and other services as are ordinary and customary in the servicing of revolving credit accounts and installment credit accounts.

In consideration of the Company's servicing of the Standard Receivable portfolio owned by SCUSA, SCUSA pays a servicing fee to and shares a portion of the profits of the portfolio with the Company. The portfolio profits are based on finance charge, fees and other revenues, less write-offs of uncollectable receivables, servicing fees, an agreed upon cost of funds and in certain circumstances a merchant fee. Upon transfer, any servicing asset or liability is initially recognized at fair value. The compensation received for 2013 approximates adequate compensation for the services, and as such, there is no servicing asset or liability as of January 31, 2014.

In addition to the Standard Receivables the Company is obligated to sell, the Company sold all existing Standard Receivables with a current status on September 27, 2013 and October 4, 2013 to SCUSA. For the year ended January 31, 2014, the Company purchased $763.2 million new Standard Receivables under the A/R Program Agreements. For the year ended January 31, 2014, the Company sold $1,250.8 million new and existing Standard Receivables and recorded a net charge to provision for doubtful accounts expense of $29.2 million to reduce the Standard Receivables value to net realizable value. The Standard Receivables were sold for $1,178.6 million, which approximated the carrying value of the Standard Receivables, and the Company recorded a charge-off of $72.2 million.

The Company is subject to the following financial covenants under the Program Agreement:

- *Minimum Net Liquidity* — The Company must maintain net liquidity of at least $40 million measured at each fiscal month end as the sum of (i) unrestricted cash and cash equivalents, and (ii) availability of cash under any credit facility maintained by the Company or any of its subsidiaries.
- *Leverage Ratio* — The Company must maintain a leverage ratio of less than or equal to 3.0 to 1.0 measured at each fiscal quarter end as (a) Total Debt outstanding to (b) consolidated adjusted EBITDA (for the most-recently ended four fiscal quarters). Under the Program Agreement, consolidated adjusted EBITDA is defined as earnings before interest, tax, depreciation and amortization and, among other items, includes the add back of the loss from derivatives in our own equity and loss on early extinguishment of debt.
- *Fixed Charge Ratio* — The Company must maintain a fixed charge ratio equal to or greater than 1.10x measured at each fiscal quarter end for the most recently ended four fiscal quarters, as (i) consolidated adjusted EBITDA minus capital expenditures made during such period (excluding the portion thereof funded with long term debt financing provided by third parties) to (ii) consolidated fixed charges.

Failure to comply with these covenants is an event of default, subject to certain grace periods or waivers. As of January 31, 2014, the Company was in compliance with all covenants.

In executing the transactions described above, the Company incurred approximately $6.7 million of direct and incremental expenses including broker, legal, consulting and accounting expenses. These costs were capitalized and amortized to net credit expense (income) over the seven-year initial term of the agreements.

3. CUSTOMER ACCOUNTS RECEIVABLE

Customer accounts receivable as of January 31, 2014 and February 1, 2013 are as follows (in thousands):

	January 31, 2014	February 1, 2013
Revolving accounts receivable	$ 50,257	$ 851,686
FreshStart installment accounts receivable	14,924	18,927
PayCheck Direct installment accounts receivable	3,823	319
Other accounts receivable	4,503	13,595
Customer accounts receivable	73,507	884,527
Less allowance for doubtful accounts	(37,101)	(164,449)
Customer accounts receivable — net	$ 36,406	$ 720,078
Period-end balances 30+ days delinquent [(a)]	$ 38,287	$ 125,298
Period-end balances 30+ days delinquent as a percentage of total customer accounts receivable [(b)]	56.6 %	14.4 %

(a) Delinquent balances as of the customers' statement cycle dates prior to or on fiscal period end.

(b) Delinquent balances as of the customers' statement cycle dates prior to or on fiscal period end as a percentage of total customer accounts receivable as of the customers' statement cycle dates prior to or on fiscal period end.

The Credit Issuers extend credit directly to the Fingerhut and Gettington.com customers. The Company is obligated to purchase and assume ownership of the receivables after a contractual holding period by the Credit Issuers, generally one or two business day. The purchase price includes the unpaid balance of the receivable, plus accrued interest during the Credit Issuers' holding periods, plus an origination and interchange fee.

Fingerhut revolving credit is typically accepted on customary revolving credit terms and offers the customer the option of paying the entire balance during a "grace period" of at least 24 days without incurring finance charges. Alternatively, customers may make scheduled minimum payments and incur finance charges on the revolving balance. Depending on the dollar value of the account balance, minimum payments range from $5.99 to $69.99 for balances up to $1,399, or 5% of the account balance for balances greater than $1,399. For balances of $5.99 or less, the minimum payment is the outstanding balance. The Company also offers qualifying customers credit on deferred billing terms. Generally, the deferral periods are between 30 and 150 days. Unless the entire deferred account balance is paid in full on or before the expiration of the deferred billing period, the deferred billing account balance converts to a revolving account at the end of the deferral period, and finance charges are assessed from the date the sale is posted to the customer's account.

The Company's Fingerhut FreshStart credit product is designed to offer customers, otherwise unable to qualify for revolving credit, the alternative of purchasing merchandise on installment credit terms. Once approved and after a $30 down payment has been received, Fingerhut FreshStart applicants are allowed a one-time purchase of Fingerhut merchandise up to their credit limit. The remaining balance is repaid by monthly installments. If all payments are made on time and for the full amount, the customer credit account is graduated to Fingerhut's customary revolving credit terms.

Gettington.com revolving credit is accepted on customary revolving credit terms and offers the customer the option of paying the entire balance during a "grace period" of at least 24 days without incurring finance charges. Alternatively, customers may make scheduled minimum payments and incur finance charges on the revolving balance. Minimum payments depend on whether the customer has chosen the Fast Option or the Easy Option. The Fast Option calculates the minimum payment in four equal monthly installments at the time of purchase, which includes related interest charges. The Easy Option minimum payment amount is determined by the purchases and balances on the Easy Option plan. The minimum payment is calculated on the original purchase as either $20 or 5.5% of the beginning account balance, whichever is greater. The Easy Option payment is recalculated after each additional purchase.

PayCheck Direct installment receivables are issued by the Company to consumers who are members and employees of participating organizations and employers in the program. Customers make installment payments through payroll deductions or automatic bank withdrawals based on their company or organization's payroll frequency over the course of one year or less. No interest is charged on these installment receivables.

Finance charge and fee income is recognized on customer accounts receivable according to the contractual provisions of the credit account agreements. An estimate of uncollectible finance charge and fee income is included in the allowance for doubtful accounts.

The Company maintains an allowance for doubtful accounts at a level intended to absorb estimated probable losses inherent in customer accounts receivable, including accrued finance charges and fees as of the balance sheet date. The provision for doubtful accounts is included in net credit expense (income) in the consolidated statements of operations. Upon charge-off, any unpaid principal is applied to the allowance for doubtful accounts and any accrued but unpaid finance charges and fees are netted against finance charge and fee income with an offsetting equivalent reversal of the allowance for doubtful accounts through the provision for doubtful accounts.

Changes in the allowance for doubtful accounts for the years ended January 31, 2014 and February 1, 2013, are as follows (in thousands):

	January 31, 2014	February 1, 2013
Allowance for doubtful accounts — beginning of year	$ 164,449	$ 139,553
Provision for doubtful accounts	74,562	129,080
Principal charge-offs (a)	(224,397)	(126,751)
Recoveries	22,487	22,567
Allowance for doubtful accounts — end of year	$ 37,101	$ 164,449
As a percentage of period-end customer accounts receivable	50.5 %	18.6 %
As a percentage of balances 30+ days delinquent	96.9 %	131.2 %

(a) For the period ended January 31, 2014, charge-offs include $72.2 million related to the sale of accounts receivable under the terms of the A/R Program Agreements.

The average time since origination of customer accounts affects the stability of delinquency and loss rates. Older accounts are typically more stable than more recently originated accounts. The peak delinquency rate for a new account vintage is approximately eight months after origination. Accounts past this peak delinquency curve exhibit greater stability in their performance. The Company estimates the allowance for doubtful accounts by segmenting customer accounts receivable by time since origination.

The time since origination of customer accounts and their related accounts receivable balance as of January 31, 2014 and February 1, 2013, are as follows (in thousands):

	January 31, 2014	February 1, 2013
Time since origination, as segmented in our estimate of the allowance for doubtful accounts:		
0 - 3 months	$ 10,318	$ 59,669
4 - 6 months	5,131	40,654
7 - 9 months	2,362	38,807
10 - 12 months	2,810	29,982
13 - 15 months	5,163	54,197
16 - 18 months	2,231	38,124
19+ months	32,737	590,899
Impaired [(a)]	12,755	32,195
Period-end customer accounts receivable	$ 73,507	$ 884,527

(a) Includes qualified hardship, bankrupt, deceased, and re-aged customer accounts.

4. FINANCING

Outstanding financing agreements as of January 31, 2014 and February 1, 2013, are as follows (in thousands):

	January 31, 2014	February 1, 2013
Short-term debt:		
Term Loan — net of discount of $1,457	$ 23,543	$ -
A/R Credit Facility — Revolving Credit Tranche (Tranche A)	-	319,000
A/R Credit Facility — Term Loan Tranche (Tranche B)	-	75,000
13% Senior Subordinated Secured Notes — net of discount of $82	-	29,918
Inventory Line of Credit	2,763	18,778
Capital lease obligation	1,088	282
Other notes payable	585	506
Short-term debt	$ 27,979	$ 443,484
Long-term debt:		
Term Loan — net of discount of $4,992	$ 195,008	$ -
Debt Due to Affiliates	400	400
Capital lease obligation	2,641	940
Other notes payable	231	277
Long-term debt	$ 198,280	$ 1,617

Interest Expense — net for the years ended January 31, 2014 and February 1, 2013, is as follows (in thousands):

	January 31, 2014	February 1, 2013
Interest on debt	$ 14,549	$ 28,084
Interest on capital lease obligation	173	44
Amortization of deferred charges	4,994	4,437
Amortization of original issue discount	82	594
Interest income	(26)	(1)
Interest expense — net	$ 19,772	$ 33,158

Term Loan — On December 6, 2013, the Company entered into a $225 million long-term debt facility with a syndicate of banks ("Term Loan") which matures on December 6, 2018. The Term Loan was issued with an original issue discount totaling $6.7 million. The discount is amortized under the effective interest method as interest expense over the term of the Term Loan. Direct loan origination fees of $4.8 million were capitalized as deferred charges. These fees are amortized on a straight-line basis (which approximates the effective interest method) as interest expense over the

term of the Term Loan. Proceeds from the Term Loan were used to pay dividends. See Note 5 *Mezzanine Equity and Shareholders' Deficit*.

Outstanding balances under the Term Loan will, at the Company's request, be classified as either LIBOR Loans or Base Rate Loans. The rate of interest payable by the Company in respect of loans outstanding under the Term Loan is (a) with respect to LIBOR Loans, LIBOR plus 6.5% for the interest period elected with LIBOR not to be below 1.00%; or (b) with respect to Base Rate Loans, the highest of 5.5% plus (i) the Prime Rate, (ii) the Federal Funds Rate plus 0.50% or (iii) one month LIBOR plus 1%.

The Company is required to make quarterly payments of $2.8 million for the first two years and $4.2 million for the next three years with a balloon payment on the Term Loan's maturity date. Subsequent to year-end, the Company made payments of $25.0 million on the Term Loan. As such, the Company has classified $25.0 million as short-term debt as of January 31, 2014. The Term Loan is secured by a first lien on unencumbered property and equipment and a second lien on the Company's inventory and accounts receivable not sold to SCUSA. The Company is subject to the following financial covenants under the Term Loan:

- *Minimum Net Liquidity* — The Company must maintain net liquidity of at least $40 million measured at each fiscal quarter end as the sum of (i) unrestricted cash and cash equivalents, and (ii) availability of cash under any credit facility maintained by the Company or any of its subsidiaries. At least $20 million unrestricted cash and cash equivalents must be available.
- *Leverage Ratio* — The Company must maintain a leverage ratio of less than or equal to 2.5 to 1.0 from December 2013 through January 2017, 2.25 to 1.0 from February 2017 through January 2018, and 2.0 to 1.0 from February 2018 and thereafter, measured at each fiscal quarter end as (a) Total Debt outstanding less Unrestricted Cash and Cash Equivalents on such date not to exceed $50 million to (b) consolidated adjusted EBITDA (for the most-recently ended four fiscal quarters). Under the Term Loan agreement, consolidated adjusted EBITDA is defined as earnings before interest, tax, depreciation and amortization and, among other items, includes the add back of the loss from derivatives in our own equity, loss on early extinguishment of debt and compensation expense related to dividend equivalents. For the first three quarters of fiscal 2013, consolidated adjusted EBITDA is on a pro forma basis, as defined in the Term Loan agreement.
- *Fixed Charge Ratio* — The Company must maintain a fixed charge ratio equal to or greater than 1.10x measured at each fiscal quarter end for the most recently ended four fiscal quarters, as (i) consolidated adjusted EBITDA, as defined by the Term Loan agreement, minus capital expenditures made during such period (excluding the portion thereof funded with long term debt financing provided by third parties) to (ii) consolidated fixed charges.

Failure to comply with these covenants is an event of default, subject to certain grace periods or waivers. As of January 31, 2014, the Company was in compliance with all covenants.

Inventory Line of Credit — The Company has a line of credit, as amended, that is secured by inventory and a second lien on other unencumbered assets of the Company (the "Inventory Line of Credit"). On July 11, 2012, the Company entered into an amendment (the "July 2012 Amendment") that increased the total availability amount of the line to $60 million from September through January, subject to borrowing capacity. The July 2012 Amendment also decreased the amount of unused commitment fees, lowered the rate at which interest accrues and consolidated the line of

credit with one lender. On April 19, 2013, the Company amended the Inventory Line of Credit to extend the maturity date to March 31, 2016. On December 6, 2013, the Company entered into an amendment that allowed the execution of the Term Loan and conformed certain attributes of its covenant to the Term Loan. A $0.3 million loss on early extinguishment of debt was recognized as a result of the July 2012 Amendment in an amount equal to the unamortized deferred charges of the line of credit underwritten by the former lender.

Borrowing capacity under the Inventory Line of Credit is calculated as the lower of 85% of the liquidation value from the latest inventory appraisal, or 65% of eligible inventory, in either case less any reserves, up to a maximum of $50 million from February through August, and $60 million from September through January.

Daily outstanding balances on the Inventory Line of Credit will, at the Company's request, be classified as either LIBOR Loans, or Floating Rate Loans (both as defined in the Inventory Line of Credit Agreement), subject to available balances. The rate of interest payable by the Company in respect of loans outstanding under the Inventory Line of Credit is (i) with respect to LIBOR Loans, the Adjusted LIBOR Rate (as defined) for the interest period elected, plus 2.50%; or (ii) with respect to Floating Rate Loans, the Prime Rate (as defined).

The Inventory Line of Credit agreement required the payment of an unused commitment fee of 0.375% prior to April 19, 2013, and effective afterwards requires an unused commitment fee of 0.25% on the average daily-unused portion of the revolving commitment.

Effective December 6, 2013, the Company is subject to the following financial covenants under the Inventory Line of Credit:

- *Minimum Net Liquidity* — The Company must maintain net liquidity of at least $40 million measured at each fiscal month end as the sum of (i) unrestricted cash and cash equivalents, and (ii) availability of cash under any credit facility maintained by the Company or any of its subsidiaries.
- *Leverage Ratio* — The Company must maintain a leverage ratio of less than or equal to 3.0 to 1.0 measured at each fiscal quarter end as (a) Total Debt outstanding less Unrestricted Cash and Cash Equivalents to (b) consolidated adjusted EBITDA (for the most-recently ended four fiscal quarters). Under the Inventory Line of Credit agreement, consolidated adjusted EBITDA is defined as earnings before interest, tax, depreciation and amortization and, among other items, includes the add back of the loss from derivatives in our own equity, loss on early extinguishment of debt and compensation expense related to dividend equivalents.
- *Fixed Charge Ratio* — The Company must maintain a fixed charge ratio equal to or greater than 1.10x measured at each fiscal quarter end for the most recently ended four fiscal quarters, as (i) consolidated adjusted EBITDA minus capital expenditures made during such period (excluding the portion thereof funded with long term debt financing provided by third parties) to (ii) consolidated fixed charges.

From April 19, 2013 through December 6, 2013, the Company was subject to similar financial covenants as required under the Program Agreement. Prior to April 19, 2013, the Company was also subject to certain tangible net worth, last twelve months adjusted EBITDA margin and minimum adjusted EBITDA covenants. Failure to comply with these covenants is an event of default, subject to certain grace periods or waivers. As of January 31, 2014 and February 1, 2013, the Company was in compliance with all covenants.

As of January 31, 2014 and February 1, 2013, outstanding borrowings on the Inventory Line of Credit were $2.8 million and $18.8 million, respectively. As of January 31, 2014 and February 1, 2013, $29.7 million and $5.0 million were available, respectively, under the Inventory Line of Credit. The Company had $0.3 million of outstanding letters of credit as of both January 31, 2014 and February 1, 2013, respectively.

A/R Loan — On April 19, 2013, the Company, through its newly established entity, Bluestem Receivables I, LLC ("BRI"), entered into the $511 million Loan and Security Agreement with Wells Fargo Bank National Association and Gemini Securitization Corp., LLC (an affiliate of Deutsche Bank AG) maturing April 18, 2015 ("A/R Loan"). BRI is a wholly-owned, special purpose, bankruptcy-remote entity established for the purpose of purchasing all Standard and Nonstandard Receivables owned by the Company on April 19, 2013, along with any Nonstandard Receivables generated after April 19, 2013, to hold as collateral under the A/R Loan agreement. The receivables held by BRI were not available to general creditors of the Company. Proceeds from the A/R Loan were used to pay off the outstanding balance of and terminate the A/R Credit Facility.

All cash flows on receivables held by BRI, including customer payments and proceeds from the sale of existing Standard Receivables to SCUSA, were required to be used to pay down the outstanding balance of the A/R Loan until that agreement was paid off. Outstanding balances under the A/R Loan bore interest at LIBOR plus 3% during the first twelve months and LIBOR plus 4%, had a balance remained outstanding, after twelve months. The Company incurred direct loan origination fees of $8.3 million that were amortized on a straight-line basis (which approximates the effective interest method) as interest expense over the actual term of the A/R Loan. In October 2013, the A/R Loan was paid off and the remaining $4.5 million of unamortized deferred financing fees were written-off and reported as a loss on early extinguishment of debt. Subsequent to the payoff, all outstanding accounts receivable held by BRI were sold back to its parent holding company, Bluestem Brands, Inc.

A/R Credit Facility —Through the Company's consolidated wholly-owned subsidiary, Fingerhut Receivables I, LLC ("FRI"), the Company had a $415 million A/R Credit Facility, of which $340 million was under the Revolving Credit Tranche and $75 million was under the Term Loan Tranche (as amended), with a maturity date of August 20, 2013. FRI was a special-purpose, bankruptcy remote entity established for the purpose of purchasing customer accounts receivable from Bluestem Brands, Inc. to hold as collateral under applicable credit agreements. The receivables transferred to FRI were not available to general creditors of Bluestem Brands. The transfers of receivables were recorded as secured borrowings on the Company's balance sheet in accordance with GAAP.

On April 27, 2012, the Company amended its A/R Credit Facility (the "April 2012 Amendment") which increased the maximum commitment of the Revolving Credit Tranche lenders from $290 million to $340 million, adjusted certain covenants, and modified the interest rate payable under the Term Loan Tranche. The April 2012 Amendment also lowered certain rates, increased certain undrawn commitment fee, expanded inclusion of certain Receivables as Eligible Underlying Receivables, lowered certain portfolio covenants for a certain period and allowed for certain adjustments to Consolidated Adjusted EBITDA. Additionally, the $75 million Term Loan Tranche was assigned by the original lender equally to two different lenders. This assignment was an extinguishment of debt and as a result, a $2.8 million loss was recognized which included $2.3 million paid to the former Term Loan Tranche lenders as an exit or prepayment fee, as well as the write-off $0.5 million of unamortized deferred charges for the year ended February 1, 2013.

Under the A/R Credit Facility, all customer accounts receivable were held by FRI and were collateral against any outstanding balances. However, not all customer accounts receivable were

used to calculate the borrowing base or performance covenants. The pool of customer accounts receivable from which the borrowing base and performance covenants were calculated in accordance with the A/R Credit Facility was known as "Eligible Underlying Receivables." The A/R Credit Facility agreement stated customer accounts receivable must meet certain requirements before they could be placed in the pool of Eligible Underlying Receivables. The primary requirements were that the customer must have made at least one payment since inception of the receivable and have a FICO score greater than 525 at origination. The combined borrowing capacity of the Revolving Credit Tranche and the Term Loan Tranche (as amended) was the lesser of $415 million, or the product of (i) 66% and (ii) the sum of the outstanding principal amount of Eligible Underlying Receivables, and amounts on deposit representing principal collections on customer accounts receivable held by FRI (subject to reserve adjustments and concentration limits).

The A/R Credit Facility was paid off on April 19, 2013. The payoff was accounted for as an early extinguishment of debt, and the Company recorded a $3.6 million loss on early extinguishment of debt related to applicable prepayment penalties and the write-off of unamortized deferred charges.

Prior to April 2013, the Company was subject to certain Eligible Underlying Receivables portfolio covenant thresholds and were evaluated for compliance on a monthly basis. In addition to Eligible Underlying Receivables portfolio covenants, there were certain Eligible Underlying Receivables portfolio performance thresholds that, if not met, required the Company to provide cash collateral. Violation of any Eligible Underlying Receivables portfolio covenant was an event of default under the A/R Credit Facility. If an event of default was not cured within the agreed upon time period, or if a waiver from the lenders was not granted, the outstanding balance would become due immediately. As of February 1, 2013, and through April 2013, the Company was in compliance with all covenants.

Senior Subordinated Secured Notes — On March 24, 2006, the Company issued the Senior Subordinated Secured Notes in an aggregate principal amount of $30 million. The Senior Subordinated Secured Notes, as amended, matured November 21, 2013, and bore interest at 13% per annum payable quarterly. In June 2013, the Senior Subordinated Secured Notes was refinanced with a different lender, which decreased the interest rate to 10%. The Senior Subordinated Secured Notes was paid off in the third quarter of 2013 and the remaining $0.2 million of unamortized deferred financing fees was written-off and reported a loss on early extinguishment of debt.

In connection with the original Senior Subordinated Secured Notes issued, warrants were issued to purchase 41,742,458 shares of the Company's Series A Preferred Stock. The warrants were valued at $0.10 per share or $4.2 million utilizing the Black-Scholes-Merton ("BSM") valuation model and accounted for as original issue discount on the debt and a derivative liability in our own equity. The original issue discount was amortized to interest expense over the term of the Senior Subordinated Secured Notes. The fair value of derivative liabilities in our own equity was estimated as of each balance sheet date with changes in fair value recorded as a gain or loss from derivatives in our own equity. See Note 5 *Fair Value Measurements and Fair Value of Financial Instruments* — Warrants. These Senior Subordinated Secured Notes were secured by a second lien on the Company's assets. Direct loan origination fees of $2.2 million were capitalized and reported in deferred charges in the consolidated balance sheets and were amortized on a straight-line basis (which approximates the effective interest method) as interest expense over the term of the Senior Subordinated Secured Notes.

The financial covenants of the Senior Subordinated Secured Notes were similar in form but less restrictive than the financial covenants of the Inventory Line of Credit. Failure to comply with these

covenants was an event of default, subject to certain grace periods or waivers. As of February 1, 2013, and through October 2013 the Company was in compliance with all covenants.

Deferred Charges — During 2013, direct loan origination fees of $13.1 million, of which $8.3 million and $4.8 million were in connection with the A/R Loan and Term Loan, respectively, were recorded. During 2012, direct loan origination fees of $1.7 million in connection with the April 2012 Amendment to the A/R Credit Facility and the July 2012 Amendment to the Inventory Line of Credit were recorded. Direct loan origination fees are reported as deferred charges within prepaid and other current assets (equal to amortization scheduled to occur within the next year) and as long-term deferred charges on the Company's consolidated balance sheets, net of amortization. Direct loan origination fees are amortized on a straight-line basis (which approximates the effective interest method) as interest expense over the remaining term of the Term Loan and Inventory Line of Credit.

Loss on Early Extinguishment of Debt — The $8.3 million loss on early extinguishment of debt recognized during 2013 was a result of the advance payoff of debt, which included $1.5 million, $4.5 million and $0.2 million related to unamortized deferred financing fees on the A/R Credit Facility, A/R Loan and Senior Subordinated Secured Notes, respectively, and $2.1 million prepayment penalty related to the payoff of the A/R Credit Facility. The $3.1 million loss on early extinguishment of debt recognized during 2012 was a result of the April 2012 Amendment to the A/R Credit Facility and the July 2012 Amendment to the Inventory Line of Credit. The Company recognized $2.8 million loss on the April 2012 Amendment, which included a $2.3 million prepayment and a $0.5 million write-off of unamortized deferred financing fees specific to the Term Loan Tranche. The Company also recognized a $0.3 million loss on the July 2012 Amendment to its Inventory Line of Credit to write-off unamortized deferred financing fees.

Debt Due to Affiliates — The Company has an obligation of $0.4 million as of January 31, 2014 and February 1, 2013, that is payable after, or in connection with, a transaction or series of transactions in which the holders of Series A Preferred Stock receive consideration with a value in excess of 250% of the total amount invested by such holders in the equity securities of the Company.

Capital Lease Obligation — As of January 31, 2014 and February 1, 2013, capital lease obligations were $3.7 million and $1.2 million, respectively, with interest rate ranging from from 2.4% and 3.2% per annum for the years ended January 31, 2014 and February 1, 2013, respectively.

Other Notes Payable — As of both January 31, 2014 and February 1, 2013, the Company has $0.8 million of other notes payable with interest rates ranging from 3% to 9% per annum, including a note payable to the landlord of its corporate headquarters building that is being repaid over the term of the lease. See Note 9 *Commitments and Contingencies*.

The future maturities of long-term debt for subsequent years as of January 31, 2014, are as follows (in thousands):

Fiscal Years	
2014	$ -
2015	10,970
2016	16,653
2017	16,143
2018	154,114
Thereafter	400
	$ 198,280

5. MEZZANINE EQUITY AND SHAREHOLDERS' DEFICIT

Recapitalization — On December 6, 2013, the Company recapitalized its equity through a series of transactions, as follows:

- The Company's board of directors ("Board") amended the Fourth Amended and Restated Certificate of Incorporation ("Fifth Amendment") to eliminate the liquidation preference and redemption rights of the Series B Preferred Stock and Series A Preferred Stock holders.
- The Company declared payment on Series B Preferred Stock and Series A Preferred Stock accrued but unpaid dividends.
- The Company declared an $11 common stock dividend, which included the participation rights of preferred stock holders and restricted stock award holders.
- The Company declared an $11 common stock dividend equivalent to unexpired and unexercised stock option holders. See Note 7 *Stock-Based Compensation*.
- The holders of the common stock warrants and Series A Preferred Stock warrants exercised the warrants. See Note 6 *Fair Value Measurements and Fair Value of Financial Instruments.*
- The Company amended the contingent fee, in which among other items, terminated the contingent fee on the common stock dividend payment date. See Note 6 *Fair Value Measurements and Fair Value of Financial Instruments.*
- The Company entered into the $225 million Term Loan which matures on December 6, 2018. Proceeds from the Term Loan were used to pay the dividends declared. See Note 4 *Financing*.

On December 13, 2013, the Company paid a common stock dividend to common stock holders and preferred stock holders and restricted stock award holders for their participation rights in a common stock dividend totaling $254.9 million, including related fees. In addition certain restricted stock award holders will receive $2.6 million, of which the Company paid $0.7 million for the year ended January 31, 2014.

The elimination of liquidation preference and redemption rights and declaration of payment on the preferred stock dividend accrued but unpaid are further described below.

Equity and Incentive Plan — At both January 31, 2014 and February 1, 2013, the Company had 4,137,812,560 shares of authorized capital stock, of which 2,592,550,586 shares are designated as common stock, and 1,545,261,974 shares designated as preferred stock, $0.00001 par value per

share, of which 791,738,012 shares were designated as Series A Preferred Stock and 753,523,962 shares were designated as Series B Preferred Stock.

In November 2010, the Board amended the 2008 Equity and Incentive Plan to increase the number of shares of Common Stock of the Company available for issuance or transfer thereunder by 167,952. In July 2011, the Board approved the 2011 Long-Term Incentive Plan (the "2011 Plan") which allows the Company to grant stock options, stock appreciation rights, restricted stock, stock units, other stock-based awards, and cash incentive awards. As of January 31, 2014, there are 2,129,836 shares of the Company's common stock available for future grants pursuant to the 2011 Plan, which includes shares that remained available for future awards under its 2008 Plan on the effective date of the 2011 Plan.

The Series B Preferred Stock and Series A Preferred Stock included, but were not limited to, the following:

Dividends — Holders of the Series B Preferred Stock are entitled to receive, when and as declared by the Board, cumulative cash dividends at an annual rate of 6% on the Series B Preferred Stock purchase price, prior and in preference to, any declaration or payment of any dividend to the holders of shares of Series A Preferred Stock and common stockholders. Dividends on the Series B Preferred Stock are cumulative and accrue daily but compound annually on each anniversary after the date of original issuance of each share of Series B Preferred Stock, whether or not earned or declared, and whether or not there are earnings or profits, surplus, or other funds or assets of the Company legally available for the payment of dividends. As part of the recapitalization, $21.6 million of accrued Series B Preferred Stock dividends was paid on December 13, 2013. Accumulated unpaid dividends on the Series B Preferred Stock were $0.5 million and $17.8 million as of January 31, 2014 and February 1, 2013, respectively.

Holders of the Series A Preferred Stock are entitled to receive, when and as declared by the Board, cumulative cash dividends at an annual rate of 8% on the Series A Preferred Stock purchase price, prior and in preference to, any declaration or payment of any dividend to the holders of shares of common stock. Dividends on the Series A Preferred Stock are cumulative and accrue daily but compound annually on each anniversary after the date of original issuance of each share of Series A Preferred Stock, whether or not earned or declared, and whether or not there are earnings or profits, surplus, or other funds or assets of the Company legally available for the payment of dividends. As part of the recapitalization, $86.7 million of accrued Series A Preferred Stock dividends was paid on December 13, 2013. Accumulated unpaid dividends on the Series A Preferred Stock were $0.9 million and $78.6 million as of January 31, 2014 and February 1, 2013, respectively.

Prior to December 6, 2013, dividends were reflected as an addition to mezzanine equity in the consolidated balance sheets. Effective December 6, 2013, dividends are reflected as an addition to Series A Preferred Stock and Series B Preferred Stock in shareholders' deficit. The Company records the accretion as a reduction to additional paid-in capital to the extent available, or increase accumulated deficit.

In the event that the Board declares a dividend payable on the then outstanding shares of common stock (other than a stock dividend on the common stock payable solely in the form of additional shares of common stock), the holders of Preferred Stock shall be entitled, in addition to any cumulative dividends to which they may be entitled to receive, the amount of dividends per share of such Preferred Stock that would be payable on the number of whole shares of the common stock into which each share of such Preferred Stock held by each holder could be converted. As part of the recapitalization, $87.7 million and $92.2 million of additional dividends, including related fees,

were paid to Series B Preferred Stock and Series A Preferred Stock holders for their participant rights in the common stock dividend on December 13, 2013, respectively.

In the event that the Company has cumulative accrued and unpaid dividends outstanding on the Preferred Stock immediately prior to a conversion of any shares of Preferred Stock, the Company has the option to either pay in cash or allow such dividends to be converted into a number of shares of common stock with a value equal to the amount of accrued and unpaid dividends.

Redemption of Preferred Stock — Prior to December 6, 2013, in the event that a Qualified Public Offering had not been consummated on or prior to February 28, 2014 and upon the request of holders of 66% of the outstanding Series B Preferred Stock, the Series B Preferred Stock had the right to be redeemed for cash. In the event redemption of the Series B Preferred Stock was requested, holders of 50% or more of the Series A Preferred Stock could also request redemption of the Series A Preferred Stock. The redemption price calculation for both the Series B Preferred Stock and the Series A Preferred Stock was based on the greater of (i) the purchase price for such shares, plus unpaid dividends, and (ii) the fair market value of such shares. In the event funds were insufficient to effect redemption of both classes of Preferred Stock, funds were to be utilized first to redeem Series B Preferred Stock and any remaining funds would be made available for the holders of the Series A Preferred Stock. Effective December 6, 2013, the redemption right was eliminated as part of the recapitalization under the Fifth Amendment. See Note 6 *Fair Value Measurements and Fair Value of Financial Instruments.*

Liquidation Preference — Prior to December 6, 2013, in the event of a liquidation, dissolution, or winding up of the Company, the holders of the Series B Preferred Stock would have been entitled to an amount per share equal to the greater of (A) the sum of (i) Series B Preferred Stock purchase price and (ii) an amount equal to all accrued or declared but unpaid dividends or (B) an amount that would be payable to the holders of the Series B Preferred Stock had the Series B Preferred Stock been converted into common stock immediately prior to such liquidation, dissolution or winding-up of the Company. If the assets to be distributed were insufficient to permit payment in full to the holders of the Series B Preferred Stock then the entire assets of the Company to be distributed would be distributed ratably among the holders of the Series B Preferred Stock. After payment was made in full to the holders of the Series B Preferred Stock, the holders of the Series A Preferred Stock would be entitled to an amount per share equal to the greater of (A) the sum of (i) Series A Preferred Stock purchase price and (ii) an amount equal to all accrued or declared but unpaid dividends or (B) an amount that would be payable to the holders of the Series A Preferred Stock had the Series A Preferred Stock been converted into common stock immediately prior to such liquidation, dissolution or winding-up of the Company. If the assets to be distributed after payment in full was made to the holders of the Series B Preferred Stock, were insufficient to permit payment in full to the holders of the Series A Preferred Stock then the entire assets of the Company to be distributed would be distributed ratably among the holders of the Series A Preferred Stock. Effective December 6, 2013, the liquidation preference was eliminated as part of the recapitalization under the Fifth Amendment.

Anti-dilution Rights — Holders of Series A and Series B Preferred Stock have the right to an adjustment of the conversion price applicable to their shares in the event that shares are issued at a price per share less than that paid by the holders of Series B Preferred Stock, with the result that the number of common shares into which the shares of Preferred Stock are convertible would increase.

6. FAIR VALUE MEASUREMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

Accounting standards define fair value, outline a framework for measuring fair value, and detail the required disclosures about fair value measurements. Under these standards, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market. Standards establish a hierarchy in determining the fair market value of an asset or liability. The fair value hierarchy has three levels of inputs, both observable and unobservable. Standards require the utilization of the highest possible level of input to determine fair value.

Level 1 inputs include quoted market prices in an active market for identical assets or liabilities.

Level 2 inputs are market data, other than Level 1, that are observable either directly or indirectly. Level 2 inputs include quoted market prices for similar assets or liabilities, quoted market prices in an inactive market, and other observable information that can be corroborated by market data.

Level 3 inputs are unobservable and corroborated by little or no market data.

The Company determined the fair value of its derivative liabilities using Level 3 inputs.

Conversion Feature — Holders of Preferred Stock have the option, at any time, to convert shares of Preferred Stock into common stock, initially upon issuance on a one-to-one basis, subject to certain adjustments, including, but not limited to, accrued and unpaid dividends on the Preferred Stock. All outstanding shares of Preferred Stock shall be automatically converted immediately upon the closing of a Qualified Public Offering.

All outstanding shares of Preferred Stock shall, upon the vote or written consent of holders of 66% of the Series B Preferred Stock, be automatically converted into common stock.

Prior to December 6, 2013, the conversion feature was considered a derivative liability under ASC 815, "*Derivatives and Hedging*" (ASC 815). Changes in the fair value of this derivative liability were included in gain or loss from derivatives in our own equity in the consolidated statement of operations. The liabilities associated with these derivatives were recorded as derivative liabilities in our own equity on the consolidated balance sheets. As of December 6, 2013, as a result of the elimination of the redemption rights, the conversion feature is no longer considered a derivative liability. As such, $112.1 million and $104.4 million derivative liability related to these Series B Preferred Stock and Series A Preferred Stock conversion feature, respectively, were reclassified from liabilities to shareholders' deficit.

Fair value of the conversion feature was estimated using the probability weighted expected return method. In applying the probability weighted expected return method, a range of estimated equity values was determined at various assumed liquidation dates. The aggregate estimated liquidity event date equity value was then allocated to the Preferred Stock and common stock based on each class's respective economic rights and preferences. The estimated liquidity event date value of each class of equity was then discounted to the present using discount rates that reflect the relative risk inherent in each class of stock. The aggregate estimated liquidity event date equity value was also allocated to each class of stock assuming the Series B Preferred Stock and Series A Preferred Stock did not include a conversion feature. In this allocation the aggregate value of the Series B Preferred Stock's and Series A Preferred Stock's liquidation preference and accrued dividends at the time of the liquidity event were discounted to the present using risk adjusted rates for the Company's fixed income securities. The estimated value of the conversion feature included in the Series B Preferred

Stock and the Series A Preferred Stock for each scenario in the probability weighted expected return analysis equals the difference between the estimated fair value of the stock with and without the conversion feature. The estimated value of the conversion feature from each scenario was probability weighted to estimate fair value.

The expected equity growth rate used in the analysis was based on estimated Adjusted EBITDA over the period until the liquidity event, and a range of valuation multiples based on observed market multiples for a group of the Company's publicly traded peers.

The assumptions used to estimate the fair value of the conversion feature as of and for the fiscal year ended February 1, 2013, were as follows:

Average annual growth rates	17.4% to 32.8%
Equity discount rate	19.0% to 20.0%
Discount rate for the fixed income components of Preferred Stock	16.0% to 18.0%
Probability of a liquidity event occurring in:	
One year	5.0%
Two years	50.0%
Three years	35.0%
Four years	10.0%

Warrants — The Company issued warrants to purchase 41,742,458 shares of Series A Preferred Stock with an exercise price of $0.01 per share and 2,282,099 shares of common stock with an exercise price of $0.95 per share to certain lenders. The warrants contained a provision that allowed the holders to cash settle the award once a qualifying contingent event occurred. Most of these events relate to a sale or liquidation of the Company. As a result, the Company was required to account for the warrants as derivatives with changes in fair value being recorded as a gain or loss from derivatives in our own equity.

On December 6, 2013, warrants to purchase 41,742,458 shares of Series A Preferred Stock issued on March 24, 2006 and 2,282,099 shares of common stock issued on May 15, 2008 were exercised. Upon exercise, the $12.8 million and $34.0 million derivative liability related to these Series A Preferred Stock and common stock warrants, respectively, were reclassified from liabilities to shareholders' deficit.

On June 21, 2012, warrants to purchase 349,807 shares of common stock issued on November 1, 2004 were exercised and in lieu of the exercise price, the Company issued 307,132 common shares. Upon exercise, the $2.4 million derivative liability related to these common stock warrants was reclassified from liabilities to shareholders' deficit.

The assumptions used to estimate the fair value of the common stock warrants and Series A Preferred Stock warrants as of and for the fiscal year ended February 1, 2013, were as follows:

Expected volatility	27.6%
Expected term (years)	3.00
Risk-free interest rate	0.42%

Contingent Fee — The Company had a contingent fee agreement ("Contingent Fee") whereby it agreed to pay certain lenders a fee contingent upon the occurrence of a defined liquidation, sale, or change of control transaction. A fee was also payable in connection with an IPO by the Company,

unless no Preferred Stock was outstanding thereafter, in which case no fee was payable and the agreement terminates. The fee ranged from $0 to $28.9 million based on the timing and value of the Company's equity (including warrants outstanding) at the time of a liquidation, sale, or change of control transaction occurring before May 15, 2018. The Contingent Fee was considered a derivative liability under ASC 815. Changes in the fair value of this derivative liability were included in gain or loss from derivatives in our own equity in the consolidated statement of operations. The liabilities associated with these derivatives were recorded as derivative liabilities in our own equity in the consolidated balance sheet. As of December 6, 2013, the contingent fee was terminated.

Fair value of the Contingent Fee was estimated using the probability weighted expected return method. In applying the probability weighted expected return method, a range of estimated equity values was determined at various assumed liquidation dates. Based on the estimated liquidity event date equity value, the amount required to satisfy the contingent fee was calculated. The aggregate value of the contingent fee was then discounted to the present using discount rates based on the estimated yield that would be required on the Company's subordinated debt.

The expected equity growth rate used in the analysis was based on estimated Adjusted EBITDA over the period until the liquidity event, and a range of valuation multiples based on observed market multiples for a group of the Company's publicly traded peers.

The assumptions used to estimate the fair value of the Contingent Fee as of and for the fiscal year February 1, 2013, were as follows:

Average annual growth rates	17.4% to 32.8%
Discount rate	15.0%
Probability of a liquidity event occurring in:	
One year	5.0%
Two years	50.0%
Three years	35.0%
Four years	10.0%

There were no assets and liabilities measured at fair value on a recurring basis as of January 31, 2014. The following table shows assets and liabilities measured at fair value on a recurring basis as of February 1, 2013, and the input category associated with those assets and liabilities (in thousands):

	Fair Value Using Level 3
Liabilities - Fair value of warrants	$ 22,392
Liabilities - Fair value of conversion feature in preferred stock	62,900
Liabilities - Fair value of Contingent Fee	700
	$ 85,992

The changes in Level 3 liabilities measured at fair value on a recurring basis for the years ended January 31, 2014 and February 1, 2013, are as follows (in thousands):

	Fair Value of Derivative Liabilities
Balance February 3, 2012	$ 86,389
Change in fair value of common stock warrants	70
Exercise of common stock warrants	(2,385)
Change in fair value of preferred warrants	418
Change in fair value of conversion feature in preferred stock	1,800
Change in fair value of contingent fee	(300)
Balance February 1, 2013	85,992
Change in fair value of common stock warrants	19,213
Change in fair value of preferred warrants	5,176
Change in fair value of conversion feature in preferred stock	153,600
Change in fair value of contingent fee	(700)
Reclassification of common stock warrants to shareholder's deficit	(34,008)
Reclassification of preferred stock warrants to shareholder's deficit	(12,773)
Reclassification of conversion feature in preferred stock to shareholder's deficit	(216,500)
Balance January 31, 2014	$ -

7. STOCK-BASED COMPENSATION

The Company compensates officers, directors, and key employees with stock-based compensation under four stock plans approved by shareholders in 2003, 2005, 2008 and 2011 and administered under the supervision of the Board. The Company has 8,830,488 authorized shares of common stock for the grant of nonqualified stock options and restricted stock awards to employees under the 2003, 2005, 2008, and 2011 Equity Incentive Plans (the “Equity Incentive Plans”). As of January 31, 2014, there were 2,129,836 shares of common stock available for grant under the Equity Incentive Plans.

As part of the December 2013 recapitalization, the Company declared an $11 common stock dividend equivalent to unexpired and unexercised stock option holders for a total of $41.0 million. The dividend equivalents were paid upon vesting of the stock options. As of January 31, 2014, $10.5 million dividends were paid on vested stock options. A dividend equivalent declared in connection to an equity restructuring is considered a modification to the stock option. The post-modification fair values of both vested and unvested options outstanding were in excess of the pre-modification fair values of $41.0 million. The Company recorded $10.5 million stock compensation on vested options outstanding for the excess in post-modification fair values over pre-modification fair values. The unvested options’ excess of post-modification fair values over pre-modification fair values of $30.5 million will be amortized over the remaining requisite period of the options.

In October 2013, in connection with the termination of an employee, the Company modified certain stock options to accelerate vesting and extend the exercise period of the stock options. The post-modification fair value was in excess of the pre-modification fair value of $0.3 million. The Company recorded $0.3 million stock compensation for the excess in post-modification fair values over pre-modification fair values.

Stock Options — A summary of stock option activity for the years ended January 31, 2014 and February 1, 2013, are as follows:

	Stock Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (Years)
Outstanding — February 3, 2012	654,264	$ 3.49	7.6
Granted	1,383,552	7.44	
Forfeited	(64,582)	5.95	
Exercised	(6,889)	0.88	
Outstanding — February 1, 2013	1,966,345	$ 6.20	8.1
Granted	1,955,100	7.99	
Forfeited	(173,251)	9.63	
Exercised	(17,804)	4.28	
Outstanding — January 31, 2014	3,730,390	$ 6.99	8.1
Exercisable — January 31, 2014	959,013	$ 5.01	6.5

Other information pertaining to options for the years ended January 31, 2014 and February 1, 2013, are as follows (in thousands, except per share amounts):

	2014	2013
Weighted-average grant date per share fair value of stock options granted	$ 13.51	$ 2.59
Cash received from the exercise of stock options	76	6
Stock-based compensation expense	15,065	871

Stock options generally vest proportionally over periods of four years from the dates of the grant and expire after ten years. At January 31, 2014, there was approximately $32.5 million of unrecognized stock option compensation expense related to nonvested stock options that is expected to be recognized over a weighted-average period of approximately 1.8 years.

Determining Fair Value — A third party valuation advisor is utilized to assist management in determining the fair value of options granted using the BSM option-pricing model based on the grant price and assumptions regarding the expected term, expected volatility, dividends, and risk-free interest rates. A description of significant assumptions used to estimate the expected volatility, expected term, risk-free interest rate, and forfeiture rate are as follows:

- *Expected volatility* — Expected volatility was determined based on historical volatility of stock prices of a public company peer group.
- *Expected term* — Expected term represents the period that stock-based awards are expected to be outstanding and was determined based on historical experience and anticipated future exercise patterns, considering the contractual terms of unexercised stock-based awards.
- *Risk-free interest rate* — The risk-free interest rate was based on the implied yield currently available on U.S. Treasury zero-coupon issues with a term equal to the expected term.
- *Forfeiture rate* — Historical data was used to estimate forfeitures.

The assumptions used to calculate the fair value of awards granted during the years ended January 31, 2014 and February 1, 2013, using the BSM option-pricing model are as follows:

	January 31, 2014	**February 1, 2013**
Expected volatility	27.7 %	32.4 %
Expected term (years)	6.5	6.5
Risk-free interest rate	1.2 %	1.2 %
Forfeiture rate	5.0 %	5.0 %
Expected dividend yield	-	-

Restricted Stock Awards — A summary of restricted stock activity for the years ended January 31, 2014 and February 1, 2013, are as follows:

	Restricted Stock	Weighted-Average Grant Date Fair Value
Outstanding — February 3, 2012	610,294	$ 0.91
Granted	-	
Forfeited	-	
Vested	(349,358)	0.70
Outstanding — February 1, 2013	260,936	$ 1.19
Granted	238,100	7.42
Forfeited	-	
Vested	(213,076)	0.56
Outstanding — January 31, 2014	285,960	$ 6.84

Restricted stock awards generally vest over four years. At January 31, 2014, there was approximately $1.5 million of unrecognized compensation expense related to nonvested restricted stock awards that is expected to be recognized over a weighted-average period of approximately 2.1 years.

8. INCOME TAXES

The Company recognizes deferred tax assets and liabilities for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax laws and rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established for any portion of deferred tax assets that are not considered more likely than not to be realized.

The tax effects of temporary differences that give rise to deferred income taxes as of January 31, 2014 and February 1, 2013, were as follows (in thousands):

	January 31, 2014	February 1, 2013
Allowance for doubtful accounts	$ 6,697	$ 44,283
Net operating loss and other credit carryforwards	139	702
Inventory	2,457	1,633
Net other deferred assets	7,847	4,899
Deferred tax asset — net	17,140	51,517
Depreciation and amortization expense	(2,513)	(3,569)
Deferred advertising	(3,244)	(3,441)
Finance charge income not currently taxable	(4,051)	(31,033)
Net other deferred liabilities	(2,364)	(3,111)
Deferred tax liability — net	(12,172)	(41,154)
Total deferred taxes	$ 4,968	$ 10,363
Reflected as:		
Current assets	$ 5,847	$ 12,963
Noncurrent liabilities	(879)	(2,600)
	$ 4,968	$ 10,363

The provision for income taxes for the years ended January 31, 2014 and February 1, 2013, is as follows (in thousands):

	January 31, 2014	February 1, 2013
Current:		
Federal	$ 20,043	$ 24,669
State	579	319
Total current provision	20,622	24,988
Deferred:		
Federal	5,488	(3,720)
State	(93)	(25)
Total deferred (benefit) provision	5,395	(3,745)
Total provision	$ 26,017	$ 21,243

A reconciliation of our effective income tax rate compared to the statutory federal income tax rate for the years ended January 31, 2014 and February 1, 2013, is as follows:

	January 31, 2014	February 1, 2013
Statutory federal income tax rate	35.0 %	35.0 %
State income taxes — net of federal benefit	(0.3)	0.3
Loss from derivatives in our own equity	(61.5)	1.2
Other — net	1.0	0.5
Effective income tax rate	(25.8)%	37.0 %

Gains and losses from derivatives in our own equity are not deductible for income tax purposes and therefore, have been treated as permanent differences. Our marginal tax rate excluding the impact of derivatives in our own equity was 34.0% and 35.8% in 2013 and 2012, respectively.

For the years ended January 31, 2014 and February 1, 2013, federal and state net operating loss carry forwards were $0.8 million and $2.4 million, respectively, which expire in 2022 through 2024.

Internal Revenue Code Section 382 ("Section 382") limits the availability and timing of the use of net operating loss carry forwards in the event of a change in ownership. We determined that a change in ownership under Section 382 occurred on November 1, 2004, thus we will utilize net operating loss carry forwards in accordance with Section 382 regulations.

Management believes that it is more likely than not that the full benefit of the deferred tax assets will be realized on the basis of evaluating anticipated profitability over the years in which the net operating losses may be used and when the underlying temporary differences are expected to become tax deductions. The actual realization of these deferred tax assets depends on the ability of the Company to generate sufficient taxable income in the future.

We file income tax returns in the U.S. federal jurisdiction, Minnesota, Nebraska, North Carolina, Texas, California, Indiana and North Dakota. In the normal course of business, the Company is subject to examination by federal and state taxing authorities. During 2012, the Internal Revenue Service completed its examination of our 2010 U.S. consolidated federal income tax return. With few exceptions, we are no longer subject to income tax examinations for years before 2010. No states are currently examining any of our state income tax returns.

Unrecognized Tax Benefits — Our liability for unrecognized tax benefits was $1.5 million including interest of $0.1 million, net of tax benefit, at January 31, 2014. A reconciliation of the beginning and ending amounts of unrecognized tax benefits for 2013 and 2012 was as follows (in thousands):

	Federal and State Tax
Balance February 3, 2012	$ 2,463
Balance February 1, 2013	2,463
Decreases related to expiration of the applicable statute of limitations	(1,011)
Balance January 31, 2014	$ 1,452

We recognize interest (not included in the "Federal and State Tax" above) as components of income tax expense. No penalties related to income tax matters have been recognized in the consolidated statements of operations. The amount of tax related interest expense for the years ended January 31, 2014 and February 1, 2013, was $0.1 million and $0.2 million, respectively.

The amount of unrecognized tax benefits may decrease by $0.5 million (excluding interest) within the next 12 months due to the expiration of the statute of limitations on our net operating loss carry forwards.

9. EMPLOYEE BENEFIT PLANS

The Bluestem 401(k) Retirement Savings Plan (the "Bluestem 401(k) Plan") is open to eligible employees who have attained age 21. Employees covered by a collective bargaining agreement are not eligible for participation. The Bluestem 401(k) Plan allows for employee pretax contributions up to the Internal Revenue Code contribution limit. The first 3% of employee contributions are matched by the Company at a rate of 100%, and the next 2% of employee contributions are matched by the Company at a rate of 50%, up to a total maximum company matching contribution of $10,400. Employees are 100% vested in their pretax contributions at all times and are fully vested in the employer matching contribution when made. Contributions are expensed as incurred and were $1.6 million and $1.3 million for the years ended January 31, 2014 and February 1, 2013, respectively.

During the years ended January 31, 2014 and February 1, 2013, the Company participated in a multiemployer retirement plan, Unite Here National Retirement Plan (the "Retirement Plan"). The Retirement Plan is open to eligible union employees at the Company's St. Cloud, Minnesota, distribution center. The eligibility for participation in the Retirement Plan is completion of 1,000 hours of service. The participants earn a right to benefits after attaining five years of vesting service. The union collective bargaining agreement expires March 31, 2014 and sets forth terms of the Company's participation. Subsequent to year-end, the union collective bargaining agreement was extended to March 31, 2017. The Company's contributions were $0.2 million and $0.1 million for the years ended January 31, 2014 and February 1, 2013, respectively.

10. COMMITMENTS AND CONTINGENCIES

Operating Lease Commitments — The Company has operating lease commitments for equipment and facilities that expire on various dates through 2024. Rental expense was $6.6 million and $7.6 million for each of the years ended January 31, 2014 and February 1, 2013, respectively, and is included in general and administrative expenses in the consolidated statements of operations.

Distribution Center — The Company leases its St. Cloud, Minnesota, distribution center under a lease effective February 1, 2009, with an initial term of 180 months, payments beginning February 1, 2009, and increasing at 2.5% per annum. The Company is responsible for all operating expenses. The lease contains tenant allowances that are amortize over the term of the lease. The Company has an option to accelerate the termination of the lease that can be exercised between January 31, 2022 through January 31, 2024, by providing written notice to the landlord and incurring a termination fee. The termination fee is determined based on a formula, including monthly minimum and additional rentals, operating expenses, and the recapture of the remaining unamortized portion of the tenant allowances and real estate broker commissions paid by the landlord. The Company also has an option to extend the lease for two consecutive five-year terms.

Headquarters Building — The Company leases the corporate headquarters building under a lease effective June 1, 2008, with an initial term of 124 months, including a four-month rent holiday, with payments beginning October 1, 2008, and increasing at 2% per annum. The Company is responsible for all operating expenses. The lease contains tenant allowances that the Company amortizes over the term of the lease. The Company has the option to reduce the amount of space utilized or terminate the lease effective July 1, 2015, by providing written notice to the landlord by May 30, 2014 and incurring a termination fee calculated based on a formula, including monthly minimum and additional rentals, operating expenses, direct costs incurred by the landlord to convert the facility to a multitenant facility, and the recapture of the remaining unamortized portion of the tenant allowances. In addition, the Company has the option to extend the lease for two consecutive five-year terms.

The aggregate minimum rental commitments under operating leases and future maturities of capital leases for subsequent years as of January 31, 2014, are as follows (in thousands):

Fiscal Years	Operating	Capital
2013	$ 5,469	$ 1,174
2014	4,726	1,174
2015	4,683	1,118
2016	4,758	438
2017	4,340	-
Thereafter	17,782	-
Total future minimum lease payments	$41,758	3,904
Less: Amount representing interest		(174)
Present value of future minimum lease payments		$ 3,730

Certain of the Company's leases contain predetermined rent increases over the lease term. These rent increases are included in the above minimum rental commitments table in the year in which the rent increase occurs.

Legal Proceedings — The Company is periodically involved in legal proceedings arising in the ordinary course of business including, among others, claims relating to collection activities. The Company is well positioned to defend against such claims but, due to the general uncertainty of litigation could, in the future, enter into settlements of claims or incur judgments that could have a material adverse effect on its results of operations in any particular period. Any losses that could occur in connection with these matters are provided for in the consolidated financial statements if

the liability is probable and estimable in accordance with GAAP. Legal costs for these matters are expensed as incurred.

Subsequent to the balance sheet date, the Company entered into an agreement to settle certain claims relating to allegations that the Company failed to comply with certain requirements of the Telephone Consumer Protection Act. The Company has recorded a $3.5 million liability related to the settlement as of January 31, 2014. At the present time, any potential loss from other existing or threatened legal claims against the Company are not probable or estimable.