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GADZOOKS

a n n u a l r e p o r t

G A D Z O O K S is a dynamic
retail environment catering to today's teenager.

Clothing, shoes and accessories in a
merchandising mix that is ever-changing
with the style and attitudes of our customers
makes us unique.

Change keeps us moving.

Image and Positioning.

These are key ingredients to retail success, especially in the teen market. Another increasingly important element is often overlooked...

vision.

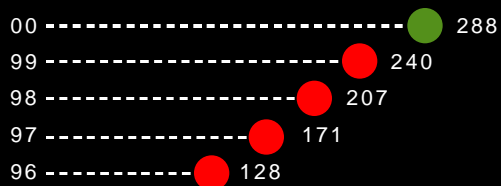
While we have no crystal ball, Gadzooks has in place a proven and successful business model that includes buying and marketing strategies, as well as ongoing research into our customers' preferences regarding product selection. In addition, the Gadzooks specialty retailing concept is not bound by single-fashion trends, limited branding, or lifestyle changes. We have the unique ability to move forward with our customer base as their preferences change, and as they refresh their wardrobes and personal styles. Our teenage market is made up of both guys and girls, and Gadzooks provides clothes and accessories for both. Today's teens share many of the same interests, their brand preferences are similar, and they enjoy the same trends in everything from clothes to activities and music.

Gadzooks recognizes these similarities and brings them to the forefront of our image.

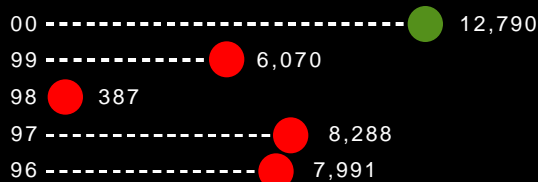
FINANCIAL & OPERATING HIGHLIGHTS

	February 3, 2001	January 29, 2000	January 30, 1999
Net sales (in thousands)	\$288,411	\$240,253	\$207,172
Net income (in thousands)	\$12,790	\$6,070	\$387
Net income per share			
Basic	\$1.44	\$0.68	\$0.04
Diluted	\$1.38	\$0.67	\$0.04
Average shares outstanding (in thousands)			
Basic	8,911	8,910	8,852
Diluted	9,293	9,043	9,036
Comparable store sales increase (decrease)	7.6%	5.4%	(5.6%)
Average net sales per store	\$826,000	\$746,000	\$714,000
Average net sales per square foot	\$345	\$315	\$302
Capital expenditures (in thousands)	\$12,936	\$7,008	\$10,082
Number of stores at year end	375	326	312

NET SALES (in millions)



NET INCOME (in thousands)



NUMBER OF STORES



Gadzooks continues to evolve. In 1999, we were bouncing back and had bright prospects for 2000. And what a year 2000 turned out to be! Record sales, record profits and a sound business foundation to continue our move forward. Our demographic group of teens continues to grow and we plan on growing right along with them.

Fiscal 2000 continued the momentum that began with an exceptional final quarter of 1999. Net sales for the fiscal year ended February 3, 2001 were up 20 percent from the prior year at \$288.4 million. Net income was up as well, at \$1.38 per diluted share, or

\$12.8 million — a significant gain from \$0.79 per diluted share, or \$7.1 million (before non-comparable charges) the year before. Gadzooks' comparable store sales, a key measure for retailers, were up 7.6 percent for stores open for 14 full months or more. In addition, we opened 52 stores to increase our total store count to 375.

Gadzooks continues to implement a number of strategies that contribute to higher sales and growing operating profits. Whether through an improved markdown system, upgraded planning and allocation systems, a stronger visual program or focus groups for customer feedback, we are committed to continue to raise the level of return we expect and achieve on our investments.

For over 17 years, Gadzooks has promoted the concept of providing our teenage customers with brands they recognize and desire. We know our customers, and we know that their fashion trends can develop quickly — and run their course just as fast. We are not limited by gender, lifestyle, brand or fashion. Some may view this as a risk; however, we see it as an opportunity — to remain fresh, young, and a “destination” store for teens looking for change.

During the past two years, we have refined our target customer by concentrating product offerings towards teens from 14 to 18 years of age. This focus has enabled us to better tailor our merchandise, store environment, and marketing program to our customers.

Additionally, we recognize the link between our audience and their culture relating to music and entertainment. In response, we provide our stores with the most current music videos and an atmosphere where both teens and their parents are comfortable.

The image of Gadzooks has been reinforced more than ever. Through in-store visuals and graphics, expanded national advertising, an active website and key exclusive associations with many of our vendors, we have put a brighter light on the Gadzooks storefront. But the effort does not stop with marketing. We continue to focus on our people as well. Gadzooks has developed programs that enable us to recruit, train and retain high-quality associates. While ambitious, these programs have resulted in an experienced management team with tenure, and a home office and field staff that are trained for our business and prepared for the future.

As we look down the road, our customer base remains one of the fastest-growing market segments in all of retailing. We begin 2001 with 375 stores, plans for 50- 60 new locations in the coming year, \$20.3 million in cash or equivalents, and a balance sheet with no debt.

Thanks to every Gadzooks associate, shareholder, and vendor for making “Gaditude” a significant force in the retailing arena. This year was a pleasure.



Jerry Szczepanski
Chairman and Chief Executive Officer
March 20, 2001

image.

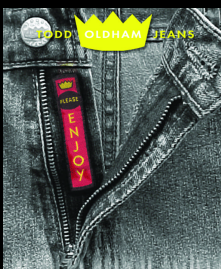
Gadzooks was founded on the concept of providing the teenage customer with the most exciting and entertaining place to shop. We also know that nothing inspires the teen market like fashion and music. To deliver a dynamic and energetic environment, we bring the latest music videos, movie clips, and promotional features to our in-store audio-visual systems. Gadzooks stores combine clusters of video monitors and quality sound systems with a casual, yet energetic retail atmosphere that surrounds our customers with an array of cool merchandise, recognized brands, and a good time.



d k n y j e a n s



b i l l a b o n g



t o d d o l d h a m

Throughout 2000, Gadzooks continued to enhance its positive image by sponsoring special appearances at major promotional events. In November, at the opening of our flagship Mall of America store, national recording artist Mark McGrath of the band *Sugar Ray* signed autographs and met with customers at a special VIP party. At another event – launching Gadzooks' all-store roll out of our DKNY Junior collection – over 10,000 teens joined us for a concert featuring *98 Degrees*, *Soul Decision*, *Pink*, and others. These opportunities provide us with true interaction into our customers' lifestyle.

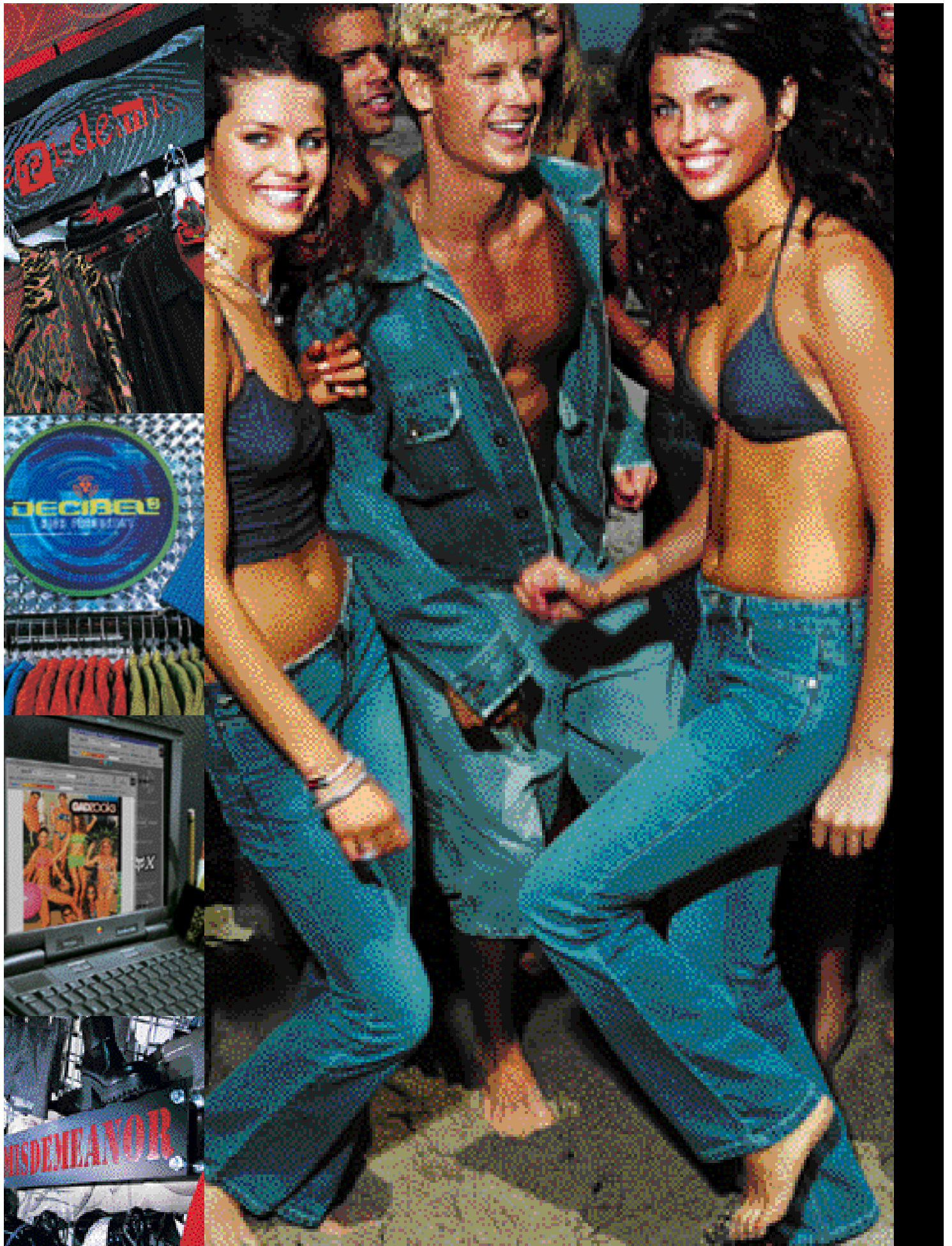
In addition to other exclusives, Gadzooks has introduced Candie's swimwear and apparel items. While Gadzooks is already considered a "destination" store, these name-brand exclusives provide even more drawing power for our customer base. Other unique lines were added this past year too, such as our private labels – Epidemic, Misdemeanor and Decibel – which offer a constantly evolving selection of fashion-forward looks for all of our teens.

Gadzooks continues to evolve the physical presentation of the store.

As we grow, we incorporate new elements to maintain a fresh, current format that attracts our customer base. More importantly, our customers know that they can count on us to provide the latest, hippest styles. While we remain loyal to them and our concept, they remain loyal to us.



candie's



position.

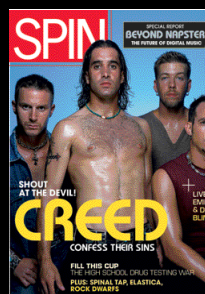
During the past two years, Gadzooks has strengthened vendor partnerships through the development of an extensive marketing program focused on our top key branded resources. This initiative attracts new customers in our expanding markets through the use of national magazine ads, website advertising, and events and promotions. High-impact in-store campaigns add to the reach and reinforcement of the program.

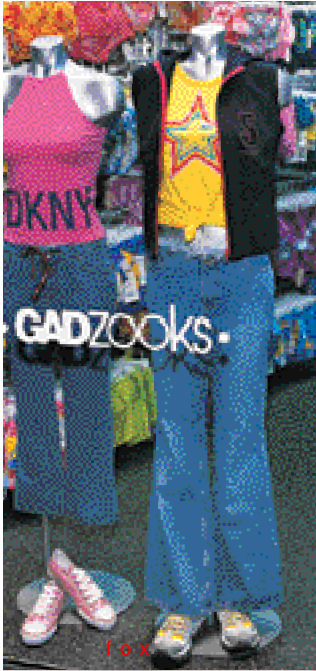
With the increasing competition to capture the growing teenage market, Gadzooks has expanded its advertising in the most popular teen market publications. The seasonal ads promote swimwear, back-to-school, and holiday selections. We go where our customers are – *Seventeen*, *Teen People*, *Teen Style*, *Spin* and *Rolling Stone*.

In this age of electronic media, our teens are also among the most web-savvy Internet surfers. To capture their attention, Gadzooks teamed with AEI Music in the fall of 2000 to create a website that features the hottest new music videos, dazzling animation, and interactive games and promotions.

By staying in touch with our teens, we stay in tune to their tastes, drives, and lifestyles. We stay in front of them, and we keep them in front of us.

Gadzooks' website (shown far left) plays host to a number of interactive features, teen-focused content, store locations, and a lot more.





gadzooks.

C H A N G E moves

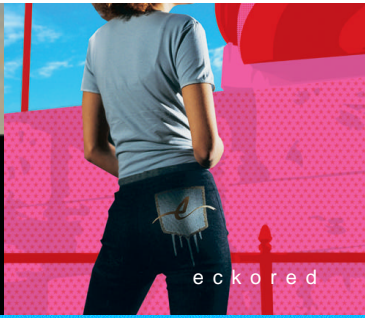
us forward with our customers.

Their shifting needs and tastes

drive our stores to remain fresh

and keep our business vital.

Change is constant, change is good.



featuring

ECKO

Billabong

Fox

Hurley

Candie's

DKNY Jeans

Todd Oldham

FINANCIAL INFORMATION



Gadzooks is traded on The NASDAQ Stock Market under symbol GADZ

SELECTED FINANCIAL DATA

(\$ in thousands, except operating data and per share amounts)

	Fiscal Year Ended				
	February 3, 2001	January 29, 2000	January 30, 1999	January 31, 1998	February 1, 1997
INCOME STATEMENT DATA:					
Net sales	\$ 288,411	\$ 240,253	\$ 207,172	\$ 170,828	\$ 127,631
Cost of goods sold	205,505	173,778	157,728	120,309	87,418
Gross profit	82,906	66,475	49,444	50,519	40,213
Selling, general and administrative expenses	63,450	55,558	49,496	37,962	28,455
Provision for store closings and asset impairments	—	1,721	—	—	—
Operating income (loss)	19,456	9,196	(52)	12,557	11,758
Interest income, net	792	496	536	706	945
Income before income taxes	20,248	9,692	484	13,263	12,703
Provision for income taxes	7,458	3,622	97	4,975	4,712
Net income	\$ 12,790	\$ 6,070	\$ 387	\$ 8,288	\$ 7,991
Net income per share					
Basic	\$ 1.44	\$ 0.68	\$ 0.04	\$ 0.95	\$ 0.94
Diluted	\$ 1.38	\$ 0.67	\$ 0.04	\$ 0.91	\$ 0.87
Average shares outstanding					
Basic	8,911	8,910	8,852	8,683	8,525
Diluted	9,293	9,043	9,036	9,100	9,143
SELECTED OPERATING DATA:					
Comparable store sales increase (decrease) ¹	7.6%	5.4%	(5.6%)	1.8%	6.1%
Number of stores at year end	375	326	312	250	183
Average net sales per store	\$ 826,000	\$ 746,000	\$ 714,000	\$ 791,000	\$ 810,000
Average net sales per square foot	\$ 345	\$ 315	\$ 302	\$ 338	\$ 353
Total square footage at end of period	908,000	772,000	736,000	585,000	422,000
Operating income percentage	6.7%	3.8%	—	7.3%	9.2%
Capital expenditures (in 000s)	\$ 12,936	\$ 7,008	\$ 10,082	\$ 12,624	\$ 6,864
BALANCE SHEET DATA:					
Working capital	\$ 44,986	\$ 38,367	\$ 31,629	\$ 34,878	\$ 34,333
Total assets	118,794	96,662	86,442	84,321	64,747
Total debt	—	—	—	—	—
Shareholders' equity	79,388	66,145	60,031	58,480	49,063

¹A store becomes comparable after it has been open for 14 full fiscal months.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

Gadzoos is a mall-based specialty retailer of casual apparel and related accessories for young men and women, principally between the ages of 14 and 18. The Company opened its first store in 1983, and at fiscal year-end 2000, operated 375 stores in 36 states. The Company opened 52 stores in fiscal 2000, 19 stores in fiscal 1999 and 63 new stores in fiscal 1998. Five stores were closed during fiscal 1999, and three stores were closed during fiscal 2000.

Results of Operations

Classification of Discounts on Employee Sales. The Company has historically recorded discounts related to the sale of merchandise to employees as a component of selling, general and administrative expenses ("SG&A"). Beginning with the second quarter of fiscal 2000, the Company began classifying these discounts as a reduction of gross sales. As a result, sales and gross profit have been reduced by the amount of the employee discounts, which have been offset by a like reduction in SG&A expenses for each period presented. This reclassification represents a change in income statement presentation only, and has no impact on net income or earnings per share. Employee discounts totaled \$1.5 million, \$1.4 million and \$1.0 million for the years ended February 3, 2001, January 29, 2000 and January 30, 1999, respectively.

The following table sets forth for the periods indicated certain selected income statement data expressed as a percentage of net sales and certain store data:

	Fiscal Year		
	2000	1999	1998
Net sales	100.0%	100.0%	100.0%
Cost of goods sold, including buying, distribution and occupancy costs	71.2	72.3	76.1
Gross profit	28.8	27.7	23.9
Selling, general and administrative expenses	22.0	23.2	23.9
Provision for store closings and asset impairments	—	0.7	—
Operating income	6.8	3.8	—
Interest income, net	0.2	0.2	0.3
Income before income taxes	7.0	4.0	0.3
Provision for income taxes	2.6	1.5	0.1
Net income	4.4%	2.5%	0.2%
Number of stores open at end of period	375	326	312

Fiscal Year. The Company's fiscal year is the 52- or 53-week period that ends on the Saturday nearest January 31. Fiscal 2000 was the 53-week period ending February 3, 2001. The Company estimates that the 53rd, or "extra," week included in fiscal 2000 increased net income by about \$450,000, or \$.05 per diluted share. The estimated impact of this 53rd week on the individual income statement components is discussed under the respective captions below.

Fiscal 2000 Compared to Fiscal 1999. Net sales increased approximately \$48.1 million, or 20.0 percent, to \$288.4 million during fiscal 2000 from \$240.3 million during fiscal 1999. Net sales attributed to the 52 new stores opened during 2000 and for those not yet qualifying as comparable stores (excluding the effect of the 53rd week) contributed \$25.4 million of the increase in total sales. Sales for the 53rd week contributed \$4.5 million to the total increase in sales. Comparable store sales increased by \$18.2 million, or 7.6 percent in fiscal 2000. The Company experienced comparable store sales increases in all but two of its major categories – young men's and shoes. The increase in comparable store sales is due to several factors, including continued improvements in product mix, a greater concentration of branded merchandise and visual merchandising improvements. The merchandise changes drove increases in unit sales up more than 10% per average store over the prior year. The Company experienced an overall decline in its average selling price per unit of approximately 3%, which was due primarily to slight shifts in the sales mix toward lower-priced merchandise, such as t-shirts and accessories. A store becomes comparable after it has been open for 14 full fiscal months.

Gross profit increased approximately \$16.4 million to \$82.9 million during fiscal 2000 from \$66.5 million in fiscal 1999. As a percentage of net sales, gross profit increased 108 basis points to 28.75 percent from 27.67 percent in fiscal 1999. The Company estimates that gross profit attributable to the 53rd week approximated \$1.7 million. The majority of the increase in gross profit resulted from leverage achieved on store occupancy and buying and distribution costs (which are relatively fixed in nature) due to comparable store sales increases. Store occupancy and buying and distribution costs, as a percent of sales, decreased by 75 basis points and 7 basis points, respectively. Merchandise margin increased approximately 26 basis points, which was due primarily to a

higher percentage of the Company's sales incurred in lower priced, merchandise with a higher initial mark-up, such as t-shirts, and the introduction of private label and exclusive merchandise.

Selling, general and administrative expenses increased approximately \$7.9 million to \$63.5 million in fiscal 2000 from \$55.6 million in fiscal 1999. The Company estimates that SG&A attributable to the 53rd week approximated \$1.0 million. The aggregate increase in SG&A is primarily attributable to additional store expenses as a result of the Company's expanded store base during the past year and an increase in administrative costs to support the larger store base. As a percentage of net sales, SG&A decreased 112 basis points to 22.00 percent in fiscal 2000 from 23.12 percent in fiscal 1999. The decrease in SG&A as a percentage of sales is due primarily to the Company's ability to leverage corporate overhead and store costs as a result of the comparable store sales increase. These gains were partially offset, by an increase in compensation, of which a large portion is performance based.

Net interest income increased \$296,000 to \$792,000 in fiscal 2000 from \$496,000 in fiscal 1999 primarily due to higher average cash balances on hand.

The Company's effective income tax rate decreased to 36.8 percent in fiscal 2000 from 37.4 percent in fiscal 1999. This decrease was primarily due to lower state income taxes resulting from the implementation of a new legal structure of the Company during the year, offset by the impact of graduated federal income tax rates. Additionally, the Company favorably settled with the Internal Revenue Service the open tax years of fiscal 1997 and 1998.

Fiscal 1999 Compared to Fiscal 1998. Net sales increased approximately \$33.1 million, or 16.0 percent, to \$240.3 million during fiscal 1999 from \$207.2 million during fiscal 1998. Net sales of the 19 new stores opened during fiscal 1999 and for those not yet qualifying as comparable stores contributed \$22.3 million of the increase in total sales. Comparable store sales increased by \$10.8 million, or 5.4 percent in fiscal 1999. The Company experienced comparable store sales increases in all but two of its major categories, unisex t-shirts and shoes. Both of which, however, improved as the year progressed. The increase in comparable store sales is due to several factors, including a greater concentration of brand-name merchandise, enhancements to the stores' appearance and visual merchandising changes. The merchandise changes allowed for higher price points and improved sell-through, which reduced the number of markdowns taken. In addition, units sold per store increased approximately 8 percent during the fourth quarter of fiscal 1999.

Gross profit increased approximately \$17.1 million to \$66.5 million during fiscal 1999 from \$49.4 million in fiscal 1998. As a percentage of net sales, gross profit increased 380 basis points to 27.67 percent from 23.87 percent in fiscal 1998. The majority of the increase in gross profit resulted from an increase in merchandise margin of 336 basis points. The Company's updated product offerings, which consist increasingly of branded merchandise, allowed the Company to generate improved inventory sell-through with a reduced level of retail markdowns leading to the improvement in merchandise margin. In addition, gross profit for the fourth quarter of fiscal 1998 was negatively impacted by a charge of approximately \$0.6 million to reduce the cost of slow-moving inventory to net realizable value. Store occupancy costs (which are relatively fixed in nature) as a percent of sales decreased by 32 basis points due to leverage achieved as a result of the comparable store sales increase. Buying and distribution costs as a percent of sales decreased by 12 basis points as a result of both operating and comparable store sales leverage.

Selling, general and administrative expenses increased approximately \$6.1 million to \$55.6 million in fiscal 1999 from \$49.5 million in fiscal 1998. The aggregate increase in SG&A is primarily attributable to additional store expenses as a result of the Company's expanded store base during the past year and an increase in administrative costs to support the larger store base. As a percentage of net sales, SG&A decreased 77 basis points to 23.12 percent in fiscal 1999 from 23.89 percent in fiscal 1998. The decrease in SG&A as a percentage of sales is due primarily to the Company's ability to leverage corporate overhead and store costs as a result of the comparable store sales increase.

The Company's net interest income decreased \$40,000 to \$496,000 in fiscal 1999 from \$536,000 in fiscal 1998, due primarily to higher average cash balances in fiscal 1998.

The Company's effective income tax rate increased to 37.4 percent in fiscal 1999 from 20.1 percent in fiscal 1998. The increase is due primarily to tax-free interest income, which accounted for a significantly higher portion of income before income taxes in fiscal 1998.

Provision for Store Closings and Asset Impairments. During 1999, the Company decided to close eight stores that had been identified as under-performing and recognized a \$1.2 million pre-tax provision for costs (consisting of the write down of long-lived assets and lease termination costs) related to closing the facilities. As of February 3, 2001, seven of the eight stores had been closed. The remaining store was closed on March 3, 2001. As of February 3, 2001 substantially all costs to close the eight stores had been incurred. The components of the provision, an analysis of amounts charged against the accrual and the sales and operating loss data for the eight stores are outlined in Note 3 of the "Notes to the Consolidated Financial Statements."

As indicated in Note 4 of the "Notes to the Consolidated Financial Statements," the Company recorded a non-cash impairment charge of \$533,000 in fiscal 1999 to reflect fixtures and leasehold improvements at their respective estimated fair value in six other under-performing stores. In January 2001, the Company closed one of these stores, the effect of which was not material to the

consolidated financial statements. The remaining locations were not targeted for closure. This impairment charge is expected to reduce depreciation expense by approximately \$115,000 annually over the average remaining useful lives of these assets (approximately 3.7 years). Management regularly reviews the performance of all the Company's stores. If management determines that it is unlikely that a store with negative cash flow will increase its sales volume to a level that would allow the store to generate positive cash flow, management will consider remedial actions up to and including closing the store. If the Board of Directors approves a plan for closing a store or stores, the Company will recognize a provision for store closing costs during the quarter in which such approval is granted.

The aforementioned charges totaling \$1.7 million have been combined and are reflected under the caption "Provision for store closings and asset impairments" in the accompanying Consolidated Statement of Income for fiscal 1999.

Quarterly Results and Seasonality

The Company's quarterly results of operations may fluctuate materially depending on, among other things, the timing of new store openings, net sales contributed by new stores, increases or decreases in comparable store sales and changes in the Company's merchandise mix.

The Company's business is also subject to seasonal influences, with higher sales during the Christmas holiday, back-to-school, and spring break seasons. The Christmas holiday season remains the Company's single most important selling season. The Company believes, however, that the significance of the back-to-school season (which affects operating results in the second and third quarters) and spring break season (which affects operating results in the first quarter) reduces somewhat the Company's dependence on the Christmas holiday selling season. As is the case with many apparel retailers, the Company's net sales and net income are typically lower in the first quarter.

The following table sets forth certain statement of income and operating data for each of the Company's last eight fiscal quarters. The following quarterly data were derived from unaudited financial statements of the Company, which in the opinion of management of the Company, contain all adjustments (consisting only of normal recurring adjustments) necessary for fair presentation thereof. Results for any quarter are not necessarily indicative of results that may be achieved for a full fiscal year.

	Fiscal 2000				Fiscal 1999			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter (1)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(\$ in thousands, except operating data and per share amounts)								
Statement of income data:								
Net sales	\$ 62,955	\$ 64,223	\$ 67,328	\$ 93,904	\$ 51,182	\$ 57,748	\$ 56,202	\$ 75,121
Gross profit	17,881	16,801	18,512	29,712	13,725	15,335	14,957	22,457
Operating income ⁽²⁾	3,747	2,248	3,381	10,081	809	1,766	728	5,893
Net income ⁽²⁾	2,495	1,537	2,311	6,447	600	1,185	522	3,763
Net income per share ⁽²⁾								
Basic	\$ 0.28	\$ 0.17	\$ 0.26	\$ 0.72	\$ 0.07	\$ 0.13	\$ 0.06	\$ 0.42
Diluted	\$ 0.27	\$ 0.17	\$ 0.25	\$ 0.69	\$ 0.07	\$ 0.13	\$ 0.06	\$ 0.42
Average shares outstanding								
Basic	8,927	8,915	8,894	8,909	8,893	8,906	8,919	8,921
Diluted	9,381	9,215	9,248	9,325	8,994	9,116	9,000	9,063
Selected operating data:								
Stores open at end of period	328	345	368	375	316	324	325	326

(1) The fourth quarter of fiscal 2000 includes results for a 13-week period versus 12 in the prior year. The Company estimates that this 53rd week increased sales, gross profit, operating income, net income and diluted earnings per share by \$4.5 million, \$1.7 million, \$720,000, \$450,000 and \$.05, respectively.

(2) Includes a charge for store closings and asset impairments of \$405,000 (\$255,000 after tax, or \$0.03 per diluted share) and \$1,316,000 (\$821,000 after tax, or \$0.09 per diluted share) during the third and fourth quarters of 1999, respectively.

Liquidity and Capital Resources

General. During the last three fiscal years, the Company's primary uses of cash have been to finance new store openings and store remodels, and to purchase merchandise inventories. The Company has historically satisfied its cash requirements principally from cash flow from operations and proceeds from the sale of equity securities.

Cash Flows. During fiscal 2000, 1999 and 1998, cash flows from operating activities were \$14.1 million, \$9.3 million and \$6.4 million, respectively. Cash flow from operations before working capital changes increased to \$18.7 million in fiscal 2000 from \$13.9 million in the prior year primarily due to higher net income.

Working capital components used \$4.6 million in fiscal 2000. Cash used was primarily the result of funding higher inventory levels (\$11.5 million) offset, in part, by increases in accounts payable and income taxes payable of \$7.5 million. Working capital

components used \$4.7 million of cash flow in fiscal 1999. Cash used was primarily the result of funding higher inventory levels (\$10 million) offset, in part, by a decrease in accounts receivable of \$1.8 million, and increases in accounts payable and other accrued liabilities of \$3.7 million.

Cash used in investing activities approximated \$12.9 million, \$7.0 million and \$0.9 million for fiscal 2000, 1999 and 1998, respectively. The Company spent \$12.9 million on capital expenditures during fiscal 2000, the primary components of which were \$11.6 million to open new stores or remodel and refurbish existing stores and \$1.3 million to purchase and/or upgrade information systems and other corporate purposes.

The Company spent \$7.0 million on capital expenditures during fiscal 1999, the primary components of which were \$4.3 million to open new stores or remodel and refurbish existing stores and \$1.7 million to purchase and/or upgrade information systems. The Company opened 52, 19 and 63 new stores in fiscal 2000, 1999 and 1998, respectively.

Net cash flow provided by financing activities totaled \$453,000, \$44,000 and \$1.2 million for fiscal 2000, 1999 and 1998, respectively. During fiscal 2000, the Company received \$435,000 from the exercise of employee stock options as well as \$162,000 of related tax benefit. The Company used \$144,000 for net purchases of treasury stock. During fiscal 1999, the Company received \$66,000 from the exercise of employee stock options as well as \$20,000 of related tax benefit. The Company used \$41,000 for net purchases of treasury stock in fiscal 1999.

Credit Facility. On June 1, 2000, the Company renewed and revised its existing credit facility with Wells Fargo Bank. The revised facility provides an unsecured revolving line of credit totaling \$15 million. The total amount available to borrow pursuant to the credit agreement is limited to 150% of cash flow (as defined in the credit agreement) for the trailing 12-month period. Amounts borrowed under the revolving line bear interest at the lesser of either the bank's prime rate, or 195 basis points above LIBOR. The Company pays commitment fees of 0.33% on the unused portion of the revolving line of credit. The credit agreement also provides for the issuance of letters of credit that are generally used in connection with international merchandise purchases. Outstanding letters of credit issued by the bank reduce amounts otherwise available for borrowing under the revolving line of credit. The credit facility subjects the Company to various restrictions on the incurrence of additional indebtedness, acquisitions, loans to officers and stock repurchases. The covenants also require the Company to maintain certain tangible net worth, working capital, debt to equity, net income and fixed charge coverage minimums as well as certain other ratios customary in such agreements. Amounts available to borrow under the line of credit, as limited by the cash flow multiple, totaled \$14.9 million at February 3, 2001. No borrowings (other than letters of credit totaling \$100,000) were outstanding under the revolving line at February 3, 2001. Any amount borrowed under the revolving line of credit will become due on June 1, 2001, the date the credit agreement matures.

Capital Expenditures. The Company anticipates that it will spend approximately \$13 million on capital expenditures in fiscal 2001 to open 50 to 60 new stores, remodel seven existing stores, and purchase and/or upgrade information systems. During fiscal 2000, the Company had capital expenditures of \$12.9 million, of which \$11.6 million was used to open 52 new stores, remodel 6 existing stores, refurbish approximately 7 stores and purchase other assets for open stores. The remaining \$1.3 million was used primarily for corporate purposes, such as the purchase and/or upgrade of information systems. The Company believes that its existing cash balances, cash generated from operations, and funds available under its credit facility will be sufficient to satisfy its cash requirements through fiscal 2001.

Inflation

The Company does not believe that inflation has had a material effect on net sales or results of operations. The Company has generally been able to pass on increased costs through increases in selling prices.

Quantitative and Qualitative Disclosures About Market Risk

The Company does not engage in trading market risk sensitive instruments and does not purchase as investments, as hedges, or for purposes "other than trading," instruments that are likely to expose the Company to market risk, whether it be from interest rate, foreign currency exchange, commodity price or equity price risk. The Company has issued no debt instruments, entered into no forward or futures contracts, purchased no options and entered into no swaps.

The Company's primary market risk exposure is that of interest rate risk. A change in LIBOR or the Prime Rate as set by Wells Fargo Bank would affect the rate at which the Company could borrow funds under its credit facility.

Statement Regarding Forward-Looking Disclosure

Certain sections of this Annual Report, contain various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act, which represent the Company's expectations or beliefs concerning future events. These forward-looking statements involve risks and uncertainties, and the Company cautions that these statements are further qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements, including, without limitation, those set forth in the "Risk Factors" section of the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2001.

CONSOLIDATED BALANCE SHEETS

	February 3, 2001	January 29, 2000
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 20,284,368	\$ 18,643,475
Accounts receivable	3,125,995	1,216,579
Inventory	55,941,468	44,418,484
Other current assets	1,956,079	1,855,620
	<u>81,307,910</u>	<u>66,134,158</u>
Leaseholds, fixtures and equipment, net	36,025,881	30,234,808
Deferred tax assets	1,459,884	293,126
	<u>37,485,765</u>	<u>30,527,934</u>
	<u>\$118,793,675</u>	<u>\$ 96,662,092</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 25,233,423	\$ 20,395,375
Accrued payroll and benefits	4,241,859	3,532,655
Other current liabilities	3,306,201	2,928,135
Income taxes payable	3,540,830	910,764
	<u>36,322,313</u>	<u>27,766,929</u>
Accrued rent	3,083,419	2,750,280
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized, none issued	—	—
Common stock, \$.01 par value, 25,000,000 shares authorized, 8,969,825 and 8,922,528 shares issued and outstanding, respectively	89,698	89,225
Additional paid-in capital	43,042,615	42,282,468
Retained earnings	36,699,218	23,909,645
Treasury stock, at cost, 52,797 and 19,548 shares, respectively	(443,588)	(136,455)
	<u>79,387,943</u>	<u>66,144,883</u>
	<u>\$118,793,675</u>	<u>\$ 96,662,092</u>

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

	Fiscal Year Ended		
	February 3, 2001	January 29, 2000	January 30, 1999
Net sales	\$ 288,410,676	\$ 240,252,299	\$ 207,172,393
Costs and expenses:			
Cost of goods sold, including buying, distribution and occupancy costs	205,504,899	173,777,873	157,728,597
Selling, general and administrative expenses	63,449,926	55,557,545	49,496,257
Provision for store closings and asset impairments	—	1,721,343	—
	<u>268,954,825</u>	<u>231,056,761</u>	<u>207,224,854</u>
Operating income (loss)	19,455,851	9,195,538	(52,461)
Interest expense	127,709	97,686	58,265
Interest income	919,423	594,339	594,738
Income before income taxes	20,247,565	9,692,191	484,012
Provision for income taxes	7,457,992	3,621,953	97,188
Net income	<u>\$ 12,789,573</u>	<u>\$ 6,070,238</u>	<u>\$ 386,824</u>
Net income per share			
Basic	<u>\$ 1.44</u>	<u>\$ 0.68</u>	<u>\$ 0.04</u>
Diluted	<u>\$ 1.38</u>	<u>\$ 0.67</u>	<u>\$ 0.04</u>
Average shares outstanding			
Basic	<u>8,911,331</u>	<u>8,910,084</u>	<u>8,851,609</u>
Diluted	<u>9,292,895</u>	<u>9,043,135</u>	<u>9,035,841</u>

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock		Additional	Retained	Treasury Stock		Total
	Shares	Capital	Paid-In Capital	Earnings	Shares	Capital	
Balance, January 31, 1998	8,754,577	\$87,546	\$40,868,605	\$17,524,264	—	\$ —	\$58,480,415
Stock issued under option plans	138,159	1,381	604,713	—	—	—	606,094
Purchase of treasury stock	—	—	—	—	29,500	(312,031)	(312,031)
Sale of treasury stock	—	—	—	(55,635)	(14,274)	200,667	145,032
Tax benefit from exercise							
of stock options	—	—	724,311	—	—	—	724,311
Net income	—	—	—	386,824	—	—	386,824
Balance, January 30, 1999	8,892,736	88,927	42,197,629	17,855,453	15,226	(111,364)	60,030,645
Stock issued under option plans	29,792	298	65,274	—	—	—	65,572
Purchase of treasury stock	—	—	—	—	25,000	(212,981)	(212,981)
Sale of treasury stock	—	—	—	(16,046)	(20,678)	187,890	171,844
Tax benefit from exercise							
of stock options	—	—	19,565	—	—	—	19,565
Net income	—	—	—	6,070,238	—	—	6,070,238
Balance, January 29, 2000	8,922,528	89,225	42,282,468	23,909,645	19,548	(136,455)	66,144,883
Stock issued under option plans	47,297	473	434,504	—	—	—	434,977
Purchase of treasury stock	—	—	—	—	50,000	(423,938)	(423,938)
Sale of treasury stock	—	—	163,177	—	(16,751)	116,805	279,982
Tax benefit from exercise							
of stock options	—	—	162,466	—	—	—	162,466
Net income	—	—	—	12,789,573	—	—	12,789,573
Balance, February 3, 2001	8,969,825	\$89,698	\$43,042,615	\$36,699,218	52,797	\$(443,588)	\$79,387,943

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Year Ended		
	February 3, 2001	January 29, 2000	January 30, 1999
Cash flows from operating activities:			
Net income	\$ 12,789,573	\$ 6,070,238	\$ 386,824
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for store closings	—	1,188,547	—
Impairment of long-lived assets	—	532,796	—
Loss on disposal of assets	193,939	288,813	135,456
Depreciation	6,951,320	5,841,152	4,653,433
Deferred income taxes	(1,232,138)	(15,338)	(433,967)
Changes in operating assets and liabilities:			
Accounts receivable	(1,909,416)	1,785,072	(186,207)
Inventory	(11,522,984)	(10,014,677)	1,360,026
Other assets	(35,079)	(146,331)	(126,571)
Accounts payable	4,838,048	2,246,639	1,426,928
Accrued payroll and benefits	709,204	1,033,897	387,474
Income taxes payable	2,630,066	910,764	(2,494,855)
Other liabilities	711,205	(467,219)	1,251,260
Net cash provided by operating activities	14,123,738	9,254,353	6,359,801
Cash flows from investing activities:			
Capital expenditures	(12,936,332)	(7,008,271)	(10,082,106)
Purchases of short-term investments	—	—	(7,596,979)
Proceeds from redemption of short-term investments	—	—	16,754,188
Net cash used in investing activities	(12,936,332)	(7,008,271)	(924,897)
Cash flows from financing activities:			
Issuance of common stock, net	434,977	65,572	606,094
Purchase of treasury stock	(423,938)	(212,981)	(312,031)
Sale of treasury stock under employee stock purchase plan	279,982	171,844	145,032
Tax benefit from exercise of stock options	162,466	19,565	724,311
Net cash provided by financing activities	453,487	44,000	1,163,406
Net increase in cash and cash equivalents	1,640,893	2,290,082	6,598,310
Cash and cash equivalents at beginning of year	18,643,475	16,353,393	9,755,083
Cash and cash equivalents at end of year	\$ 20,284,368	\$ 18,643,475	\$ 16,353,393
Cash paid during the year for:			
Interest	\$ 68,564	\$ 93,348	\$ 63,240
Income taxes	5,900,872	2,736,158	4,407,154

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

I. Organization and Nature of the Company

Gadzooks, Inc. (the "Company") is a mall-based, specialty retailer of casual apparel and related accessories for young men and women principally between the ages of 14 and 18. At February 3, 2001, the Company had 375 company-owned stores in metropolitan and middle markets in 36 states.

The Company's fiscal year ends on the Saturday nearest January 31. All references in these financial statements to fiscal years are to the calendar year in which the fiscal year begins. Fiscal year 2000 represents the 53-week period ended February 3, 2001 and fiscal years 1999 and 1998 represent the 52-week periods ended January 29, 2000 and January 30, 1999, respectively.

II. Summary of Significant Accounting Policies

Principles of Consolidation. In June 2000, the Company completed a corporate restructuring. The consolidated financial statements include the accounts of Gadzooks, Inc. and its wholly-owned affiliates, Gadzooks Holding Company and Gadzooks Management, L.P. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents. Cash and cash equivalents include cash on hand and marketable securities with original maturities of three months or less.

Inventory. Inventory is valued at the lower of average cost or market.

Leaseholds, Fixtures and Equipment. Leaseholds, fixtures and equipment are stated at cost. Depreciation of fixtures and equipment is based upon the estimated useful lives of the assets, generally from five to ten years, computed on the straight-line method. Amortization of leasehold improvements is computed on the straight-line method over estimated useful lives or lease terms, if shorter. The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate the respective net carrying amounts may not be recoverable. An impairment loss is recognized if the sum of the expected future cash flows (undiscounted and before interest) from the use of the assets is less than the net book value of the assets. The amount of the impairment loss is measured as the difference between the net book value of the assets and the estimated fair value of the related assets.

Revenue Recognition. Retail merchandise sales are recognized at the point of sale less sales returns and employee discounts. The Company adopted the provisions of SEC Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101") in the fourth quarter of fiscal 2000. The effect of the adoption of this standard was immaterial to the Company's results of financial position and income. Gadzooks has historically recorded discounts related to the sale of merchandise to employees as a component of selling, general and administrative expenses ("SG&A"). Beginning with the second quarter of fiscal 2000, such discounts were reported as a reduction of sales. As a result, gross profit was reduced by the amount of the employee discounts each period, which was totally offset by a like reduction in SG&A expenses. Employee discounts have been retroactively reflected as a reduction of sales on all historical statements of income presented by the Company. Employee discounts totaled \$1.5 million, \$1.4 million and \$1.0 million for the years ended February 3, 2001, January 29, 2000 and January 30, 1999, respectively.

Advertising. Advertising costs are expensed when incurred. Advertising costs were \$1,212,657, \$748,311 and \$610,945 for fiscal years 2000, 1999 and 1998, respectively.

Store Pre-Opening Costs. Costs incurred with the setup of a new store prior to its opening for business were expensed as incurred in fiscal 2000, 1999 and 1998.

Income Taxes. Deferred income taxes are provided on the liability method. Under this method, deferred tax assets and liabilities are recognized based on differences between the financial statement and the tax basis of assets and liabilities using presently enacted tax rates. The Company reviews its deferred tax assets for ultimate realization and will record a valuation allowance to reduce the deferred tax asset if it is more likely than not that some portion, or all, of these deferred tax assets will not be realized.

Earnings per Share. Basic earnings per share are computed by dividing net income by the weighted average number of shares outstanding during each period. Diluted earnings per share are computed by dividing net income by the weighted average number of shares outstanding during each period after giving effect to dilutive potential common shares resulting from stock options.

Reclassifications. Certain prior year amounts have been reclassified to conform to current year presentation.

Use of Estimates. The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at February 3, 2001 and January 29, 2000 and the reported amounts of revenues and expenses during each of the three years in the period ended February 3, 2001. Actual results could differ from these estimates.

Fair Value of Financial Instruments. All financial instruments classified as current are recorded at cost, which approximates fair value due to the short maturity of these instruments.

III. Provision for Store Closings

During 1999, the Company decided to close eight stores that had been identified as under-performing, and recognized a \$1,189,000 pre-tax provision for costs related to closing the facilities. As of February 3, 2001, seven of the eight stores had been closed. The remaining store was closed on March 3, 2001. As of February 3, 2001, substantially all costs to close the eight stores had been incurred. The components of the provision and an analysis of the amounts charged against the accrual are outlined below.

In thousands	1999 Original provision	Charges through 1/29/00	Balance at 1/29/00	Charges through 2/03/01	Balance at 2/03/01
Lease termination costs	\$ 382	\$ (263)	\$ 119	\$ (113)	\$ 6
Impairment of long-lived assets	807	(807)	—	—	—
Total	\$ 1,189	\$ (1,070)	\$ 119	\$ (113)	\$ 6

Sales and operating loss of the eight stores are shown below for the years ended February 3, 2001, January 29, 2000 and January 30, 1999 (unaudited):

In thousands	February 3, 2001	January 29, 2000	January 30, 1999
Sales	\$ 883,117	\$ 3,015,017	\$ 3,576,634
Operating loss	(58,608)	(695,402)	(924,816)

IV. Impairment of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets to be Disposed of," which requires that long-lived assets held and used by an entity be reviewed for impairment whenever events or circumstances indicate that the net book value of the asset may not be recoverable, the Company recorded a non-cash impairment charge of \$533,000 in fiscal 1999 to reflect fixtures and leasehold improvements at their respective fair value in six under-performing stores. In January 2001, the Company closed one of these stores, the effect of which was not material to the consolidated financial statements. The remaining locations were not targeted for closure. Management regularly reviews the performance of all the Company's stores. If management determines that it is unlikely that a store's sales volume will increase to a level that would allow the store to generate positive cash flows, management will consider remedial actions up to and including closing the store. If the Board of Directors approves a plan for closing a store or stores, the Company will recognize a provision for store closing costs during the quarter in which such approval is granted.

V. Leaseholds, Fixtures and Equipment

Leaseholds, fixtures and equipment are summarized as follows:

	February 3, 2001	January 29, 2000
Leasehold improvements	\$ 35,748,417	\$ 29,080,001
Fixtures and equipment	24,789,217	19,516,913
	60,537,634	48,596,914
Less accumulated depreciation	(24,511,753)	(18,362,106)
	\$ 36,025,881	\$ 30,234,808

VI. Long-Term Obligations

On June 1, 2000, the Company renewed and revised its existing credit facility with Wells Fargo Bank. The revised facility provides an unsecured revolving line of credit totaling \$15 million. The total amount available to borrow pursuant to the credit agreement is limited to 150% of cash flow (as defined in the credit agreement) for the trailing 12-month period. Amounts borrowed under the revolving line bear interest at the lesser of either Prime Rate or 195 basis points above LIBOR. The Company pays commitment fees of 0.33% on the unused portion of the revolving line of credit. The credit agreement also provides for the issuance of letters of credit that are generally used in connection with international merchandise purchases. Outstanding letters of credit issued by the bank reduce amounts otherwise available for borrowing under the revolving line of credit. The credit facility subjects the Company to various restrictions on the incurrence of additional indebtedness, acquisitions, loans to officers and stock repurchases. The covenants also require the Company to maintain certain tangible net worth, working capital, debt to equity, net income and fixed charge coverage minimums as well as certain other ratios customary in such agreements. Amounts available to borrow under the line of credit, as limited by the cash flow multiple and reduced by outstanding letters of credit, totaled \$14.9 million at February 3, 2001. Any amount borrowed under the revolving line of credit will become due on June 1, 2001, the date the credit agreement matures. Prior to June 1, 2001, management expects to be able to renegotiate and extend this facility under terms no less favorable to the Company than those of the current credit agreement. No assurance can be given, however, that such negotiations will be successful, or that the Company will be able to obtain terms equivalent to the current credit agreement. As of February 3, 2001, there were no borrowings outstanding under the revolving line, and \$100,000 in letters of credit were outstanding.

VII. Leases

The Company leases store, office, and warehouse space under non-cancelable leases with terms that generally range from five to ten years. Most of the store leases provide for additional rentals based on a percentage of store sales and specify rental increases over the term of the lease. Total rent expense under these operating leases was \$23,112,695, \$20,775,846 and \$18,717,424, for fiscal years 2000, 1999 and 1998, respectively. Included in these total rent figures are \$608,000, \$350,000 and \$511,000 of contingent rent for fiscal years 2000, 1999 and 1998, respectively. Accrued rent of \$3,083,419 as of February 3, 2001 and \$2,750,280 as of January 29, 2000 has been provided to account for rent expenses on a straight-line basis. Future minimum lease payments under non-cancelable operating leases as of February 3, 2001 are as follows:

Fiscal year	
2001	\$ 23,993,466
2002	24,214,395
2003	23,776,689
2004	22,830,998
2005	21,453,563
Thereafter	53,569,228
Total minimum lease payments	<u>\$ 169,838,339</u>

VIII. Income Taxes

The provision for federal and state income taxes consists of the following:

	2000	1999	Fiscal 1998
Current tax expense	\$ 8,690,125	\$ 3,637,291	\$ 531,155
Deferred tax benefit	(1,232,133)	(15,338)	(433,967)
	<u>\$ 7,457,992</u>	<u>\$ 3,621,953</u>	<u>\$ 97,188</u>

The following table reconciles the provision for income taxes to the amount computed by applying the U.S. statutory federal tax rate of 34% to pre-tax income:

	2000	1999	Fiscal 1998
Tax provision at the federal corporate rate	\$ 6,884,172	\$ 3,295,345	\$ 164,564
State income taxes, net of related federal benefit	599,533	410,099	31,209
Graduated federal rate	100,000	—	—
Tax exempt interest	—	—	(69,613)
Other, net	(125,713)	(83,491)	(28,972)
Provision for income taxes	<u>\$ 7,457,992</u>	<u>\$ 3,621,953</u>	<u>\$ 97,188</u>

Deferred tax assets (liabilities) are comprised of the following:

	February 3, 2001	January 29, 2000
Deferred tax assets:		
Accruals not currently deductible	\$ 1,750,452	\$ 1,255,934
Depreciation	719,158	257,756
	<u>2,469,610</u>	<u>1,513,690</u>
Deferred tax liabilities	—	(276,213)
	<u>\$ 2,469,610</u>	<u>\$ 1,237,477</u>

At February 3, 2001 and January 29, 2000, \$1,009,726 and \$944,351, respectively of net current deferred tax assets were classified as other current assets. The early disposition of certain qualified stock options and the exercise of certain nonqualified stock options in fiscal 2000, 1999 and 1998 resulted in income tax benefits to the Company of \$162,466, \$19,565 and \$724,311 respectively, which was credited to additional paid-in capital. The income tax benefit is the tax effect of the difference between the market price on the date of exercise and the option price.

IX. Employee Benefit Plans

Effective January 1, 1995, the Company established the Gadzoos, Inc. Employees' Savings Plan (the "401(k) Plan"). The 401(k) Plan is open to substantially all employees who have been employed at least one year and who work at least 1,000 hours per year. Under the 401(k) Plan, a participant may contribute up to 15% of earnings, with the Company matching 50% of the employee's first 5% contribution. Employee and Company contributions are paid to a corporate trustee and invested in various mutual funds or the Company's common stock at the discretion of the participant. Company contributions made to participants' accounts become 100% vested on the fifth anniversary of the employee's initial participation in the Plan. For the years ended February 3, 2001, January 29, 2000 and January 30, 1999, the Company contributed \$104,854, \$130,837 and \$117,917, respectively, in matching contributions to the 401(k) Plan.

On June 18, 1998, the shareholders approved the Gadzoos, Inc. Employee Stock Purchase Plan ("ESPP"). The ESPP allows eligible employees the right to purchase common stock on a monthly basis at 85 percent of the closing market price of the shares on the last day of the respective calendar month. The aggregate number of shares that may be offered under the ESPP was increased from 60,000 to 110,000 in fiscal 2000. During fiscal 2000, 1999 and 1998, 16,751, 20,678 and 14,274 shares, respectively, of the Company's common stock were sold to employees pursuant to the plan. The Company may purchase shares of common stock from time to time on the open market to provide shares for sale pursuant to the ESPP.

During fiscal 1999, the Company dissolved a nonqualified deferred compensation program which permitted officers to defer a portion of their compensation on a pre-tax basis until their retirement. Participant deferrals that were deposited into variable life insurance contracts held in a Rabbi Trust were remitted back to the participants during 1999.

X. Stock Option Plans

The Company has three incentive and nonstatutory stock option plans. The "Employee Plan" for employees and consultants was adopted in February 1992; the "Key Employee Plan" for key employees was adopted in September 1994; and the "Nonemployee Director Plan" for the Company's outside directors was adopted in August 1995. Under these plans, options are granted to purchase common stock at a price no less than fair market value at the grant date. For options granted prior to the initial public offering, the Board of Directors considered various factors in determining fair market value including, among other things, the rights and preferences of holders of other securities issued by the Company, the financial position and results of operations of the Company, and the liquidity of the Company's common stock. Subsequent to the initial public offering, all shares have been granted at the closing price of the Company's common stock traded on The NASDAQ Stock Market on the date of grant. Options have vesting periods of generally two to five years from date of grant and may be exercised at any time once they become vested, but not more than 10 years from the date of grant.

During fiscal 2000, the Employee Plan was amended to adjust the maximum aggregate number of shares that may be optioned and sold under the plan to 2,100,000 shares. During fiscal 1998, the Nonemployee Director Plan was amended to adjust the maximum aggregate number of shares that may be optioned and sold to 100,000 shares. The maximum aggregate number of shares that may be optioned and sold under the Key Employee Plan is 272,651 shares.

On December 15, 1998, options to purchase 517,585 shares of the Company's common stock at prices ranging from \$17.63 to \$29.25 were cancelled and replaced with options to purchase 393,438 shares of common stock at prices of either \$9.00 per share or \$11.60 per share. The closing price of the Company's common stock on December 15, 1998 was \$6.75 per share. The newly issued options vest over the same period as the cancelled options they replaced. For officers of the Company the replacement options provide the right to purchase from 50% to 67% of the number of shares subject to purchase under the cancelled options depending on the exercise price of the options cancelled. For all other employees, the replacement options provide the right to purchase the same number of shares as provided by the cancelled options.

The following table includes option information for the Employee Plan, Key Employee Plan and Nonemployee Director Plan:

	2000		1999		Fiscal 1998	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,049,652	\$ 9.72	870,070	\$ 9.71	698,360	\$ 13.00
Granted	197,025	15.79	555,580	9.82	973,595	14.65
Exercised	(52,273)	9.41	(30,192)	2.21	(138,159)	4.38
Cancelled	(76,893)	11.89	(345,806)	10.50	(663,726)	21.54
Outstanding at end of year	1,117,511	\$ 10.64	1,049,652	\$ 9.72	870,070	\$ 9.71
Available for grant at end of year	659,697		179,829		389,603	

The following table summarizes information about stock options outstanding at February 3, 2001:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 2/03/01	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at 2/03/01	Weighted Average Exercise Price
\$ 0.21 – \$ 5.78	142,237	4 years	\$ 3.87	142,237	\$ 3.87
\$ 6.16 – \$ 8.88	199,873	8 years	\$ 7.27	42,461	\$ 7.29
\$ 9.00 – \$ 11.56	210,685	8 years	\$ 9.91	73,491	\$ 9.63
\$ 11.60 – \$ 12.38	370,202	8 years	\$ 11.99	119,023	\$ 11.84
\$ 12.44 – \$ 28.13	194,514	9 years	\$ 17.32	31,307	\$ 23.50
\$ 0.21 – \$ 28.13	1,117,511			408,519	

The Company measures and records compensation expense in accordance with current practices as prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and provides disclosure about pro forma compensation expense in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation,"

If the Company had elected to recognize compensation expense based on the fair value of options granted at the grant date as prescribed by SFAS No. 123, net income and earnings per share would have been reduced to the pro forma amounts indicated in the following table:

	2000	1999	Fiscal 1998
Net income – as reported	\$ 12,789,573	\$ 6,070,238	\$ 386,824
Net income (loss) – pro forma	10,764,338	4,831,365	(1,560,440)
Diluted earnings per share – as reported	1.38	0.67	0.04
Diluted earnings (loss) per share – pro forma	1.16	0.53	(0.18)

The fair value of each option grant is estimated as of the date of grant using the Black-Scholes Multiple Option pricing model with the following weighted-average assumptions used for grants:

	2000	1999	Fiscal 1998
Expected volatility	226%	248%	87%
Risk-free interest rate	4.6%	6.5%	5.1%
Expected lives	4.1 years	4.2 years	3.7 years
Dividend yield	0%	0%	0%

The weighted average fair value of options granted was \$15.23, \$9.63 and \$7.43 per share for fiscal 2000, 1999 and 1998, respectively.

XI. Earnings Per Share

The following table outlines the Company's calculation of weighted average shares outstanding:

	2000	1999	Fiscal 1998
Weighted average common shares outstanding (basic)	8,911,331	8,910,084	8,851,609
Effect of dilutive options	381,564	133,051	184,232
Weighted average common and dilutive potential shares outstanding (diluted)	<u>9,292,895</u>	<u>9,043,135</u>	<u>9,035,841</u>

The treasury stock method is used to determine dilutive potential common shares outstanding related to stock options. Options which, based on their exercise price, would be antidilutive are not considered in the treasury stock method calculation. Options excluded from the earnings per share calculation due to their antidilutive nature totaled 51,232, 215,389 and 22,132 in fiscal 2000, 1999 and 1998, respectively.

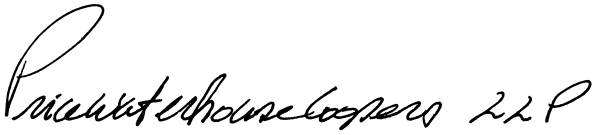
XII. Shareholder Rights Plan

On September 3, 1998, the Company declared a dividend of one Preferred Share Purchase Right ("Right") on each outstanding share of Gadzooks, Inc. common stock. The dividend distribution was made on September 15, 1998 to shareholders of record on that date. The Rights become exercisable if a person or group acquires 20 percent or more of the Company's common stock or announces its intent to do so. Each Right will entitle shareholders to buy one one-thousandth of a new series of junior participating preferred stock at an exercise price of \$110. When the Rights become exercisable, the holder of each Right (other than the acquiring person or members of such group) is entitled (1) to purchase, at the Right's then current exercise price, a number of the acquiring company's common shares having a market value of twice such price; (2) to purchase, at the Right's then current exercise price, a number of the Company's common shares having a market value of twice such price; or (3) at the option of the Company, to exchange the Rights (other than Rights owned by such person or group), in whole or in part, at an exchange ratio of one share of common stock (or one-thousandth of a share of the new series of junior participating preferred stock) per Right. The Rights may be redeemed for one cent each by the Company at any time prior to acquisition by a person (or group) of beneficial ownership of 20 percent or more of the Company's common stock. The Rights will expire on September 15, 2008.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of Gadzooks, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Gadzooks, Inc. and its subsidiaries at February 3, 2001 and January 29, 2000, and the results of their operations and their cash flows for each of the three years in the period ended February 3, 2001 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

A handwritten signature in cursive script, reading "Price Waterhouse Coopers LLP".

Fort Worth, Texas

March 8, 2001

CORPORATE INFORMATION

Directors

Gerald R. Szczepanski
Chairman of the Board
Co-Founder of Gadzooks
Director since 1983

G. Michael Machens^{A,C}
General Partner
Phillips-Smith Specialty
Retail Group
Director since 1992

Robert E.M. Nourse^C
Private Investor
Former President and
Chief Executive Officer
The Bombay Company, Inc.
Director since 1993

Ron G. Stegall^A
President
Arlington Equity Partners, Inc.
Director since 1999

Lawrence H. Titus, Jr.^A
Co-Founder of Gadzooks
(retired)
Director since 1983

^A Audit Committee

^C Compensation Committee

Officers

Gerald R. Szczepanski
Chairman of the Board and
Chief Executive Officer

Paula Y. Masters
Senior Vice President
General Merchandising Manager

James F. Wimpres, Jr.
Senior Vice President
Store Operations

James A. Motley
Vice President and
Chief Financial Officer
Treasurer and Secretary

William S. Kotch III
Vice President
Real Estate

Stephen R. Puterbaugh
Vice President
Human Resources

Jeffrey P. Creecy
Vice President
Information Systems

Annual Meeting

The Annual Meeting of Gadzooks, Inc. will be held at 9:00 a.m., on June, 14, 2001, at the Company's headquarters.

Transfer Agent and Registrar

Mellon Investor Services
Overpeck Centre
85 Challenger Road
Ridgefield Park, NJ 07660
(800) 635-9270
www.mellon-investor.com

Corporate Counsel

Akin, Gump, Strauss, Hauer & Feld, L.L.P.
Dallas, Texas

Independent Accountants

PricewaterhouseCoopers LLP
Fort Worth, Texas

Shareholder Information

A copy of Form 10-K, excluding exhibits, as filed with the Securities and Exchange Commission, may be obtained without charge upon written request to Investor Relations at the Company's headquarters. Copies of exhibits are available upon payment of a \$125.00 fee to cover the costs of reproduction.

Common Stock

Listed on The Nasdaq Stock MarketSM — Symbol: GADZ

Share Price Data

The following table sets forth, for the quarterly periods indicated, the high and low closing prices per share of the common stock as reported on The Nasdaq Stock Market:

Fiscal Quarters	2000		1999	
	High	Low	High	Low
First Quarter	\$24.13	\$12.38	\$ 9.94	\$ 6.56
Second Quarter	23.13	7.94	16.00	9.13
Third Quarter	18.75	11.00	10.38	6.13
Fourth Quarter	21.13	12.94	13.69	7.44

On March 20, 2001 the closing sales price on The Nasdaq Stock Market was \$24.64. As of March 20, 2001, the approximate number of common shareholders of record was 84, although the Company believes that the actual number of beneficial owners is significantly higher. The Company presently intends to retain earnings for use in its business and therefore does not anticipate declaring a cash dividend in the near future.

Certain statements contained in this Annual Report (other than historical information) are forward-looking statements that involve risks and uncertainties. Reference is made to the "Risk Factors" section of the Company's most recent Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission for factors that, among others, could cause the actual results of the Company to differ materially from those contained in the forward-looking statements.

Corporate Headquarters

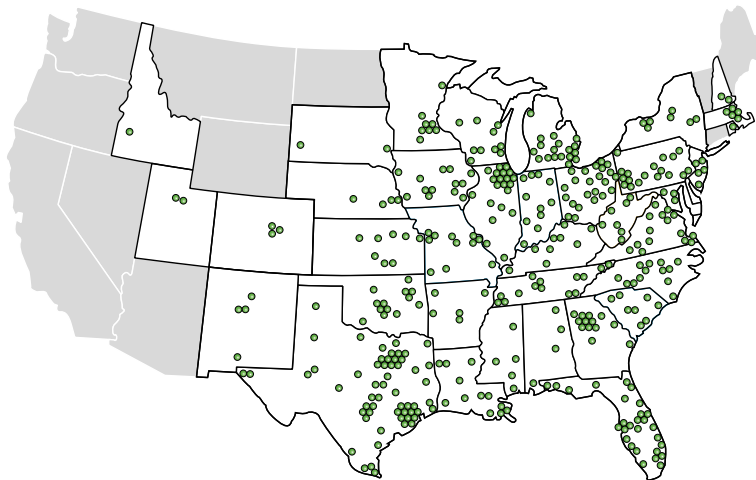
4121 International Parkway
Carrollton, Texas 75007
(972) 307-5555
(972) 662-4290 Fax
www.gadzooks.com

Gadzooks and the Gadzooks logo are registered trademarks and service marks of Gadzooks, Inc.

Gaditude is a registered service mark of Gadzooks, Inc.

STORE LOCATIONS

There are currently 383 Gadzooks stores in 36 states.*



- ALABAMA**
Huntsville
Mobile
Montgomery
Oxford
- ARKANSAS**
Fayetteville
Fort Smith
Jonesboro
Little Rock (2)
- COLORADO**
Denver (3)
- FLORIDA**
Daytona Beach
Fort Lauderdale (3)
Fort Myers
Fort Walton Beach
Gainesville
Jacksonville (2)
Jensen Beach
Lakeland
Merritt Island
Miami
Naples
Orlando (4)
Panama City
Pensacola
Port Charlotte
Sarasota
Tallahassee
Tampa (4)
West Palm Beach
- GEORGIA**
Athens
Atlanta (8)
Augusta
Macon
Rome
Savannah
- IDAHO**
Boise
- ILLINOIS**
Bloomington
Carbondale
Champaign
Chicago (13)
Fairview Heights/St. Louis
Moline
Peoria
Rockford
Springfield
- INDIANA**
Bloomington
Elkhart
Evansville
Fort Wayne
Indianapolis (2)
Lafayette
Merrillville
Muncie
South Bend
Terre Haute
- IOWA**
Cedar Falls
Cedar Rapids (2)
Council Bluffs
Davenport
Des Moines (3)
Dubuque
- (Iowa, cont'd)
Fort Dodge
Iowa City
Sioux City
Waterloo
- KANSAS**
Hays
Hutchinson
Kansas City
Manhattan
Salina
Topeka
Wichita (2)
- KENTUCKY**
Ashland
Bowling Green
Elizabethtown
Florence/Cincinnati
Lexington
Louisville (2)
Owensboro
Paducah
- LOUISIANA**
Alexandria
Baton Rouge (2)
Houma
Lafayette
Lake Charles
Monroe
New Orleans (3)
Shreveport/Bossier City (2)
- MARYLAND**
Baltimore (2)
Frederick
- MASSACHUSETTS**
Boston (5)
- MICHIGAN**
Ann Arbor
Battle Creek
Detroit (5)
Flint
Grand Rapids (2)
Holland
Jackson
Lansing
Monroe
Port Huron
Portage
Saginaw
Traverse City
- MINNESOTA**
Duluth
Mankato
Minneapolis/St. Paul (5)
St. Cloud
- MISSISSIPPI**
Biloxi
Hattiesburg
Jackson
Meridian
Tupelo
- MISSOURI**
Cape Girardeau
Columbia
Jefferson City
Joplin
Kansas City (3)
Springfield
St. Louis (3)

- NEBRASKA**
Grand Island
Lincoln
Omaha (2)
- NEW HAMPSHIRE**
Manchester
Salem
- NEW JERSEY**
Deptford/Philadelphia
Freehold
Livingston
Mays Landing
Wayne
- NEW MEXICO**
Albuquerque (2)
Las Cruces
Santa Fe
- NEW YORK**
Albany (2)
Rochester (3)
Syracuse (2)

- OKLAHOMA**
Bartlesville
Enid
Lawton
Muskogee
Norman
Oklahoma City (4)
Shawnee
Tulsa (3)
- PENNSYLVANIA**
Altoona
Erie
Harrisburg (2)
Johnstown
Lancaster
Muncy
Philadelphia (2)
Pittsburgh (6)
Scranton
State College
Wilkes-Barre

- (Texas, cont'd)
Harlingen
Houston (12)
Killeen
Laredo
Longview
Lubbock
Lufkin
McAllen
Midland/Odessa (2)
Port Arthur
San Angelo
San Antonio (5)
Sherman
Temple
Texarkana
Tyler
Victoria
Waco
Wichita Falls

- NORTH CAROLINA**
Cary
Charlotte (2)
Concord
Fayetteville
Greensboro
Greenville
Hickory
High Point
Raleigh-Durham (2)
Wilmington
Winston-Salem

- RHODE ISLAND**
Providence
- SOUTH CAROLINA**
Charleston (2)
Columbia (2)
Florence
Greenville
Myrtle Beach
Spartanburg

- UTAH**
Salt Lake City (2)
- VIRGINIA**
Charlottesville
Chesapeake
Christiansburg
Danville
Fredericksburg
Harrisonburg
Lynchburg
Newport News
Norfolk
Roanoke
Virginia Beach
Washington, DC (3)
Winchester

- OHIO**
Akron
Cincinnati (2)
Cleveland (4)
Columbus
Dayton (2)
Findlay
Heath
Lancaster
Lima
Mansfield
New Philadelphia
Piqua
Sandusky
St. Clairsville
Toledo
Youngstown/Niles (2)
Zanesville

- SOUTH DAKOTA**
Rapid City
Sioux Falls
- TENNESSEE**
Chattanooga (2)
Clarksville
Jackson
Johnson City
Kingsport
Knoxville (2)
Memphis (3)
Nashville (3)

- WEST VIRGINIA**
Bluefield
Bridgeport
Charleston
Huntington
Morgantown
Mount Hope
Parkersburg

- TEXAS**
Abilene
Amarillo
Austin (2)
Beaumont
Brownsville
College Station
Corpus Christi
Dallas/Fort Worth (11)
Denton
El Paso (2)

- WISCONSIN**
Appleton
Eau Claire
Green Bay
LaCrosse
Madison (2)
Milwaukee (3)
Wausau

*As of March 30, 2001