

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

FORM 10-K

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2013

Commission File No. 001-34061

HSN, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

1 HSN Drive, St. Petersburg, Florida  
(Address of principal executive offices)



(727) 872-1000

(Registrant's telephone number, including area code)

26-2590893  
(I.R.S. Employer  
Identification No.)

33729  
(Zip Code)

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

<u>Title of each class</u>	<u>Name of exchange on which registered</u>
Common Stock, par value \$0.01	NASDAQ Global Select Market
Series A Junior Participating Preferred Stock Purchase Rights	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, an Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registration was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The aggregate market value of the registrant's outstanding common stock held by non-affiliates as of June 30, 2013 (the registrant's most recently completed second fiscal quarter), was \$1,759,570,690 (based on a closing price of \$53.72 per share for the registrant's common stock on the NASDAQ Global Select Market).

As of February 18, 2014, the registrant had 53,122,005 shares of common stock, \$0.01 par value per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2014 Annual Meeting of Shareholders to be filed with the U.S. Securities and Exchange Commission no later than 120 days after the end of the registrant's 2013 fiscal year end are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this Form 10-K.

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## FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K contains certain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”), which are based on management’s exercise of business judgment, as well as assumptions made by and information currently available to management. When used in this document, the words “may,” “will,” “anticipate,” “believe,” “estimate,” “expect,” “intend” and words of similar import, are intended to identify any forward-looking statements. These forward-looking statements include, among other things, statements relating to the following: HSNi’s future financial performance, HSNi’s business prospects and strategy, anticipated trends and prospects in the various markets in which HSNi’s businesses operate and other similar matters. These forward-looking statements relate to expectations concerning matters that are not historical fact and are based on management’s current expectations and assumptions about future events, which are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. Although we believe our expectations are based on reasonable estimates and assumptions, they are not guarantees of performance.

Should one or more of these uncertainties, risks or changes in circumstances materialize, or should underlying assumptions prove incorrect, our actual results could differ materially from those anticipated in these forward-looking statements. Factors that could cause or contribute to such differences include but are not limited to those described under “Risk Factors,” and the following:

- the influence of the macroeconomic environment and its impact on consumer confidence and spending levels;
- changes in our relationships with pay television operators, vendors, manufacturers and other third parties;
- changes in product shipping promotions or delivery costs particularly if we are unable to offset them;
- any technological or regulatory developments that could negatively impact the way we do business, including developments requiring us to collect and remit state and local sales and use taxes;
- risks associated with possible systems failures and/or security breaches, including, any security breach that results in the theft, transfer or unauthorized disclosure of customer, employee or company information, or the failure to comply with various laws applicable to HSNi in the event of such a breach;
- HSNi’s business prospects and strategy, including whether HSNi’s initiatives will be effective; and
- our ability to offer new or alternative products and services through various platforms in a cost effective manner and consumer acceptance of these products and services;
- risks associated with acquisitions including the ability to successfully integrate new businesses and achieve expected benefits and results;
- the loss of any key member of our senior management team.

Other unknown or unpredictable factors that could also adversely affect HSNi’s business, financial condition and results of operations may arise from time to time.

You should not place undue reliance on these forward-looking statements. All written or oral forward-looking statements that are made or are attributable to us are expressly qualified in their entirety by this cautionary notice. Such forward-looking statements speak only to the date such statements are made and we do not undertake to update, revise or otherwise publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof, or to reflect the occurrence of any unanticipated events. Although we believe that our expectations are based on reasonable assumptions, we can give no assurance that our expectations will materialize. Historical results should not be considered an indication of future performance.

## PART I

### ITEM 1. BUSINESS

Unless otherwise indicated in this Annual Report or the context otherwise requires, all references in this Annual Report to "HSNi," the "Company," "us," "our" or "we" are to HSN, Inc. and/or its subsidiaries and affiliates.

#### Business Overview

HSNi is an interactive multi-channel retailer offering customers innovative and differentiated experiences through various platforms including television, online, mobile, catalogs and in retail and outlet stores through the eight brands of its two operating segments, HSN and Cornerstone.

HSN is an interactive entertainment and lifestyle retailer offering a curated assortment of exclusive products and top brand names to its customers primarily through television home shopping programming on the HSN television networks, through its business-to-consumer digital commerce site HSN.com, through mobile applications and through its outlet stores. HSN incorporates entertainment, inspiration and personalities to provide an entirely unique shopping experience.

Cornerstone is comprised of interactive, aspirational home and apparel lifestyle brands, including Ballard Designs, Chasing Fireflies, Frontgate, Garnet Hill, Grandin Road, Improvements and TravelSmith. Cornerstone operates eight separate e-commerce sites, distributes approximately 320 million catalogs annually and operates 10 retail and outlet stores. For financial information about our operating segments, please refer to Note 6 to our audited consolidated financial statements, as well as to Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations," each of which are included elsewhere in this document.

Our principal offices are located at 1 HSN Drive, St. Petersburg, Florida 33729 and our main telephone number is 727-872-1000. Our website is located at <http://www.hsn.com>.

#### History

HSNi's predecessor company began broadcasting television home shopping programming from its studios in St. Petersburg, Florida in 1981 and, by 1985, was broadcasting this programming through a national network of cable and local television stations 24 hours a day, seven days a week. The company continued to broaden its national distribution network through a combination of cable, satellite and broadcast systems and, as of December 31, 2013, the HSN television networks reached approximately 95.0 million residential homes in the United States.

The company began conducting business online in 1994 and formally launched HSN.com, the online shopping portal for the HSN television network, in 1999.

The company acquired Improvements, a catalog featuring thousands of innovative home, patio and outdoor products, in June 2001, and significantly grew its catalog business through the acquisition of Cornerstone Brands, Inc., with its portfolio of leading print catalogs and related websites, in April 2005.

HSNi was incorporated in Delaware in May 2008 in connection with the spin-off of several businesses previously owned by IAC/InterActiveCorp, or IAC. HSNi was formed to hold HSN and Cornerstone, the businesses that previously comprised most of IAC's retailing segment. The spin-off from IAC (the "Spin-off") occurred on August 20, 2008 and, in connection with the Spin-off, HSNi's shares began trading on the NASDAQ Global Select Market under the symbol "HSNI."

In early 2012, the Company initiated efforts to strengthen its portfolio of aspirational home and apparel lifestyle catalog brands. This resulted in the acquisition of Chasing Fireflies, LLC, a leading direct-to-consumer premium children's and family's lifestyle brand, in April 2012. This was followed by the divestitures of Smith+Noble, a brand specializing in window treatments, in May 2012 and The Territory Ahead, a brand specializing in casual apparel for men and women, in July 2012.

#### What We Do

HSNi markets and sells a wide range of third party and proprietary private label merchandise directly to consumers through HSN, which includes the HSN television networks and digital platforms, including mobile, as well as through Cornerstone's portfolio of catalogs and digital platforms, including mobile.

HSNi is committed to providing customers with an evolving variety of quality products at reasonable prices and from brands that resonate with its customers. Products offered through HSN include jewelry, fashion (apparel & accessories), beauty & health, and home & other (including household, home design, electronics, culinary and other). Featured products include proprietary label products and third party-branded products, some of which are produced exclusively for HSN, as well as merchandise generally available through other retailers. Cornerstone primarily offers home and outdoor furnishings, in addition to women and children's apparel with the majority produced exclusively for its Cornerstone brands.

## **HSN**

### ***Overview***

HSN includes the HSN television networks; its related website, HSN.com; its mobile applications and a limited number of outlet stores. The HSN television network broadcasts live, customer interactive home shopping programming 24 hours a day, seven days a week. HSN2, which debuted in August 2010, is a network that primarily distributes taped programming on a limited distribution basis. HSN's programming is intended to promote sales and customer loyalty through a combination of product quality, value and selection, coupled with product information, entertainment and interactive experiences. Programming is divided into separately televised segments, most of which have hosts who present and convey information regarding featured products, sometimes with the assistance of a celebrity, industry expert, representative from the product vendor or someone retained to aid in the sale of the products. HSN also produces entertainment such as live concerts to entertain and engage with customers and promote certain products. HSN.com is a business-to-consumer digital commerce site that sells all of the merchandise offered on the HSN television networks, together with complementary products and select merchandise sold exclusively on HSN.com. HSN provides seamless experiences across all digital platforms and optimizes each unique platform by delivering exclusive content both at HSN.com and on mobile phones and tablets, including the iPad, iPhone and Android and Windows devices. The HSN strategy is to create immersive experiences, offer differentiated products and leverage technology to build seamless relationships with its customers across all of its platforms. HSN fosters social communities as part of the HSN experience to encourage customers to share their product finds, thoughts and reviews with their friends via Facebook, Twitter, Pinterest and Instagram.

### ***Reach***

HSN produces live programming for the HSN television network primarily from its studios in St. Petersburg, Florida, and distributes this programming by means of satellite uplink facilities, which it owns and operates, to two transponders (one for the HSN high definition feed along with HSN2 and the other for the HSN standard definition feed) on the same satellite. The satellite transponders are leased on a full-time basis; one satellite transponder is leased through January 2015 and the other is leased through May 2019. Each satellite transponder lease provides for continued carriage of the HSN television networks on a replacement transponder and/or replacement satellite, as applicable, in the event of a failure of the transponder and/or satellite. HSN has also designed business continuity and disaster recovery plans intended to ensure its continued satellite transmission capability on a temporary basis in the event of inclement weather or a natural or other disaster.

As of December 31, 2013 and 2012, the HSN television networks reached approximately 95.0 million homes of the approximately 115.6 million and 114.2 million homes, respectively, in the United States with a television set. Television households reached by the HSN television networks as of December 31, 2013 and 2012 primarily include approximately 64.1 million and 64.0 million households capable of receiving cable and/or telephone company ("Telco") transmissions, respectively, and approximately 30.9 million and 31.0 million direct broadcast satellite system, or DBS, households, respectively.

### ***Pay Television Distribution***

HSN has entered into multi-year distribution and affiliation agreements with cable television, Telco and DBS operators, collectively referred to in this document as pay television operators, in the United States to carry the HSN television networks, as well as to promote the networks by carrying related commercials and distributing related marketing materials to their respective subscriber bases. HSN currently has contracts with many local and national pay television operators to distribute HSN television programming.

HSN's larger pay television operators include Comcast, DirecTV, EchoStar/DISH and Time Warner Cable.

In exchange for this carriage and related promotional and other efforts, HSN generally pays these pay television operators a fee consisting of commissions based on a percentage of the net merchandise sales to their subscriber bases and/or a per subscriber fee. In some cases, pay television operators receive additional compensation in the form of commission guarantees in exchange for their commitments to deliver a specified number of subscribers, channel placement incentives and advertising insertion time on the HSN television network.

HSN typically negotiates multi-year agreements that require HSN to pay monthly or annual fees. Distribution and affiliation agreements with pay television operators expire from time to time and renewal and negotiation processes may be lengthy. At any given time in the ordinary course of business HSN is likely to be engaged in renewal and/or negotiation processes with one or more pay television operators. In some cases, renewals are not agreed upon prior to the expiration of a given agreement and the HSN television network continues to be carried by the relevant pay television operator without an effective affiliation agreement in place or via month-to-month contracts. HSN expects that any extension of agreements that have expired will be on terms that, when taken as a whole, are commercially reasonable to HSN and competitive with the economics of other pay television operators.

### ***Broadcast Television Distribution***

As of December 31, 2013, HSN also had affiliation agreements with 86 broadcast television stations for leased carriage of the HSN television network with terms ranging from several weeks to several years. In exchange for this carriage, HSN pays the broadcast television stations hourly or monthly fixed rates or commissions based on a percentage of the net merchandise sales to their viewership bases. HSNi's subsidiary, Ventana Television, Inc. also owns 26 broadcast television stations that carry the HSN television networks on a full-time basis.

### ***HSN.com***

HSN also includes HSN.com, a transactional e-commerce site that sells merchandise offered on the HSN television networks, as well as select merchandise sold exclusively on HSN.com. HSN.com provides customers with additional content to support and enhance HSN television programming. For example, HSN.com provides users with an online program guide, value-added video of product demonstrations, live streaming video of the HSN television network, customer-generated product reviews and additional information about HSN show hosts and guest personalities. HSN.com offers customers a content-rich experience that houses more than 50,000 product and how-to videos.

### ***Digital Distribution***

HSN has applications for the iPhone, iPad and Android and Windows devices. These applications are highly video-centric, customized experiences that allow users to order merchandise, stream live video from HSN and watch previously-aired content from the network's video library while simultaneously browsing related products. Among other things, these applications also allow customers to create their own personalized channels, select their favorite brands or categories of merchandise and compile videos focused on these preferences. Mobile devices represent our fastest growing sales channel.

### **Cornerstone**

Cornerstone consists of a portfolio of aspirational home and apparel brands, prominent in the direct marketing and retail space, including catalog distribution and related websites. Although there is some overlap in the product offerings, the home brands are comprised of Frontgate, Ballard Designs, Grandin Road and Improvements. The apparel brands are comprised of Garnet Hill, TravelSmith and Chasing Fireflies. There are also 10 retail and outlet stores located throughout the United States.

Frontgate features premium, high quality, luxury bed, bath, kitchen, outdoor, patio, garden and pool furnishings and accessories. Ballard Designs features **European-inspired** bed, bath, dining and office furnishings and accessories, as well as rugs, shelving and architectural accents for the home. Grandin Road offers an affordable style assortment of products ranging from occasional furniture, accessories, holiday décor and outdoor furniture and Improvements features thousands of innovative home, patio and outdoor products.

Garnet Hill offers apparel and accessories for women and children as well as bed and bath furnishings and soft goods. TravelSmith offers travel wear for men and women and related accessories. Chasing Fireflies is a leading children's and family lifestyle brand offering keepsake-quality apparel, gifts and accessories.

The Cornerstone brands generally incorporate on-site photography and real-life settings, coupled with related editorial content describing the merchandise and depicting situations in which it may be used. Branded catalogs are designed and produced in-house, which enables each individual brand to control the production process and reduces the amount of lead time required to produce a given catalog.

New editions of full-color catalogs are mailed to customers several times each year, with a total annual circulation in 2013 of approximately 320 million catalogs. The timing and frequency of catalog circulation varies by brand and depends upon a number of factors, including the timing of the introduction of new products, marketing campaigns and promotions and inventory levels, among other factors.

Cornerstone also operates websites for each of its featured brands, such as Frontgate.com, BallardDesigns.com, Chasing-Fireflies.com, GarnetHill.com, GrandinRoad.com, TravelSmith.com, Improvementscatalog.com and Wish-Works.com. These websites serve as additional storefronts for products featured in related print catalogs, as well as provide customers with additional content and product assortments to support and enhance their shopping experience. Additional content provided by these websites, which differs across the various websites, includes decorating tips, measuring information, online design centers, gift registries and travel centers, as well as a feature that allows customers to browse the related catalog online. In addition, a growing number of customers use mobile devices to shop the Cornerstone brands.

## **Supply**

HSN and Cornerstone purchase products by way of short- and long-term contracts and purchase orders, including products made to their respective specifications, as well as name brand merchandise and lines from third party partners, typically with certain exclusive rights. The terms of these contracts and purchase orders vary depending upon the underlying products, the retail channel in which the products will ultimately be sold and the method of sale. In some cases, these contracts provide for the payment of additional amounts to partners in the form of commissions, the amount of which is based upon the achievement of agreed upon sales targets, among other milestones. In addition, in the case of some purchases, HSNi may have certain return, extended payment and/or termination rights. The mix and source of products generally depends upon a variety of factors, including price and availability, and HSNi manages inventory levels through periodic, ongoing analyses of anticipated and current sales. No single vendor accounted for more than 10% of HSNi's consolidated net sales in 2013, 2012 or 2011.

## **Marketing and Merchandising**

HSNi offers our customers a broad assortment of differentiated products in a compelling, informative and entertaining format that will inspire them to regularly engage and shop with us. For example, HSN frequently collaborates with experts from a variety of fields to present special events on the HSN television network featuring HSN products and relevant expert content. HSN has also begun producing live entertainment as a way to further engage with our customers. These events are staged at HSN's television studios or elsewhere. Certain special events are also featured on HSN.com and HSN2 for a limited period of time following their live broadcast on the HSN television network. HSN also has integrated a gamification strategy into its e-commerce platform to promote customer loyalty and engagement. In addition, HSN.com has over 50,000 video demonstrations of products and how-to videos.

In an effort to promote its own differentiated brand, HSN seeks to provide its customers with unique products that can only be purchased through HSN. HSN frequently partners with leading personalities and brands to develop product lines exclusive to HSN and believes that these affiliations enhance the awareness of the HSN brand among consumers, as well as increase the extent to which HSN and/or products sold through HSN are featured in the media. In some cases, vendors have agreed to market their HSN affiliation to their existing customers (e.g., notifying customers when their products will be featured on the HSN television network).

HSN engages in co-promotional partnerships with major media companies. These are done primarily because they offer us editorial authority while they also secure print advertising in national fashion, style and/or lifestyle publications to market HSN to prospective customers in its target demographics. HSN also engages in search engine marketing and targeted offline advertising. As part of HSN's entertainment strategy, it participates in innovative joint marketing and promotional partnerships with major motion picture companies as well as well-known recording artists. HSN also creates strategic alliances with world-class, consumer brands in an effort to reach new prospects through relevant brand integrations and occasion-based event marketing. These promotions are designed to not only generate additional revenue and create brand awareness, but to also provide unique experiences for our customers in our continued effort to drive customer engagement as well as position HSN as a proven and powerful marketing vehicle.

The Cornerstone brands differentiate themselves by offering customers an assortment of innovative proprietary and branded apparel and home products. In many cases, Cornerstone seeks to secure exclusive distribution rights for certain products. Cornerstone employs in-house designers and partners with leading manufacturers and designers to aid in the development of its unique, exclusive product assortment. The Cornerstone brands use their respective websites and e-mail marketing to promote special offers, including cross-promotions for other Cornerstone brands. In addition, Cornerstone partners with third parties to offer promotional events such as sweepstakes and/or enter into other advertising agreements.

HSNi believes that these affiliations enhance the awareness of the Cornerstone brands among consumers as well as strengthen its various brands overall.

### **Order Entry, Fulfillment and Customer Service**

HSNi provides customers with convenient options in connection with the purchase, payment and shipment of merchandise, some of which may vary by brand, business or product. Merchandise may be purchased online, through mobile devices, or ordered using toll free phone numbers through live sales and service agents. HSN also offers the convenience of an automated attendant system and, in limited markets, remote control ordering capabilities through pay television set-top boxes. Cornerstone's catalog orders can also be made via submission of traditional catalog sales order forms.

In addition to traditional payment options, such as credit and certain debit cards, payment options include private label credit cards, Paypal and, in the case of HSN, Flexpay. By utilizing Flexpay, customers may pay for select merchandise in two to six interest-free, monthly credit or debit card payments. HSN also offers its customers the convenience of ordering products under its Autoship program, through which customers may arrange to have products automatically shipped and billed at scheduled intervals. Standard and express shipping options are available and customers may generally return most merchandise for a full refund or exchange in accordance with applicable return policies (which vary by brand and business). Returns generally must be received within specified time periods after purchase, ranging from a minimum of thirty days to a maximum of one year, depending upon the applicable policy.

HSNi seeks to fulfill customer orders and process returns quickly and accurately from a network of fulfillment centers. For HSN, these centers are located in Tennessee, California, Virginia and New York, and for Cornerstone, the fulfillment centers are located in Ohio, Arizona and Washington. HSNi contracts with several third party carriers and other fulfillment partners to ensure the reliable and timely delivery of products to its customers and processing of returns.

Through HSN.com and the various websites operated by Cornerstone or through HSNi's common carriers, customers can also generally track the status of their orders, confirm information regarding shipping and, in some cases, confirm the availability of inventory and establish and manage personal accounts. Customers may communicate directly with customer service via e-mail or by telephone with call center representatives available seven days a week.

### **Government Regulation**

We market and offer a broad range of merchandise through television, online, catalogs and other channels. The manner in which we promote and sell merchandise, including claims and representations made in connection with these efforts, is regulated by a wide variety of federal, state and local laws, regulations, rules, policies and procedures. Some examples of these that affect the manner in which we sell and promote merchandise or otherwise operate our businesses include, but are not limited to, the following:

- The Federal Trade Commission's regulations related to the sale of products and/or commercial contacts with our customers or potential customers, such as the Telemarketing Sales Rule and Do Not Call;
- The Food and Drug Administration's regulations regarding marketing claims that can be made about cosmetic beauty products and over-the-counter drugs, which include products for treating acne or medical products, and claims that can be made about food products;
- Regulations related to product safety issues and product recalls including, but not limited to, the Consumer Product Safety Act, the Consumer Product Safety Improvement Act of 2008, the Federal Hazardous Substance Act, the Flammable Fabrics Act and regulations promulgated pursuant to these acts; and
- Various state laws, regulations and interpretations regarding the obligations of retailers with respect to the collection of sales tax on internet sales.

These laws, regulations, rules, policies and procedures are subject to change at any time. Unfavorable changes applicable to us could decrease demand for merchandise offered by us, increase costs which we may not be able to offset, subject us to additional liabilities and/or otherwise adversely affect our businesses.

Since October 1996, HSN has been subject to a consent order issued by the Federal Trade Commission, or FTC, which terminates on the later of April 15, 2019, or 20 years from the most recent date that the United States or the FTC files a complaint in federal court alleging any violation thereunder. Pursuant to this consent order, we are prohibited from making claims for specified categories of products, including claims that a given product can cure, treat or prevent any disease or have an effect on the structure or function of the human body, unless we have competent and reliable scientific evidence to substantiate such claims. Violation of this consent order may result in the imposition of significant civil penalties for non-compliance and related redress to consumers and/or the issuance of an injunction enjoining us from engaging in prohibited



activities. The FTC may periodically investigate our business and operations on an ongoing basis for purposes of determining our compliance with the consent order.

Online sales must comply with a variety of federal and state laws dealing with, amongst other things, privacy, intellectual property, taxation, the provision of online payment services and electronic contracts. While U.S. Supreme Court decisions generally restrict the imposition of obligations to collect state and local sales and use taxes with respect to sales from out-of-state retailers, an increasing number of states have adopted or are considering laws that would impose obligations on out-of-state retailers to collect taxes on their behalf. Congress is also considering legislation allowing states to require out-of-state sellers to collect sales and use taxes. An unfavorable change in U.S. Supreme Court guidance related to sales tax or a successful assertion by one or more states may result in material tax liabilities, interest and penalties. A change in state law or federal laws, our business model, business strategy or marketing initiatives may require us to collect sales tax in states for which we do not currently collect such tax. These developments, should they occur, may result in a decrease in future sales, may limit our ability to compete effectively or may otherwise harm our business.

While we believe that the practices of our businesses have been structured in a manner to ensure compliance with these laws and regulations; federal, state or local regulatory authorities may take a contrary position. Our failure to comply with these laws and regulations could result in proceedings against us, tax assessments, fines and penalties and/or a diminution of our reputation, each of which could adversely affect our financial condition, results of operations and businesses.

### **Intellectual Property**

We regard our intellectual property rights, including patents, service marks, trademarks, domain names, copyrights and trade secrets, as important to our success. Our businesses also rely heavily upon software, informational databases and other systemic components that are necessary to manage and support our operations. We rely on a combination of laws and contractual restrictions with employees, customers, suppliers, licensees, affiliates and other third parties to establish and protect these proprietary rights. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use trade secrets or copyrighted intellectual property without authorization which, if discovered, might require legal action to correct. In addition, third parties may independently and lawfully develop substantially similar intellectual properties.

We have generally registered and continue to apply to register, or secure by contract when appropriate, our trademarks and service marks as they are developed and used, and reserve and register domain names as we deem appropriate. We consider the protection of our trademarks to be important for purposes of brand maintenance and reputation. While we vigorously protect our trademarks, service marks and domain names, effective trademark protection may not be available or may not be sought in every country in which products and services are made available, and contractual disputes may affect the use of marks governed by private contract. Similarly, not every variation of a domain name may be available or be registered, even if available. Our failure to protect our intellectual property rights in a meaningful manner or challenges to related contractual rights could result in dilution of brand names and/or limit our ability to control marketing on or through the internet using our various domain names either of which could adversely affect our business, financial condition and results of operations.

Some of our businesses have been granted patents and/or have patent applications pending with the United States Patent and Trademark Office and/or foreign patent authorities for various proprietary technologies and other inventions. We consider applying for patents or for other appropriate statutory protection when we develop or identify new or improved proprietary technologies or inventions, and will continue to consider the appropriateness of filing for patents to protect future proprietary technologies and inventions as circumstances may warrant. The issuance or assessment of the validity of any patent involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, any patent application filed may not result in a patent being issued or existing or future patents may not be adjudicated valid by a court or be afforded adequate protection against competitors with similar technology. In addition, third parties may create new products or methods that achieve similar results without infringing upon patents that we own. Likewise, the issuance of a patent to us does not mean that our processes or inventions will not be found to infringe upon patents or other rights previously issued to third parties.

From time to time, we are subject to legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of the trademarks, copyrights, patents and other intellectual property rights of third parties. In addition, litigation may be necessary in the future to enforce our intellectual property rights, protect trade secrets or determine the validity and scope of proprietary rights claimed by others. Any litigation of this nature, regardless of outcome or merit, could result in substantial costs and diversion of management and technical resources, any of which could adversely affect our business, financial condition and results of operations. Patent litigation tends to be particularly protracted and expensive.

## **Competition**

HSNi brands and businesses operate in a highly competitive environment. These brands and businesses are in direct competition for consumers with traditional and online retailers (both television and internet retailers), ranging from large department stores to specialty shops, electronic retailers, direct marketing retailers, mail order and catalog companies, infomercial retailers, wholesale clubs and discount retailers. In addition, the HSN television networks compete for access to customers and audience share with other conventional forms of entertainment and content. The price and availability of programming for pay television systems affect the availability of distribution for HSN television programming. Principal competitive factors for HSNi brands and businesses include: (i) brand recognition, (ii) value, quality and selection of merchandise, (iii) customer experience, including customer service and reliability of fulfillment and delivery services and (iv) convenience and accessibility of sales channels.

## **Employees**

As of January 24, 2014, HSNi employed approximately 6,800 employees. No HSNi employees are represented by unions or other similar organizations and HSNi considers its relations with its employees to be good.

## **Available Information**

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and amendments to reports filed or furnished pursuant to Sections 13(a), 14 and 15(d) of the Securities Exchange Act of 1934, as amended. The public may read and copy these materials at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements and other information regarding HSN, Inc. and other companies that file materials with the SEC electronically.

Our website is located at <http://www.hsni.com>. We make available free of charge, on or through the website, our annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the SEC.

Information relating to corporate governance, including our Code of Business Conduct and Ethics and our Corporate Governance Guidelines, is also available on our website at <http://www.hsni.com/governance.cfm>. The code of conduct complies with Item 406 of SEC Regulation S-K and the rules of the NASDAQ Global Select Market. Any changes to the code of conduct that affect the provisions required by Item 406 of Regulation S-K, and any waivers of the code of conduct for our executive officers, directors or senior financial officers, will also be disclosed on our website.

The content of our website is not a part of this Annual Report or any other report filed with the SEC.

## ITEM 1A. RISK FACTORS

The risks and uncertainties described below are not the only risks that may have a material adverse effect on HSNi. There exist additional risks and uncertainties that could adversely affect our business and our results. If any of the following risks actually occur, our business, financial condition or results of operations could be negatively affected, and the market price for our shares could decline. Further, to the extent that any of the information contained in this Annual Report on Form 10-K constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important factors that could cause the actual results of HSNi to differ materially from those expressed in any forward-looking statements made by or on behalf of HSNi.

### Risks Related to Our Business

***Our long-term success depends, in large part, on our continued ability to attract new and retain existing customers in a cost-effective manner.***

In an effort to attract and retain customers, we engage in various marketing and merchandising initiatives, which involve the expenditure of considerable funds and resources, particularly in the case of the production and distribution of HSN television programming, Cornerstone catalogs and continuously updating our digital strategy. We have spent, and expect to continue to spend, increasing amounts of money on, and devote greater resources to, certain of these initiatives, particularly in connection with the growth and maintenance of our brands generally, as well as in the continuing efforts of our businesses to increasingly engage customers through digital channels. These initiatives, however, may not resonate with existing customers or consumers generally or may not be cost-effective. In addition, we believe that costs associated with the production and distribution of HSN television programming, paper and printing costs for Cornerstone catalogs and costs associated with digital marketing, including search engine marketing (primarily the purchase of relevant keywords) are likely to increase in the foreseeable future and, if significant, could have an adverse effect on our business, financial condition and results of operations to the extent that they do not result in corresponding increases in sales.

***The retail business environment is subject to intense competition, and we may not be able to effectively compete for customers.***

We operate in a rapidly evolving and highly competitive retail business environment. We have numerous and varied competitors at the national and local levels, ranging from large department stores to specialty shops, electronic retailers, direct marketing retailers, wholesale clubs, discount retailers, other televised shopping retailers such as QVC and ShopHQ, infomercial retailers, internet retailers, and mail-order and catalog companies. Many of our current and potential competitors have greater resources, longer histories, more customers and greater brand recognition than we do. They may secure better terms from vendors, adopt more aggressive pricing, offer free or subsidized shipping and devote more resources to technology, fulfillment and marketing. Other companies also may enter into business combinations or alliances that strengthen their competitive positions.

We also compete for access to customers and audience share with other providers of televised, online and hard copy entertainment and content. Our inability to compete effectively with regard to the assortment, price, shipping terms and quality of the merchandise we offer for sale or to keep pace with competitors in our marketing, service, location, reputation, credit availability and technologies, could have a material adverse effect.

***We depend on relationships with pay television operators and adverse changes in these relationships could result in an interruption, material decrease or even the cessation of carriage of the HSN television networks.***

We are dependent upon the pay television operators with whom we enter into distribution and affiliation agreements to carry the HSN television networks. We currently have contracts with many local and national pay television operators to distribute HSN television programming. Some of HSN's larger pay television operators include Comcast, DirecTV, EchoStar/DISH and Time Warner Cable. The two largest pay television operators represent 43% of our subscribers. The cessation of carriage of the HSN television networks by a major pay television operator or a significant number of smaller pay television operators for a prolonged period of time could adversely affect our business, financial condition and results of operations. While we believe that we will be able to continue to successfully manage the distribution process in the future, certain changes in distribution levels, as well as increases in fees payable for carriage, could occur notwithstanding these efforts.

We typically seek to enter into long-term distribution and affiliation agreements with these major pay television operators; however, in some cases, renewals are not agreed upon prior to the expiration of a given agreement and the HSN television networks continue to be carried by the relevant pay television operator without an effective agreement in place. We currently provide service to approximately 50% of our total subscribers pursuant to month-to-month contracts or contracts that

have expired. In addition, another 16% of our subscribers are represented by contracts that expire within one year. Renewal and negotiation processes with pay television operators are typically lengthy. No assurance can be given that we will be successful in negotiating renewals with all these operators or that the financial and other terms of renewal will be on acceptable terms. The failure to successfully renew or negotiate new distribution and affiliation agreements covering a material portion of the existing cable and satellite households on acceptable terms could adversely affect our growth, sales revenue and earnings.

***Our revenues and profit margin are negatively influenced by economic conditions that impact consumer spending. If macroeconomic conditions do not continue to improve or if conditions worsen, our business could be adversely affected.***

Retailers generally are particularly sensitive to adverse economic and business conditions, in particular to the extent they result in a loss of consumer confidence, rising unemployment, increased taxes and decreases in consumer spending, particularly discretionary spending. Our customers anticipate and respond to adverse changes in economic conditions. If macroeconomic conditions do not continue to improve or if conditions worsen, our business could be adversely affected.

***The failure to attract and retain television viewers and secure a suitable programming tier of carriage and channel placement for the HSN television network programming could result in a decrease in revenue.***

We are dependent, in part, upon the continued ability of HSN to compete effectively for television viewers. Effectively competing for television viewers is dependent, in substantial part, on the ability of HSN to secure placement of the HSN television networks within a suitable programming tier and to effectively compete against others for the leisure and entertainment time of consumers. The advent of digital compression technologies and the adoption of digital cable has resulted in increased channel capacity. In addition, there are now more programming options available to the viewing public in the form of new television networks and time-shifted viewing (e.g., personal video recorders, video-on-demand, interactive television and streaming video over broadband internet connections as well as increased access to various media through wireless devices). These have the potential to reduce the viewing of our content. New technologies have been and will continue to be developed that increase the number of entertainment choices available and the manners in which they are delivered. Our failure to effectively anticipate or adapt to emerging technologies or changes in consumer behavior could have an adverse impact on our competitive position, business and results of operations.

***A prolonged or permanent inability to broadcast the HSN television networks would result in lost customers and lost sales.***

Our success is dependent upon the continued ability of HSN to transmit the HSN television networks to broadcast and pay television operators from its satellite uplink facilities, which transmission is subject to the Federal Communications Commission ("FCC") compliance. HSN has entered into two satellite transponder leases to provide for continued carriage of the HSN television networks on a replacement transponder and/or replacement satellite, as applicable, in the event of a failure of the transponder and/or satellite. Although we believe that every reasonable measure is being taken to ensure continued satellite transmission capability, termination or interruption of satellite transmissions may occur. Any such disruption could have a material adverse effect on our competitive position, business and results of operations.

***System interruption and the lack of integration and redundancy in our systems and infrastructures may adversely affect our ability to operate websites, process and fulfill transactions, respond to customer inquiries and generally maintain cost-efficient operations.***

We use the internet, mobile devices, social networking and other online activities to connect with our customers. Our success depends, in part, on our ability to maintain the integrity of our systems and infrastructures, including websites, information and related systems, call centers and fulfillment facilities. We may experience occasional system interruptions, including those caused by system conversions, that make some or all systems or data unavailable or prevent our businesses from efficiently providing services or fulfilling orders. We also rely on affiliate and third-party computer systems, broadband and other communications systems and service providers in connection with the provision of services generally, as well as to facilitate, process and fulfill transactions. Any interruptions, outages or delays in our systems and infrastructures, our businesses, our affiliates and/or third parties, or deterioration in the performance of these systems and infrastructures, could impair our ability to provide services, fulfill orders and/or process transactions. Fire, flood, power loss, telecommunications failure, hurricanes, tornadoes, earthquakes, acts of war or terrorism, acts of God and similar events or disruptions may damage or interrupt computer, broadband or other communications systems and infrastructures at any time. In addition, we have observed an increase in the number of cyber attacks that include gaining access to digital systems for purposes of corrupting data or causing operational disruption. Any of these events could cause system interruption, delays and loss of critical data, and could prevent us from providing services, fulfilling orders and/or processing transactions which could have an adverse impact on our competitive position, business and results of operations. While we have backup systems for certain aspects of our operations, these systems are not fully redundant and disaster recovery planning is not sufficient for all eventualities. In addition, we may not have adequate insurance coverage to compensate for losses from a major interruption.

***The processing, storage, use and disclosure of personal data could give rise to liabilities as a result of governmental regulation, conflicting legal requirements or differing views of personal privacy rights.***

In the processing of consumer transactions, we receive, transmit and store a large volume of personally identifiable information and other user data. The sharing, use, disclosure and protection of this information are governed by the privacy and data security policies maintained by us. Moreover, there are federal, state and international laws regarding privacy and the storing, sharing, use, disclosure and protection of personally identifiable information and user data. Specifically, personally identifiable information is increasingly subject to legislation and regulations in numerous jurisdictions around the world, the intent of which is to protect the privacy of personal information that is collected, processed and transmitted in or from the governing jurisdiction. We could be adversely affected if legislation or regulations are expanded to require changes in business practices or privacy policies, or if governing jurisdictions interpret or implement their legislation or regulations in ways that negatively affect our business, financial condition and results of operations.

***We are subject to online and other cyber security risks and cyber incidents, including security and data breaches and identity theft.***

To succeed, we must be able to provide for secure transmission of confidential information over public networks. We have observed an increased number of cyber attacks that include attempts to gain unauthorized access to digital systems for purposes of misappropriating assets or sensitive information. Our failure, and/or the failure by the various third party vendors and service providers with which we do business, to comply with applicable privacy policies or federal, state or similar international laws and regulations or any compromise of security that results in the unauthorized release of personally identifiable information or other user data could damage the reputation of our businesses, discourage potential users from trying our products and services and/or result in fines and/or proceedings by governmental agencies and/or consumers, one or all of which could adversely affect our business, financial condition and results of operations. Any penetration of network security or other misappropriation or misuse of personal consumer information could cause interruptions in the operations of our businesses and subject us to increased costs, litigation and other liabilities. Security and data breaches could also significantly damage our reputation with consumers and third parties with whom we do business. We may be required to expend significant capital and other resources to protect against and remedy any potential or existing security and data breaches and their consequences. We also face risks associated with security and data breaches affecting third parties with which we are affiliated or otherwise conduct business online.

***We could be subject to additional sales tax liability, including liability for past sales.***

U.S. Supreme Court decisions restrict the imposition of obligations to collect state and local sales taxes with respect to sales from out-of-state retailers. As a result, approximately 39% of our revenue is not currently subject to sales tax or its equivalent. However, an increasing number of states have adopted or are considering laws that attempt to impose obligations on out-of-state retailers to collect taxes on their behalf. Congress is also considering legislation allowing states to require out-of-state sellers to collect sales and use taxes. It is not possible to predict with any degree of certainty the outcome of these initiatives or the impact of these initiatives on our business and marketing strategies that we are considering or may consider in the future.

An unfavorable change in U.S. Supreme Court guidance related to sales tax, or a successful assertion by one or more states may result in material tax liabilities, interest and penalties. A change in state or federal laws, or our business model, business strategy, or marketing initiatives may require us to collect sales tax on transactions in which we do not currently collect such tax. These developments, should they occur, may result in a decrease in future sales, may decrease our ability to compete, or otherwise harm our business.

***Increased delivery costs, particularly if we are unable to offset them by increasing prices without a detrimental effect on customer demand, and the extent to which we offer shipping promotions to our customers, could adversely impact our profits.***

We are impacted by increases in shipping rates charged by various shipping vendors relating to the procurement of merchandise from vendors and manufacturers, the shipment of merchandise to customers and the mailing of catalogs, which over the past few years have experienced volatility in comparison to historical levels. Variations in the mix and quantity of products we sell impact the cost to ship our products as do the shipping promotions we frequently offer to drive revenues. We currently expect that shipping and postal rates will continue to increase as well as the trend towards free shipping in the direct-to-consumer marketplace. In the case of deliveries to customers, we have negotiated favorable shipping rates, which increase at agreed upon levels over time, with one independent, third party shipping company pursuant to a long-term contract. If this relationship were to terminate or if the shipping company was unable to fulfill its obligations under the contract for any reason, particularly during peak shipping seasons, we would have to work with other shipping companies to deliver merchandise to customers, which could be at less favorable rates and could cause a disruption in our business. A significant increase in shipping promotions as well as any increase in shipping rates and related fuel and other surcharges passed on to us by our shipping company may adversely impact profits given that we may not be able to pass these increased costs directly to customers or offset them by increasing prices without a detrimental effect on customer demand.

***We depend on relationships with vendors, manufacturers and other third parties; any adverse changes in these relationships could result in a failure to meet customer expectations which could result in lost sales.***

We purchase merchandise from a wide variety of third party vendors, manufacturers and other sources pursuant to short- and long-term contracts and purchase orders. Our ability to identify and establish relationships with these parties, as well as access quality merchandise in a timely and efficient manner on acceptable terms and at acceptable costs, can be challenging. In particular, we purchase a significant amount of merchandise from vendors and manufacturers abroad and have experienced (and expect to continue to experience) increased costs for goods sourced in these markets. We depend on the ability of vendors and manufacturers in the U.S. and abroad to produce and deliver goods that meet applicable quality standards, which is impacted by a number of factors not within the control of these parties, such as political or financial instability, trade restrictions, tariffs, currency exchange rates and transport capacity and costs, among others. In particular, Cornerstone is dependent, in significant part, upon independent, third party manufacturers to produce its private label merchandise.

Our failure to identify new vendors and manufacturers, maintain relationships with a significant number of existing vendors and manufacturers and/or access quality merchandise in a timely and efficient manner could cause us to miss customer delivery dates or delay scheduled promotions, which would result in the failure to meet customer expectations and could cause customers to cancel orders or cause us to be unable to source merchandise in sufficient quantities, which could result in lost sales.

***The unanticipated loss of certain larger vendors could negatively impact our sales and profitability on a short term basis.***

It is possible that one or more of our larger vendors could experience financial difficulties, including bankruptcy, or otherwise could elect to cease doing business with us. While we have periodically experienced the loss of a major vendor, if a major vendor or a number of our current larger vendors ceased doing business with us, this could materially and adversely impact our sales and profitability.

***We may not be able to accurately predict and/or respond in a timely manner to evolving customer preferences and trends and industry standards, which could result in excess inventory, related markdowns and lost sales.***

Our success depends, in significant part, on our ability to accurately predict, and respond in a timely manner to, changes in customer preferences and fashion, lifestyle and other trends and industry standards. While product mix and price points are continuously monitored and adjusted in an attempt to satisfy consumer demand and respond to changing economic and business conditions, we may not be successful in these efforts, and any sustained failure could result in excess inventory and related markdowns.

In addition, e-commerce is characterized by evolving industry standards, frequent new service and product introductions and enhancements, as well as changing customer demands and increase privacy and data security needs. If we are not able to adapt quickly enough and/or in a cost-effective manner to these changes it could result in lost sales which would negatively impact our results of operations.

***We are currently the subject of a consent order issued by the FTC and violation of this consent order could result in significant civil penalties and/or an injunction enjoining HSN from engaging in prohibited activities, among other penalties or remedies.***

In October 1996, HSN became subject to a consent order issued by the FTC which terminates on the later of April 15, 2019, or 20 years from the most recent date that the United States or the FTC files a complaint in federal court alleging any violation thereunder. Pursuant to this consent order, HSNi (including its subsidiaries and affiliates) is prohibited from making claims for specified categories of products, including claims that a given product can cure, treat or prevent any disease or have an effect on the structure or function of the human body, unless it has competent and reliable scientific evidence to substantiate such claims. Violation of this consent order may result in the imposition of significant civil penalties for non-compliance and related redress to consumers and/or the issuance of an injunction enjoining us from engaging in prohibited activities. The FTC periodically investigates our business and operations on an ongoing basis for purposes of determining its compliance with the consent order.

***We may be subject to claims for representations made in connection with the sale and promotion of merchandise or for harm experienced by customers who purchase merchandise from us.***

The manner in which we sell and promote merchandise and related claims and representations made in connection with these efforts is regulated by federal, state and local law. We may be exposed to potential liability from claims by consumers or from federal, state and local regulators and law enforcement agencies, including, but not limited to, for personal injury, product safety, wrongful death and damage to personal property relating to merchandise sold and misrepresentation of merchandise features and benefits. In certain instances, we have the right to seek indemnification for related liabilities from our vendors and may require such vendors to carry minimum levels of product liability and errors and omissions insurance. These vendors, however, may be unable to obtain suitable coverage or maintain this coverage on acceptable terms; this insurance may provide inadequate coverage against all potential claims or may not even be available with respect to a particular claim. If insurance is insufficient or unavailable, our vendor may have insufficient resources to cover their indemnification obligations, or if our vendor ceases to do business, our results of operations would be negatively impacted. Even if vendors can satisfy their financial obligations, our brand and reputation could be negatively impacted.

***Failure to effectively manage our Flexpay program could result in unplanned losses.***

HSN offers Flexpay, a program which customers may pay for certain merchandise in two to six interest-free, monthly credit or debit card installments. This is an effective tool for driving sales, primarily for higher-priced items. We maintain allowances for estimated losses resulting from the inability of customers to make required payments. While actual losses due to the inability of customers to make required payments have historically been within estimates, they may increase in a given period or exceed related estimates. As Flexpay usage continues to grow, we may experience these losses at greater rates, which will require us to maintain greater allowances for doubtful accounts of estimated losses than we have historically. To the extent that Flexpay losses exceed historical levels, our results of operations may be negatively impacted.

***We may fail to protect our intellectual property rights within the full scope and manner available to us under applicable law or statute or may be accused of infringing upon the intellectual property rights of third parties.***

We regard our intellectual property rights, including patents, service marks, trademarks and domain names, copyrights and trade secrets, as critical to our success. We rely heavily upon software, databases and other systemic components that are necessary to manage and support our business operations.

We are subject to legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of the trademarks, copyrights, patents and other intellectual property rights of third parties. In addition, litigation may be necessary in the future to enforce our intellectual property rights, protect trade secrets or to determine the validity and scope of proprietary rights claimed by others. Any litigation of this nature, regardless of outcome or merit, could result in substantial costs and diversion of management and technical resources, any of which could adversely affect our business, financial condition and results of operations. Patent litigation tends to be particularly protracted and expensive. Our failure to protect our intellectual property rights in a meaningful manner or challenges to related contractual rights could result in erosion of brand names and limit our ability to control marketing on or through the internet using our various domain names or otherwise, which could adversely affect our business, financial condition and results of operations.

***Failure to comply with existing laws, rules and regulations, or to obtain and maintain required licenses and rights could subject us to additional liabilities.***

We market and provide a broad range of merchandise through television, digital, catalogs and other channels. As a result, we are subject to a wide variety of statutes, rules, regulations, policies and procedures in various jurisdictions which are subject to change at any time, including laws regarding product safety, consumer protection, privacy, the regulation of retailers generally, the importation, sale and promotion of merchandise and the operation of retail stores and warehouse facilities, as well as laws and regulations applicable to the internet and businesses engaged in digital commerce, such as those regulating the sending of unsolicited, commercial electronic mail. Our failure to comply with these laws and regulations could result in fines and/or proceedings against us by governmental agencies and/or consumers, which could adversely affect our business, financial condition and results of operations. Moreover, unfavorable changes in the laws, rules and regulations applicable to us could decrease demand for merchandise offered by us, negatively impact our marketing efforts, increase costs, subject us to additional liabilities and/or otherwise adversely affect our businesses.

***Restrictive covenants in our debt instruments could limit our flexibility to respond to current market conditions or otherwise restrict our business activities.***

The existence of, and limitations on the availability of, our debt could have important consequences. The existence of debt could, among other things:

- require a substantial portion of our cash flow from operations to be dedicated to the payment of principal and interest on our indebtedness;
- limit our ability to use cash flow or obtain additional financing for future working capital, capital expenditures or other general corporate purposes;
- increase our vulnerability to general economic and industry conditions; or
- expose us to the risk of increased interest rates for that portion of our borrowings under our credit facilities that are at variable interest rates.

Our credit facility includes restrictive financial and non-financial covenants. Limitations imposed as a part of the debt, such as the availability of credit and the existence of restrictive covenants may, among other things, make it difficult for us to satisfy our financial obligations; and/or limit our ability to respond to business opportunities.

***There are risks associated with our acquisitions.***

Mergers and acquisitions entail a number of risks including, among other things, higher than anticipated acquisition costs and expenses, the difficulty and expense of integrating the operations and personnel of the companies and the loss of key employees and customers as a result of changes in management. We may not be successful in overcoming these risks or any other problems encountered in connection with any acquisition.

Acquisition valuations require us to make certain estimates and assumptions to determine the fair value of the acquired entities (including the underlying assets and liabilities). If our estimates or assumptions used to value acquired assets and liabilities are not accurate, we may be exposed to losses that may be material.

## **Risks Related to Our Common Stock**

***The shareholders' rights plan adopted by the Board of Directors in December 2008 may inhibit takeovers that would otherwise be beneficial to shareholders.***

In the fourth quarter of 2008, our Board of Directors approved the creation of a Series A Junior Participating Preferred Stock, adopted a shareholders' rights plan and declared a dividend of one right for each outstanding share of common stock held by our shareholders. Initially, these rights, which trade with the shares of our common stock, are not exercisable. Under the rights plan, these rights will be exercisable if a person or group acquires or commences a tender or exchange offer for 15% or more of our common stock (except for certain grandfathered persons to which higher thresholds apply). If the rights become exercisable, each right will permit the holder, other than the "acquiring person," to purchase from us shares of common stock at a 50% discount to the then prevailing market price. As a result, the rights will cause substantial dilution to a person or group that becomes an "acquiring person" on terms not approved by our Board of Directors. The existence of these rights may prevent, discourage or delay us from being acquired, even if such acquisition would be beneficial to our shareholders.



*The market price and trading volume of our common stock may be volatile and may face negative pressure.*

Our stock price has experienced, and could continue to experience in the future, substantial volatility as a result of many factors, including persistent adverse macroeconomic conditions, broad market fluctuations and public perception of the prospects for the retail industry. Our failure to meet market expectations would also likely result in a decline in the market price of our stock. These and other factors may result in short-term or long-term negative pressure on the value of our common stock.

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

#### **ITEM 2. PROPERTIES**

HSNi owns its corporate headquarters in St. Petersburg, Florida, which consist of approximately 600,000 square feet of office space and include executive offices, television studios, showrooms, broadcast facilities and administrative offices for HSN. HSN leases the HSN fulfillment centers in Piney Flats, Tennessee; Fontana, California; Roanoke, Virginia; and Ronkonkoma, New York; as well as four outlet stores and other properties in various locations in the United States for administrative offices and data centers pursuant to leases that expire in 2014 through 2023. Cornerstone owns an office and storage facility in Franconia, New Hampshire. Otherwise, Cornerstone leases its properties, consisting of administrative offices, retail outlets, fulfillment centers and photo centers in West Chester, Ohio; Phoenix, Arizona; and Tukwila, Washington. Cornerstone also has 10 retail stores and outlets and other administrative offices in various locations throughout the United States, all pursuant to leases with expiration dates ranging from 2014 to 2020.

HSNi believes that the duration of each lease is adequate and does not anticipate any future problems renewing or obtaining suitable leases for its principal properties. HSNi believes that its principal properties, whether owned or leased, are currently adequate for the purposes for which they are used and are suitably maintained for these purposes. From time to time, HSNi considers various alternatives related to its long term facilities needs. While HSNi management believes existing facilities are adequate to meet its short term needs, it may become necessary to lease or acquire additional or alternative space to accommodate future growth.

#### **ITEM 3. LEGAL PROCEEDINGS**

In the ordinary course of business, we are involved in various legal matters arising out of our operations. These matters may relate to claims involving property, personal injury, contract, intellectual property (including patent infringement), sales tax, regulatory compliance and other claims. As of the date of this filing, we are not a party to any legal proceedings that are reasonably expected to have a material adverse effect on our business, results of operations, financial condition or cash flows; however, litigation matters are subject to inherent uncertainties and the results of these matters cannot be predicted with certainty. An unfavorable resolution of one or more of these matters could have a material adverse effect on our business, results of operations, financial condition or cash flows. Moreover, any claims or regulatory actions against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources.

See Note 13 – Commitments and Contingencies in Part II, Item 8 for additional information regarding legal matters in which we are involved.

#### **ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### Market and Dividend Information

Our common stock trades on the NASDAQ Global Select Market under the symbol HSNi. The table below sets forth the high and low per share sales prices of our common stock, as reported by the NASDAQ Global Select Market, and the dividends declared for the periods indicated.

	Sales Price		Dividends
	High	Low	
<b>Fiscal 2013</b>			
Fourth Quarter.....	\$ 63.54	\$ 50.03	\$ 0.25
Third Quarter .....	\$ 65.00	\$ 52.79	\$ 0.18
Second Quarter.....	\$ 58.56	\$ 50.76	\$ 0.18
First Quarter .....	\$ 60.87	\$ 49.14	\$ 0.18
<b>Fiscal 2012</b>			
Fourth Quarter.....	\$ 55.97	\$ 47.47	\$ 0.18
Third Quarter .....	\$ 49.71	\$ 39.67	\$ 0.125
Second Quarter.....	\$ 41.73	\$ 35.74	\$ 0.125
First Quarter .....	\$ 38.79	\$ 34.74	\$ 0.125

During the fourth quarters of 2013 and 2012, our Board of Directors approved increases in our quarterly cash dividend of 39% and 44%, respectively. In February 2014, our Board of Directors approved a quarterly cash dividend of \$0.25 per share payable March 19, 2014 to shareholders of record as of March 5, 2014. We currently expect to continue to declare and pay quarterly dividends of an amount similar to our past declaration. However, any determination to pay cash dividends will be at the discretion of our Board of Directors and will depend upon our operating results, financial condition and capital requirements, general business conditions and such other factors that the Board of Directors considers relevant. Our credit agreement limits the amount of and our ability to pay cash dividends.

#### Holdings

As of January 28, 2014, there were 1,612 shareholders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of shareholders, we are not able to estimate the total number of beneficial shareholders represented by these record holders.

#### Issuer Purchases of Equity Security

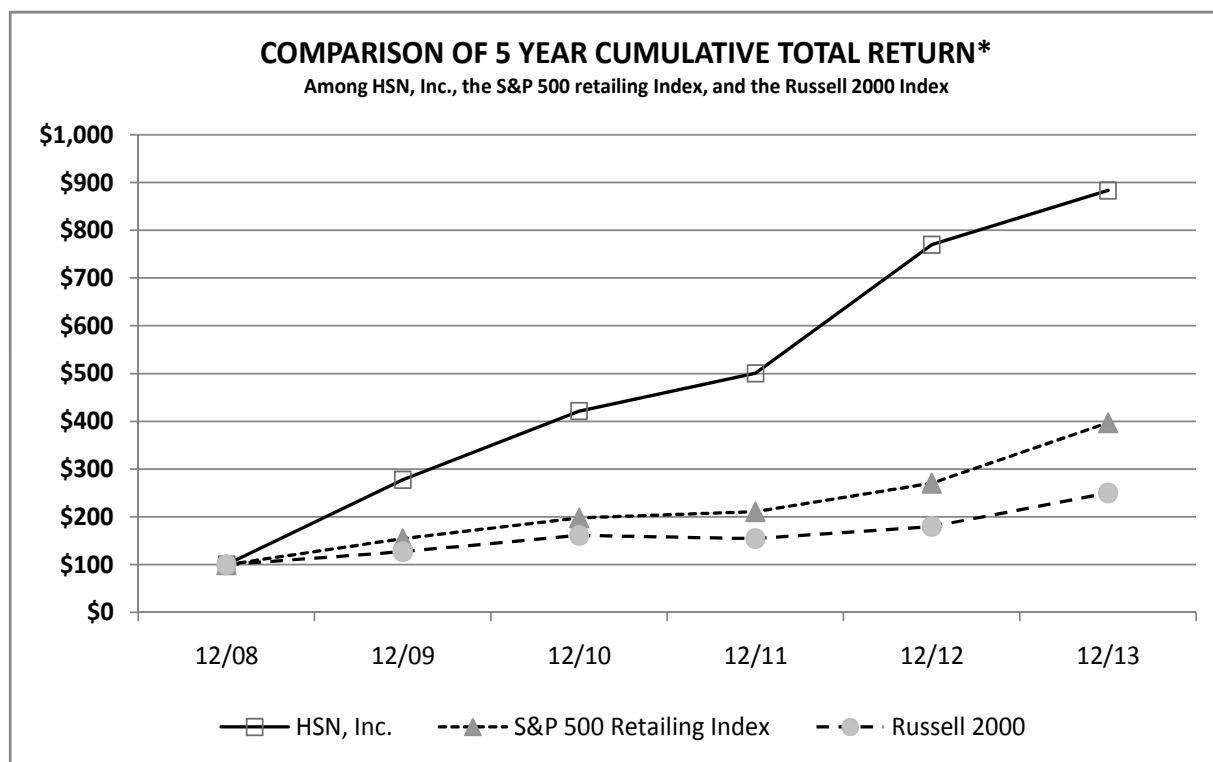
On September 27, 2011, our Board of Directors authorized us to repurchase up to 10 million shares of our common stock. Under the terms of the share repurchase program, HSNi will repurchase its common stock from time to time through privately negotiated or open market transactions, including pursuant to a trading plan in accordance with Rule 10b5-1 and Rule 10b-18 under the Securities Exchange Act of 1934, as amended, or by any combination of such methods. The timing of any repurchases and actual number of shares repurchased will depend on a variety of factors, including the stock price, corporate and regulatory requirements, restrictions under the company's debt obligations and other market and economic conditions. The repurchase program may be suspended or discontinued by HSNi at any time.

During the quarter ended December 31, 2013, we repurchased approximately 0.2 million shares at an average price of \$51.99 per share. Below is a summary of our common stock repurchases during the fourth quarter of 2013, as well as the number of shares still available for purchase as of December 31, 2013:

<u>Period</u>	<u>Number of Shares Purchased</u>	<u>Average Price Paid Per Share</u>	<u>Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number of Shares that May Yet Be Purchased under the Plans or Programs</u>
October 1, 2013 - October 31, 2013 .....	168,313	\$ 51.96	168,313	1,032,446
November 1, 2013 - November 30, 2013 .....	21,500	\$ 52.29	21,500	1,010,946
December 1, 2013 - December 31, 2013 .....	—	\$ —	—	1,010,946
	<u>189,813</u>		<u>189,813</u>	

### Performance Graph

The graph depicted below compares the five-year performance of our common stock with the cumulative total return on the S&P 500 Retailing Index and the Russell 2000 Index from December 31, 2008 through December 31, 2013.



\*Assumes \$100 invested on 12/31/08, including reinvestment of dividends.

	<u>12/31/2008</u>	<u>12/31/2009</u>	<u>12/31/2010</u>	<u>12/31/2011</u>	<u>12/31/2012</u>	<u>12/31/2013</u>
HSN, Inc. ....	100.00	277.72	421.60	500.51	770.13	883.59
S&P 500 Retailing Index .....	100.00	154.37	197.92	211.12	270.86	397.30
Russell 2000 Index .....	100.00	127.17	161.32	154.59	179.86	249.69

## ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected consolidated financial data for HSNi. The information in this table is not necessarily indicative of future performance and should be read in conjunction with “Management's Discussion and Analysis of Financial Condition and Results of Operations,” and our audited consolidated financial statements and related notes included herein.

For information about the shares used in computing earnings per share, see Note 10 of Notes to Consolidated Financial Statements.

	Year Ended December 31,				
	2013	2012	2011	2010	2009
	(In thousands, except per share data)				
<b>Statement of Operations Data:</b>					
Net sales . . . . .	\$ 3,403,983	\$ 3,266,739	\$ 3,069,356	\$ 2,884,308	\$ 2,635,959
Operating income . . . . .	282,654	258,744	239,042	198,803	163,540
Income from continuing operations . . . . .	178,449	136,497	127,652	100,441	77,309
Net income (1) . . . . .	178,449	130,675	123,070	98,523	72,488
Income from continuing operations per share:					
Basic . . . . .	\$ 3.33	\$ 2.42	\$ 2.18	\$ 1.75	\$ 1.37
Diluted . . . . .	\$ 3.25	\$ 2.36	\$ 2.10	\$ 1.69	\$ 1.35
Net income per share:					
Basic . . . . .	\$ 3.33	\$ 2.32	\$ 2.10	\$ 1.72	\$ 1.29
Diluted . . . . .	\$ 3.25	\$ 2.25	\$ 2.03	\$ 1.65	\$ 1.26
Shares used in computing earnings per share:					
Basic . . . . .	53,640	56,314	58,636	57,414	56,383
Diluted . . . . .	54,857	57,956	60,689	59,546	57,330
Dividends declared per common share . . . . .	\$ 0.79	\$ 0.555	\$ 0.125	\$ —	\$ —
<b>Balance Sheet Data (end of period):</b>					
Working capital . . . . .	\$ 391,147	\$ 384,868	\$ 505,901	\$ 451,406	\$ 332,964
Total assets . . . . .	1,337,923	1,331,952	1,394,973	1,345,743	1,218,650
Total debt, including current maturities . . . . .	240,625	250,000	239,111	308,758	338,722
Other long-term liabilities, including deferred income taxes . . . . .	104,606	94,988	101,947	100,107	90,372

- (1) Loss from discontinued operations for the periods presented includes the income and losses for The Territory Ahead and Smith+Noble, two brands sold by Cornerstone in 2012.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this annual report. Historical results and trends which might appear should not be taken as indicative of future operations. Our results of operations and financial condition, as reflected in the accompanying consolidated financial statements and related notes, are subject to management's evaluation and interpretations of business conditions, changing market conditions and other factors.

### **Management Overview**

HSNi offers innovative, differentiated retail experiences and markets and sells a wide range of third party and proprietary merchandise directly to consumers through its two operating segments, HSN and Cornerstone. HSN's business platforms include (i) the television home shopping programming broadcast on the HSN television networks; (ii) the HSN.com website; (iii) mobile applications; and (iv) outlet stores. Cornerstone's business platforms include (i) catalogs, consisting primarily of the Cornerstone portfolio of leading print catalogs which includes Ballard Designs, Chasing Fireflies, Frontgate, Garnet Hill, Grandin Road, Improvements and TravelSmith; (ii) websites, consisting primarily of the eight branded websites operated by Cornerstone; (iii) retail and outlet stores; and (iv) mobile devices.

### **Sources of Revenue**

HSN revenue includes merchandise sales originating from the live television broadcasts of its programming 24 hours per day, seven days a week; HSN2, a network that primarily distributes taped programming on a limited distribution basis; the HSN.com website; mobile handheld devices; and through outlet stores. HSN also sells merchandise through its "Autoship" program under which customers receive scheduled merchandise shipments according to a pre-determined calendar.

Cornerstone sells private label and third party merchandise through its assortment of catalogs, digital sites and retail and outlet stores. Cornerstone consists of the brands of Ballard Designs, Chasing Fireflies, Frontgate, Garnet Hill, Grandin Road, Improvements and TravelSmith.

### **Products**

HSNi sells a wide array of merchandise across its various channels of distribution. HSN merchandise categories primarily consist of jewelry, fashion (apparel & accessories), beauty & health, and home & other (including household, home design, electronics, culinary and other). HSN manages its product mix to provide a balance between satisfying existing customer demand, generating interest from potential viewers and customers, providing new merchandise to its viewership and maximizing airtime and internet efficiency. Cornerstone merchandise categories generally consist of home and outdoor furnishings and apparel & accessories.

HSNi management believes that merchandise diversification, combined with an interactive multi-channel distribution strategy, appeals to a broader segment of potential customers and is an important part of its overall business strategy. HSNi is continually developing new merchandise offerings from existing, potential and future suppliers, to supplement its existing product lines.

## Results of Operations

### Net Sales

Net sales primarily relate to the sale of merchandise, including shipping and handling fees, and are reduced by incentive discounts and actual and estimated sales returns. Sales taxes collected are not included in net sales. Digital sales include sales placed through our internet websites and our mobile applications, including tablets and smart phones.

Revenue is recorded when delivery to the customer has occurred. Delivery is considered to have occurred when the customer takes title and assumes the risks and rewards of ownership, which is on the date of shipment. HSNi's sales policy allows customers to return virtually all merchandise for a full refund or exchange, subject to pre-established time restrictions.

	Year Ended December 31,				
	2013	Change	2012	Change	2011
	(Dollars in thousands)				
HSN.....	\$ 2,312,382	2%	\$ 2,265,026	5%	\$ 2,160,341
Cornerstone.....	1,091,601	9%	1,001,713	10%	909,015
Total HSNi net sales.....	<u>\$ 3,403,983</u>	4%	<u>\$ 3,266,739</u>	6%	<u>\$ 3,069,356</u>

HSNi net sales in 2013 increased 4%, or \$137.2 million, due to 2% sales growth at HSN and 9% sales growth at Cornerstone. Digital sales grew 9% with penetration increasing 200 basis points to 46.5%, up from 44.5% in the prior year. The number of units shipped in 2013 increased 4% to 62.0 million and the average price point decreased 1% to \$62.37.

HSNi net sales in 2012 increased 6%, or \$197.4 million, due to 5% sales growth at HSN and 10% sales growth at Cornerstone. Digital sales grew 13% with penetration increasing 270 basis points to 44.5%, up from 41.8% in the prior year. The number of units shipped in 2012 increased 8% to 59.6 million and the average price point decreased 2% to \$62.92.

### HSN

HSN net sales in 2013 increased 2%, or \$47.4 million. Sales grew in beauty & health, home design and household, offset by lower sales in jewelry, culinary and electronics. HSN repositioned the jewelry and culinary businesses in 2013 through changes in product and brand assortment and, as a result, dedicated lower airtime to these product categories. Digital sales grew 7% and penetration increased 160 basis points to 37.0%, up from 35.4% in the prior year. Digital sales were tempered in the first quarter by the launch of the digital site redesign across all HSN digital platforms while HSN implemented its new technology and our customers acclimated themselves with the new website design and capabilities. The return rate decreased 80 basis points to 18.7% from 19.5% in the prior year primarily due to the shift in product mix to categories with lower return rates as well as experiencing lower than historical return rates in many of its product categories. The gross units shipped increased 5% to 46.9 million while average price point decreased 4% to \$58.21 primarily due to an increase in clearance activity and changes in product mix.

HSN net sales in 2012 increased 5%, or \$104.7 million, driven by sales growth in home design, household, beauty and culinary, offset by lower sales in jewelry. During 2012, HSN focused on several key initiatives targeted at customer acquisition and retention. Pricing strategies and product selection were designed to appeal to potential and current customers with lower overall price points and product selection to drive higher volumes; we offered entertainment events designed to reinforce our brand and company awareness in the marketplace; we continued to invest in digital marketing initiatives to appeal to the growing number of digital consumers; and we provided our customers with payment alternatives designed to make the shopping experience with HSN easier and flexible. As a result of these and other initiatives, the number of units shipped increased 8% to 44.7 million and average price point decreased 4% to \$60.57. Digital sales grew 10% with penetration increasing 160 basis points to 35.4%, up from 33.8% in the prior year. Shipping and handling revenues decreased 4% driven by an increase in shipping and handling promotions, particularly in the second half of the year. The return rate decreased 50 basis points to 19.5% from 20.0% in the prior year.

Divisional product mix at HSN is provided in the table below:

	Year Ended December 31,		
	2013	2012	2011
Jewelry.....	11.1%	13.1%	14.0%
Fashion (apparel & accessories) .....	13.9%	13.1%	13.3%
Beauty & Health .....	24.5%	22.7%	22.9%
Home & Other (including household, home design, electronics, culinary and other) .....	50.5%	51.1%	49.8%
Total .....	100.0%	100.0%	100.0%

### Cornerstone

Cornerstone net sales in 2013 increased 9%, or \$89.9 million. The increase in net sales was driven by sales growth in the home brands. Digital sales grew 11% with penetration increasing 150 basis points to 66.5%, up from 65.0% in the prior year. The return rate decreased 50 basis points to 12.9% due primarily to changes in product mix. Catalog circulation increased 5% compared to the prior year.

Cornerstone's net sales in 2012 increased 10% in 2012, or \$92.7 million, compared to the prior year. Fiscal year 2012 included 52 weeks compared to fiscal year 2011 which included 53 weeks. Excluding the incremental sales from the additional week in 2011, net sales increased 12% primarily due to strength in the home brands, the addition of Chasing Fireflies to the portfolio in April 2012 and an increase in catalog circulation. Digital sales grew 18% with penetration increasing 430 basis points to 65.0%, up from 60.7% in the prior year. The return rate decreased 130 basis points to 13.4% due to changes in product mix and a heightened focus on quality assurance efforts. Catalog circulation increased 10% compared to the prior year.

The brand mix at Cornerstone is provided in the table below:

	Year Ended December 31,		
	2013	2012	2011
Home brands (Ballard Designs, Frontgate, Grandin Road and Improvements) .....	73.9%	71.8%	71.5%
Apparel brands (Chasing Fireflies, Garnet Hill and TravelSmith) (a) .....	26.1%	28.2%	28.5%
Total .....	100.0%	100.0%	100.0%

(a) Chasing Fireflies was acquired in April 2012.

### Cost of Sales and Gross Profit

Cost of sales consists primarily of the cost of products sold, shipping and handling costs and compensation and other employee-related costs for personnel engaged in warehouse functions. Cost of products sold includes merchandise cost, inbound freight and duties and certain allocable general and administrative costs, including certain warehouse costs.

	Year Ended December 31,				
	2013	Change	2012	Change	2011
	(Dollars in thousands)				
<b>Gross profit:</b>					
HSN .....	\$ 796,705	1%	\$ 786,650	6%	\$ 741,308
HSN gross margin .....	34.5%	(20 bp)	34.7%	40 bp	34.3%
Cornerstone .....	\$ 433,110	9%	\$ 397,074	11%	\$ 358,954
Cornerstone gross margin .....	39.7%	10 bp	39.6%	10 bp	39.5%
HSNi .....	\$ 1,229,815	4%	\$ 1,183,724	8%	\$ 1,100,262
HSNi gross margin .....	36.1%	(10 bp)	36.2%	40 bp	35.8%

bp = basis points

### HSN

Gross profit for HSN in 2013 increased 1%, or \$10.1 million, compared to the prior year. Gross margin decreased 20 basis points to 34.5% primarily due to lower shipping margins due to increases in shipping and handling promotions and shipping costs.

Gross profit for HSN in 2012 increased 6%, or \$45.3 million, compared to the prior year. Gross margin improved 40 basis points to 34.7% from 34.3%. The margin increase was primarily attributable to an increase in product margins driven by product mix but were largely offset by the decrease in shipping margins primarily due to an increase in shipping promotions. The increase was also due to lower transaction costs related to debit card fees.

### ***Cornerstone***

Gross profit for Cornerstone in 2013 increased 9%, or \$36.0 million, compared to the prior year. Gross margin increased 10 basis points from 39.6% to 39.7% primarily due to an increase in product margins driven by product mix and selective price increases.

Gross profit for Cornerstone in 2012 increased 11%, or \$38.1 million, compared to the prior year. Gross margin improved 10 basis points to 39.6% from 39.5% in the prior year. The margin was positively impacted by lower inbound freight costs in the home brands, lower return rates and lower inventory reserves, offset by a decrease in net shipping margins driven by the increase in shipping promotions.

### **Selling and Marketing Expense**

Selling and marketing expense consists primarily of advertising and promotional expenditures, compensation and other employee-related costs (including stock-based compensation) for personnel engaged in customer service, sales and merchandising, production and programming functions and on-air distribution costs. Advertising and promotional expenditures primarily include catalog production and distribution costs and online marketing, including fees paid to search engines and third-party distribution partners.

	<b>Year Ended December 31,</b>					
	<b>2013</b>	<b>Change</b>	<b>2012</b>	<b>Change</b>	<b>2011</b>	
	<b>(Dollars in thousands)</b>					
HSN .....	\$ 392,715	2%	\$ 385,243	4%	\$	368,915
As a percentage of HSN net sales .....	17.0%	0 bp	17.0%	(10 bp)		17.1%
Cornerstone .....	\$ 303,079	9%	\$ 277,079	12%	\$	247,501
As a percentage of Cornerstone net sales .....	27.8%	10 bp	27.7%	50 bp		27.2%
HSNi .....	\$ 695,794	5%	\$ 662,322	7%	\$	616,416
As a percentage of HSNi net sales .....	20.4%	10 bp	20.3%	20 bp		20.1%

HSNi's selling and marketing expense in 2013 increased 5%, or \$33.5 million, and was 20.4% of net sales compared to 20.3% in the prior year. The increase was primarily due to additional catalog costs associated with a 5% increase in Cornerstone's catalog circulation and increases in employee-related and digital marketing costs.

HSNi's selling and marketing expense in 2012 increased 7%, or \$45.9 million, and was 20.3% of net sales compared to 20.1% in 2011. The increase was primarily due to additional catalog costs associated with a 10% increase in Cornerstone's catalog circulation and increases in employee-related and digital marketing costs.



## General and Administrative Expense

General and administrative expense consists primarily of compensation and other employee-related costs (including stock-based compensation) for personnel engaged in finance, legal, tax, human resources, information technology and executive management functions, bad debts, facilities costs and fees for professional services.

	Year Ended December 31,				
	2013	Change	2012	Change	2011
	(Dollars in thousands)				
HSN .....	\$ 154,434	(5)%	\$ 162,417	7%	\$ 151,813
As a percentage of HSN net sales .....	6.7%	(50 bp)	7.2%	20 bp	7.0%
Cornerstone .....	\$ 56,344	(9)%	\$ 62,236	9%	\$ 57,169
As a percentage of Cornerstone net sales.....	5.2%	(100 bp)	6.2%	(10 bp)	6.3%
HSNi.....	\$ 210,778	(6)%	\$ 224,653	7%	\$ 208,982
As a percentage of HSNi net sales .....	6.2%	(70 bp)	6.9%	10 bp	6.8%

HSNi's general and administrative expense in 2013 decreased 6%, or \$13.9 million, and was 6.2% of net sales compared to 6.9% in the prior year. The decrease in expense was primarily due to a \$7.8 million sales tax settlement at Cornerstone that occurred in the prior year and lower bad debt expense related to HSN's extended payment program ("Flexpay"), partially offset by an increase in employee-related costs. There was also an increase in severance-related costs that was offset by a decrease in stock-based compensation expense.

Additionally, Cornerstone recognized non-cash fair value adjustments in the fourth quarter of 2013 related to a contingent consideration obligation and certain intangible assets associated with its 2012 acquisition of Chasing Fireflies. The net impact of the reduction of the contingent consideration obligation and the intangible asset impairment charge was a reduction of expense of \$0.6 million which is included in "General and administrative expenses."

HSNi's general and administrative expense in 2012 increased 7%, or \$15.7 million, and was 6.9% of net sales compared to 6.8% in the prior year. The increase in expense was primarily due to a \$7.8 million sales tax settlement at Cornerstone, an increase in bad debt expense due to higher usage of Flexpay and technology-related costs, partially offset by a \$6.1 million decrease in stock-based compensation.

## Depreciation and Amortization

	Year Ended December 31,				
	2013	Change	2012	Change	2011
	(Dollars in thousands)				
HSN .....	\$ 28,372	7%	\$ 26,486	(4)%	\$ 27,652
Cornerstone .....	12,217	6%	11,519	41%	8,170
HSNi.....	\$ 40,589	7%	\$ 38,005	6%	\$ 35,822
As a percentage of HSNi net sales .....	1.2%	0 bp	1.2%	0 bp	1.2%

Depreciation and amortization in 2013 increased 7%, or \$2.6 million, compared to the prior year. The increase was primarily due to the incremental depreciation associated with recent capital expenditures for information and digital technology.

Depreciation and amortization in 2012 increased 6%, or \$2.2 million, compared to the prior year. The increase was primarily due to depreciation on leasehold improvements and equipment related to a new leased Cornerstone warehouse facility opened in 2012 and amortization of intangibles acquired in the second quarter related to the Chasing Fireflies acquisition, partially offset by certain fixed assets becoming fully depreciated during 2012.

## Adjusted EBITDA

Adjusted EBITDA is a non-GAAP measure and is defined in Note 6 of Notes to Consolidated Financial Statements.

	Year Ended December 31,				
	2013	Change	2012	Change	2011
	(Dollars in thousands)				
HSN .....	\$ 261,292	4%	\$ 250,836	7%	\$ 235,164
As a percentage of HSN net sales .....	11.3%	20 bp	11.1%	20 bp	10.9%
Cornerstone .....	\$ 76,574	4%	\$ 73,441	9%	\$ 67,595
As a percentage of Cornerstone net sales .....	7.0%	(30 bp)	7.3%	(10 bp)	7.4%
HSNi .....	\$ 337,866	4%	\$ 324,277	7%	\$ 302,759
As a percentage of HSNi net sales .....	9.9%	0 bp	9.9%	0 bp	9.9%

HSNi's Adjusted EBITDA in 2013 increased 4%, or \$13.6 million, and was 9.9% of net sales, consistent with the prior year. The increase in Adjusted EBITDA was due to a 4% increase in net sales, partially offset by a 4% increase in operating expenses (excluding non-cash charges and \$7.8 million sales tax settlement in the prior year). HSN's Adjusted EBITDA increased 4%, or \$10.5 million, primarily due to a 2% increase in net sales, partially offset by a 20 basis point decline in gross margin. HSN's operating expenses (excluding non-cash charges) were 23.2% of net sales compared to 23.7% in the prior year. Decreases in HSN's professional services fees and bad debt expense were offset by increases in employee-related and digital marketing costs. Cornerstone's Adjusted EBITDA increased 4%, or \$3.1 million, primarily due to a 9% increase in net sales, partially offset by a 10% increase in operating expenses (excluding non-cash charges and a \$7.8 million sales tax settlement in the prior year). The increase in operating expenses was largely due to catalog costs associated with the 5% increase in circulation; employee-related costs; the incremental expenses from the addition of Chasing Fireflies to the portfolio in April 2012 and investments in digital marketing.

HSNi's Adjusted EBITDA in 2012 increased 7%, or \$21.5 million, and was 9.9% of net sales, consistent with the prior year. The increase in Adjusted EBITDA was primarily due to a 6% increase in net sales and a 40 basis point improvement in gross margin, partially offset by an 8% increase in operating expenses (excluding non-cash charges and a \$7.8 million sales tax settlement). HSN's Adjusted EBITDA increased 7%, or \$15.7 million, primarily due to a 5% increase in net sales and a 40 basis point improvement in gross margin, partially offset by a 6% increase in operating expenses (excluding non-cash charges) primarily for employee-related costs, digital and brand marketing and bad debt expense. Cornerstone's Adjusted EBITDA increased 9%, or \$5.8 million, primarily due to the acquisition of Chasing Fireflies in April 2012.

## Operating Income

	Year Ended December 31,				
	2013	Change	2012	Change	2011
	(Dollars in thousands)				
HSN .....	\$ 221,184	4%	\$ 212,503	10%	\$ 192,928
As a percentage of HSN net sales .....	9.6%	20 bp	9.4%	50 bp	8.9%
Cornerstone .....	\$ 61,470	33%	\$ 46,241	—%	\$ 46,114
As a percentage of Cornerstone net sales .....	5.6%	100 bp	4.6%	(50 bp)	5.1%
HSNi .....	\$ 282,654	9%	\$ 258,744	8%	\$ 239,042
As a percentage of HSNi net sales .....	8.3%	40 bp	7.9%	10 bp	7.8%

HSNi's operating income in 2013 increased 9%, or \$23.9 million, and was 8.3% of net sales compared to 7.9% in the prior year. The increase was primarily due to 4% growth in net sales offset by a 2% increase in operating expenses. The increase in operating expenses was primarily due to increases in employee-related costs, catalog costs and digital marketing, partially offset by a \$7.8 million unfavorable sales tax settlement at Cornerstone in the prior year and decreases in professional services fees and bad debt expenses at HSN.

HSNi's operating income in 2012 increased 8%, or \$19.7 million, and was 7.9% of net sales compared to 7.8% in the prior year. The increase was primarily due to 6% growth in net sales and 40 basis point improvement in gross margin, partially offset by a 7% increase in operating expenses primarily for Cornerstone's catalog circulation and \$7.8 million sales tax settlement, digital marketing and technology costs, and employee-related costs.

## Other Income (Expense)

	Year Ended December 31,				
	2013	Change	2012	Change	2011
	(Dollars in thousands)				
Interest income . . . . .	\$ 205	(64)%	\$ 564	(17)%	\$ 679
Interest expense . . . . .	(6,718)	(68)%	(20,811)	(35)%	(31,963)
Loss on debt extinguishment . . . . .	—	NA	(18,627)	NA	—
Total other expense, net . . . . .	<u>\$ (6,513)</u>	(83)%	<u>\$ (38,874)</u>	24%	<u>\$ (31,284)</u>
As a percentage of HSNi net sales . . . . .	0.2%	(100 bp)	1.2%	20 bp	1.0%

### Interest Expense

On April 24, 2012, HSNi entered into a \$600 million five-year syndicated credit agreement (“Credit Agreement”) which replaced the credit agreement that was set to expire in July 2013. On July 31, 2012, HSNi drew \$250 million from its delayed draw term loan under the Credit Agreement. The proceeds of the term loan were used to fully redeem the \$240 million 11.25% Senior Notes due 2016 (“Senior Notes”) on August 1, 2012 as discussed below. As a result of these refinancing transactions, interest expense decreased 68% in 2013, or \$14.1 million.

Interest expense in 2012 was primarily related to the Senior Notes which bore interest at 11.25% through the August 1, 2012 redemption date and the \$250 million term loan outstanding under the Credit Agreement. Interest expense in 2011 primarily related to the Senior Notes and the \$69.8 million term loan outstanding under the prior credit agreement.

### Loss on Debt Extinguishment

On August 1, 2012, HSNi fully redeemed its \$240 million Senior Notes. The Senior Notes were redeemed for \$253.5 million, or 105.625% of the principal amount. HSNi reported approximately \$18.6 million in “Loss on debt extinguishment” primarily associated with redemption of the Senior Notes in the third quarter of 2012. These charges resulted from the redemption premium of \$13.5 million and \$5.1 million related to the write-off of unamortized issuance costs and original issue discount.

### Income Tax Provision

For the years ended December 31, 2013, 2012 and 2011, HSNi recorded tax provisions from continuing operations of \$97.7 million, \$83.4 million and \$80.1 million, respectively, which represent effective tax rates of 35.4%, 37.9% and 38.6%, respectively.

The change in the effective tax rate in 2013 from the prior periods was primarily due to discrete tax benefits of \$3.7 million realized in the third quarter of 2013 and the favorable tax treatment of the fair value adjustments related to the 2012 acquisition of Chasing Fireflies recorded in the fourth quarter of 2013. Excluding the impact of these items, the 2013 effective tax rate for continuing operations would have been 37%. The adjusted rate of 37% in 2013, as well as the 2012 and 2011 tax rates, are higher than the federal statutory rate of 35% due principally to state income taxes.

### Discontinued Operations

In May 2012, substantially all of the assets and certain liabilities of Smith+Noble, a Cornerstone brand specializing in window treatments, were sold for \$5.5 million. The operating results for Smith+Noble are included in “Loss from discontinued operations, net of tax” in the consolidated statements of operations for all periods presented. Cornerstone recorded an after-tax loss on the sale of \$0.1 million in the second quarter of 2012, which is included in “Loss from discontinued operations, net of tax” in the accompanying consolidated statements of operations.

In July 2012, substantially all of the assets and certain liabilities of The Territory Ahead, a Cornerstone brand specializing in casual apparel for men and women, were sold for approximately \$1.1 million. The operating results for The Territory Ahead are included in “Loss from discontinued operations, net of tax” in the consolidated statements of operations for all periods presented. An impairment charge of \$5.9 million was recorded in the second quarter of 2012 to reduce the carrying

value of the net assets to their estimated net realizable value and is included in “Loss from discontinued operations, net of tax” in the accompanying consolidated statements of operations.

## Liquidity and Capital Resources

As of December 31, 2013, HSNi had \$196.4 million of cash and cash equivalents, down from \$222.1 million as of December 31, 2012.

Net cash provided by operating activities attributable to continuing operations was \$231.9 million in 2013 compared to \$147.4 million in 2012, an increase of \$84.5 million. This increase was primarily due to improved operating performance and changes in working capital. Working capital improved primarily as a result of lower inventory receipts, effective inventory management and the timing of collection of credit card receivables, offset by the timing of income tax payments.

Inventory receipts were particularly high in 2012 as both HSN and Cornerstone were increasing their inventory balances to support sales growth. HSN's sales growth in 2013 was lower than expected resulting in additional clearance activity and a reduction in inventory receipts. However, these measures have resulted in inventory in 2013 decreasing by 17% compared to prior year and aged inventories being at their lowest levels since 2010. Cornerstone continued to grow its inventory in 2013 to support its future sales growth. Cornerstone's inventory increased 26% in 2013 and 10% in 2012.

Consistent with prior years, HSN continued to increase its offering of Flexpay, an installment program which allows customers to pay for select merchandise in two to six interest-free, monthly payments. This program increases the Company's cash requirements as the sales proceeds get delayed by using the Flexpay alternative. Despite the increased usage of Flexpay, the Company did not experience any deterioration in the aging of Flexpay receivables or had an increase in its write-offs of receivables in 2013.

Net cash used in investing activities attributable to continuing operations in 2013 was \$61.1 million. Capital expenditures in 2013 was \$52.0 million and was primarily for investments in information and digital technology. HSNi also made an advance payment of \$9.1 million for warehouse improvement projects.

Net cash used in financing activities attributable to continuing operations in 2013 was \$196.4 million. During 2013, HSNi repurchased 2.7 million shares of common stock for \$146.9 million at an average cost of \$53.67. HSNi also paid dividends totaling \$0.79 per common share resulting in \$42.3 million in payments during 2013. Repayments of \$9.4 million of HSNi's term loan were made in 2013. HSNi had a cash inflow of \$8.4 million from the proceeds from stock option exercises and a cash outflow of \$14.4 million to cover withholding taxes for stock-based awards. Additionally, in 2013 HSNi had \$10.4 million of excess tax benefits from stock-based awards.

HSNi's \$600 million Credit Agreement is secured by 100% of the voting equity securities of HSNi's U.S. subsidiaries and 65% of the voting equity securities of HSNi's first-tier foreign subsidiaries. This Credit Agreement replaced the credit agreement that was set to expire in July 2013. Certain HSNi subsidiaries have unconditionally guaranteed HSNi's obligations under the Credit Agreement. The Credit Agreement, which includes a \$350 million revolving credit facility and a \$250 million term loan, may be increased up to \$850 million subject to certain conditions and expires April 24, 2017. HSNi drew \$250 million from its term loan on July 31, 2012 to fund the redemption of the Senior Notes, as discussed below. As of December 31, 2013, \$240.6 million was outstanding under the term loan. HSNi capitalized \$5.5 million in financing costs related to the Credit Agreement and is amortizing these costs to interest expense over the Credit Agreement's five-year term.

The Credit Agreement contains various covenants, limitations and events of default customary for similar facilities including a maximum leverage ratio of 3.00x and a minimum interest coverage ratio of 3.00x. HSNi was in compliance with all such covenants as of December 31, 2013, with a leverage ratio of 0.73x and an interest coverage ratio of 60.68x.

Loans under the Credit Agreement bear interest at a per annum rate equal to LIBOR plus a predetermined margin that ranges from 1.50% to 2.25% or the Base Rate (as defined in the Credit Agreement) plus a predetermined margin that ranges from 0.50% to 1.25%. HSNi can elect to borrow at either LIBOR or the Base Rate and the predetermined margin is based on HSNi's leverage ratio. The term loan interest rate as of December 31, 2013 was 1.66%. HSNi pays a commitment fee ranging from 0.25% to 0.40% (based on the leverage ratio) on the unused portion of the revolving credit facility.

The amount available under the Credit Agreement is reduced by the amount of commercial and standby letters of credit issued under the revolving credit facility, which totaled \$31.7 million as of December 31, 2013. The ability to draw funds under the revolving credit facility is dependent upon meeting the aforementioned financial covenants, which may limit HSNi's ability to draw the full amount of the facility. As of December 31, 2013, the additional amount that could be borrowed under

the revolving credit facility, in consideration of the financial covenants and outstanding letters of credit, was approximately \$318.3 million.

To reduce our future exposure to rising interest rates under our credit facility, we entered into a forward-starting swap in December 2012 that effectively converts \$187.5 million of our variable rate term loan to a fixed-rate of 0.8525%, resulting in an all-in fixed rate of 2.3525% (based on HSNi's leverage ratio as of December 31, 2013), beginning January 2014 through April 2017. For additional information related to our interest rate swaps, refer to Note 8 of Notes to Consolidated Financial Statements.

On July 28, 2008, HSNi issued \$240 million of 11.25% Senior Notes due 2016. The Senior Notes were fully redeemed on August 1, 2012 for \$253.5 million, or 105.625% of the principal amount. HSNi drew \$250 million from its term loan on July 31, 2012 and used its cash on hand to fund the redemption. HSNi reported approximately \$18.6 million in pre-tax charges primarily associated with redemption of the Senior Notes. These charges resulted from the redemption premium of \$13.5 million and \$5.1 million related to the write-off of unamortized issuance costs and original issue discount.

HSNi does not currently have any material commitments for capital expenditures; however, management does anticipate that HSNi will need to make capital and other expenditures in connection with the development and expansion of its operations. HSNi's ability to fund its cash and capital needs will be affected by its ongoing ability to generate cash from operations, the overall capacity and terms of its financing arrangements as discussed above, and access to the capital markets. HSNi believes that its cash on hand, its anticipated operating cash flows, its available unused portion of the revolving credit facility and its access to capital markets will be sufficient to fund its operating needs, capital, investing and other commitments and contingencies for the foreseeable future.

On September 27, 2011, HSNi's Board of Directors approved a share repurchase program which allows HSNi to purchase 10 million shares of its common stock from time to time through privately negotiated and/or open market transactions. The timing of any repurchases and actual number of shares repurchased will depend on a variety of factors, including the stock price, corporate and regulatory requirements, restrictions under HSNi's debt obligations and other market and economic conditions. The repurchase program may be suspended or discontinued by HSNi at any time. For the year ended December 31, 2013, HSNi repurchased approximately 2.7 million shares at a cost of \$146.9 million at an average cost of \$53.67 per share. As of December 31, 2013, approximately 1.0 million shares remained authorized for repurchase under the program.

In February 2014, HSNi's Board of Directors approved a cash dividend of \$0.25 per common share. The dividend will be paid on March 19, 2014 to HSNi's record holders as of March 5, 2014.

### Contractual Obligations and Commercial Commitments

The following table presents HSNi's contractual obligations as of December 31, 2013:

<u>Contractual Obligations</u>	Payments Due by Period				
	Total Amounts Committed	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
	(In thousands)				
Long-term debt, including current maturities . . . . .	\$ 240,625	\$ 12,500	\$ 35,938	\$ 192,187	\$ —
Interest on debt (a) . . . . .	16,422	5,187	9,828	1,407	—
Operating leases . . . . .	103,407	24,756	38,285	26,666	13,700
Purchase obligations (b) . . . . .	141,678	73,610	68,016	52	—
Total contractual obligations . . . . .	<u>\$ 502,132</u>	<u>\$ 116,053</u>	<u>\$ 152,067</u>	<u>\$ 220,312</u>	<u>\$ 13,700</u>

- (a) Includes interest on variable rate debt estimated using the rate in effect as of December 31, 2013 through January 31, 2014, at which time the forward-starting interest rate swap goes into effect. An all-in fixed rate of 2.3525% based on HSNi's leverage ratio as of December 31, 2013 is then assumed from February 1, 2014 through April 2017, the date of expiration of the variable rate debt.
- (b) The purchase obligations primarily relate to contracts with pay television operators and include obligations for future cable distribution and commission guarantees.

	Amount of Commitments Expiration Per Period				
	Total Amounts Committed	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
	(In thousands)				
Letters of credit and surety bonds (c) . . . . .	\$ 35,711	\$ 35,561	\$ 150	\$ —	\$ —

(c) The letters of credit (“LOCs”) primarily consist of trade LOCs which are used for inventory purchases. Trade LOCs are guarantees of payment based upon the delivery of goods. The surety bonds primarily consist of custom bonds which relate to the import of merchandise into the United States.

We issue inventory purchase orders in the normal course of business, which represent authorizations to purchase that are cancelable by their terms. We do not consider purchase orders to be firm inventory commitments; therefore, they are excluded from the table above. If we choose to cancel a purchase order, we may be obligated to reimburse the vendor for unrecoverable outlays incurred prior to cancellation.

At December 31, 2013, we had \$1.1 million, including penalties and interest, recorded for uncertain tax positions. We are not able to reasonably estimate the timing of payments in future periods; therefore, the liability of \$1.1 million has not been included in the contractual obligations table above.

### Off-Balance Sheet Arrangements

Other than the items described above, HSNi does not have any material off-balance sheet arrangements as of December 31, 2013.

### Seasonality

HSNi is affected by seasonality, although historically our business has exhibited less seasonality than many other retail businesses. Our sales levels are generally higher in the fourth quarter. Reported revenues in the fourth quarter were 30% of total reported annual revenues in 2013, 2012 and 2011, respectively.

### Non-GAAP Measure

HSNi reports Adjusted EBITDA as a supplemental measure to generally accepted accounting principles ("GAAP"). This measure is one of the primary metrics by which HSNi evaluates the performance of its businesses, on which its internal budgets are based and by which management is compensated. HSNi believes that investors should have access to the same information that it uses in analyzing its results.

Adjusted EBITDA is defined as operating income excluding, if applicable: (1) non-cash charges including: (a) stock-based compensation expense, (b) amortization of intangibles, (c) depreciation and gains and losses on asset dispositions, and (d) goodwill, long-lived asset and intangible asset impairments; (2) pro forma adjustments for significant acquisitions; and (3) other significant items. Significant items, while periodically affecting our results, may vary significantly from period to period and have a disproportionate effect in a given period, thereby affecting the comparability of results. Adjusted EBITDA is not a measure determined in accordance with GAAP, and should not be considered in isolation or as a substitute for operating income, net income or any other measure determined in accordance with GAAP. Adjusted EBITDA is used as a measurement of operating efficiency and overall financial performance and HSNi believes it to be a helpful measure for those evaluating companies in the retail and media industries. Adjusted EBITDA has certain limitations in that it does not take into account the impact to HSNi's consolidated statements of operations of certain expenses, including stock-based compensation, amortization of intangibles, depreciation, gains and losses on asset dispositions, asset impairment charges, acquisition-related accounting and other significant items.

### Items That Are Excluded From HSNi's Non-GAAP Measure

*Stock-based compensation* expense consists principally of expense associated with the grants of restricted stock, restricted stock units, stock options and stock appreciation rights. These expenses are not paid in cash, and HSNi includes the related shares in its calculations of diluted shares outstanding. Upon vesting of restricted stock and restricted stock units and the exercise of certain stock options and stock appreciation rights, the awards can be settled, at HSNi's discretion, on a net basis, with HSNi remitting the required tax withholding amount from its current funds.

*Amortization of intangibles* is a non-cash expense relating primarily to acquisitions. At the time of an acquisition, the intangible assets of the acquired company, such as distribution agreements, customer relationships and merchandise agreements, are valued and amortized over their estimated lives.

*Depreciation, gains and losses on asset dispositions and long-lived asset impairment charges* are non-cash items relating to our long-lived assets and have been excluded from Adjusted EBITDA.

*Goodwill and intangible asset impairment charges* are also non-cash expenses that have been excluded from Adjusted EBITDA.

*Other Significant Items* represent transactions that may vary significantly from period to period and have a disproportionate effect in a given period, thereby affecting the comparability of results.

## **Reconciliation of Adjusted EBITDA**

See Note 6 of Notes to Consolidated Financial Statements for the reconciliation between Adjusted EBITDA and net income for the years ended December 31, 2013, 2012 and 2011.

## **Critical Accounting Policies and Estimates**

The following disclosure is provided to supplement the descriptions of HSNi's accounting policies contained in Note 2 of Notes to Consolidated Financial Statements in regard to significant areas of judgment. HSNi's management is required to make certain estimates and assumptions during the preparation of its consolidated financial statements in accordance with GAAP. These estimates and assumptions impact the reported amount of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the consolidated financial statements. They also impact the reported amount of net income during any period. Actual results could differ from those estimates. Because of the size of the financial statement elements to which they relate, some of HSNi's accounting policies and estimates have a more significant impact on its consolidated financial statements than others. The following is a discussion of some of HSNi's more significant accounting policies and estimates.

### **Recoverability of Long-Lived Assets**

HSNi reviews the carrying value of all long-lived assets, primarily property and equipment and definite-lived intangible assets, for impairment whenever triggering events or changes in circumstances indicate that the carrying value of an asset may be impaired. Impairment is considered to have occurred whenever the carrying value of a long-lived asset exceeds the sum of the undiscounted cash flows that is expected to result from the use and eventual disposition of the asset. The impairment is measured by comparing the fair value of the asset to its carrying value. Our valuation methodologies include, but are not limited to, discounting the future cash flows from the asset being tested. Significant judgments include determining if a triggering event has occurred, determining the future cash flows from the assets and applying the appropriate discount rate when measuring the fair value. The determination of cash flows is based upon assumptions that may not occur.

### **Impairment of Goodwill and Indefinite-Lived Intangible Assets**

HSNi assesses the impairment of goodwill and identifiable indefinite-lived intangible assets, principally trademarks and trade names, at least annually during the fourth quarter and whenever events or changes in circumstances indicate that the carrying value of an asset may be impaired. In performing this review, HSNi has the option of performing a qualitative assessment to determine whether it is more likely than not that the fair values of the reporting unit and/or indefinite-lived intangible assets are less than the carrying values. In performing the qualitative assessment, HSNi considers various factors including (but not limited to): macroeconomic, industry and market conditions; cost factors affecting the business; the overall financial performance of the business; any relevant changes in management, strategies or customers; and any sustained decreases in its stock price. If HSNi determines based on this assessment that it is not more likely that the fair value is less than its carrying value, then the goodwill and/or the indefinite-lived intangible assets are deemed to be not impaired and no further testings is required until the next annual test date (or sooner if conditions or events before that date raise concerns of potential impairment in the business). If HSNi determines that it is more likely than not that the fair value is less than its carrying value, then the quantitative goodwill and/or indefinite-lived intangible asset impairment tests must be completed.

If necessary, HSNi performs a quantitative assessment of the fair values of its goodwill and intangible assets. In performing this review, HSNi is required to make an assessment of the fair value of its intangible assets. If it is determined that the implied fair value of goodwill and/or indefinite-lived intangible assets is less than the carrying amount, an impairment charge, equal to the excess, is recorded. HSNi determines the fair value of its reporting units by using a discounted cash flow

analysis with consideration of an equity analysis based on the trading value of its common stock. HSNi utilizes the relief from royalty method to assess fair values of its trademarks and trade names.

In assessing fair value, HSNi considers, among other indicators, differences between estimated and actual cash flows and revenue streams and changes in the related discount, royalty and terminal growth rates. Determining these rates requires the exercise of significant judgments. These factors used in the determination of fair value are sensitive to, among other things, changes in the retail consumer market and the general economy.

### **Returns Reserves**

Net sales from HSNi primarily consist of merchandise sales and are reduced by incentive discounts and sales returns. HSNi's sales policy allows customers to return virtually all merchandise for a full refund or exchange, subject to pre-established time restrictions. Allowances for returned merchandise and other adjustments (including reimbursed shipping and handling costs) are provided based upon past experience. Actual levels of product returns may vary from these estimates. HSNi's estimated return rates were 17.0%, 17.8% and 18.5% in 2013, 2012 and 2011, respectively.

### **Allowance for Doubtful Accounts**

HSNi makes judgments as to its ability to collect outstanding receivables and provide allowances when it has determined that all or a portion of the receivable will not be collected. HSNi determines its allowance by considering a number of factors, including the length of time accounts receivable are past due, its previous loss history and the condition of the general economy. HSNi writes off accounts receivable when they are determined to be uncollectible.

### **Income Taxes**

Estimates of deferred income taxes and the significant items giving rise to the deferred tax assets and liabilities are shown in Note 12 of Notes to Consolidated Financial Statements, and reflect management's assessment of actual future taxes to be paid on items reflected in the consolidated financial statements, giving consideration to both timing and the probability of realization. Actual income taxes could vary from these estimates due to future changes in income tax law, state income tax apportionment, as well as actual operating results of HSNi that vary significantly from anticipated results. Valuation allowances are related to items for which it is more likely than not that the tax benefit will not be realized. In assessing the adequacy of a recorded valuation allowance, we consider all positive and negative information and a variety of factors including the scheduled reversal of deferred tax liabilities, historical and projected future taxable income and feasible tax planning strategies. HSNi recognizes liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on its technical merits. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. This measurement step is inherently difficult and requires subjective estimations of such amounts to determine the probability of various possible outcomes. HSNi considers many factors when evaluating and estimating its tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes.

### **Inventory Valuation**

Inventories are valued at the lower of cost or market, cost being determined based upon the first-in, first-out method. Market is determined on the basis of net realizable value, giving consideration to obsolescence and other factors. Net realizable value is estimated by HSNi based upon historical sales data, the age of inventory, the quantity of goods on hand and the ability to return merchandise to vendors. The actual net realizable value may vary from estimates due to changes in customer tastes or viewing habits, or judgmental decisions made by merchandising personnel when ordering new products.



## **Stock-Based Compensation**

We measure compensation cost for stock-based awards at fair value and recognize compensation over the service period for awards expected to vest. We consider many factors when estimating expected forfeitures, including types of awards, employee class and historical experience. HSNi grants performance-based equity awards whose value is based on the extent to which certain pre-established performance goals are achieved during a three-year period. Each reporting period prior to the vesting of these awards, management must apply significant judgment when estimating the expected future achievement of the designated performance metrics. The estimation of stock awards that will ultimately vest and the estimation of the value of the performance-based awards require judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. The fair value of restricted stock units is determined based on the number of shares granted and the closing price of our common stock at the grant date. The fair value of stock options, stock appreciation rights and options granted under our employee stock purchase plan are estimated on the grant date using the Black-Scholes option pricing model. This model incorporates various assumptions, including expected volatility and expected term. Expected stock price volatilities are estimated based on HSNi's historical experience and the historical and implied volatilities of comparable publicly-traded companies. The expected term of awards granted is based on analyses of historical employee termination rates and option exercise patterns, giving consideration to expectations of future employee behavior. Actual results and future estimates may differ substantially from our current estimates.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

At December 31, 2013 and 2012, HSNi's outstanding long-term debt was \$240.6 million and \$250.0 million, respectively, all of which pays interest at a variable rate, generally tied to LIBOR. Changes in interest rates on our variable rate debt could affect our earnings. We are managing our future interest rate exposure through a forward-starting interest rate swap with a notional amount of \$187.5 million and a fixed rate of 0.8525% that takes effect January 2014. A hypothetical 100 basis point increase in interest rates on the portion of our variable rate debt that is not effectively hedged by the fixed-rate interest rate swap would increase our annual interest expense by approximately \$0.6 million in 2014.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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## **Report of Independent Registered Certified Public Accounting Firm**

The Board of Directors and Shareholders of HSN, Inc.

We have audited the accompanying consolidated balance sheets of HSN, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. Our audits also included the financial statement schedule listed in the Index as Schedule II. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of HSN, Inc. and subsidiaries at December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), HSN, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated February 20, 2014, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Tampa, Florida  
February 20, 2014

**HSN, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except per share data)

	Years Ended December 31,		
	2013	2012	2011
Net sales .....	\$ 3,403,983	\$ 3,266,739	\$ 3,069,356
Cost of sales .....	2,174,168	2,083,015	1,969,094
Gross profit .....	1,229,815	1,183,724	1,100,262
Operating expenses:			
Selling and marketing .....	695,794	662,322	616,416
General and administrative .....	210,778	224,653	208,982
Depreciation and amortization .....	40,589	38,005	35,822
Total operating expenses .....	947,161	924,980	861,220
<b>Operating income</b> .....	<b>282,654</b>	<b>258,744</b>	<b>239,042</b>
Other income (expense):			
Interest income .....	205	564	679
Interest expense .....	(6,718)	(20,811)	(31,963)
Loss on debt extinguishment .....	—	(18,627)	—
Total other expense, net .....	(6,513)	(38,874)	(31,284)
<b>Income from continuing operations before income taxes</b> .....	<b>276,141</b>	<b>219,870</b>	<b>207,758</b>
Income tax provision .....	(97,692)	(83,373)	(80,106)
<b>Income from continuing operations</b> .....	<b>178,449</b>	<b>136,497</b>	<b>127,652</b>
Loss from discontinued operations, net of tax .....	—	(5,822)	(4,582)
<b>Net income</b> .....	<b>\$ 178,449</b>	<b>\$ 130,675</b>	<b>\$ 123,070</b>
<b>Income from continuing operations per share:</b>			
<b>Basic</b> .....	\$ 3.33	\$ 2.42	\$ 2.18
<b>Diluted</b> .....	\$ 3.25	\$ 2.36	\$ 2.10
<b>Net income per share:</b>			
<b>Basic</b> .....	\$ 3.33	\$ 2.32	\$ 2.10
<b>Diluted</b> .....	\$ 3.25	\$ 2.25	\$ 2.03
<b>Shares used in computing earnings per share:</b>			
<b>Basic</b> .....	53,640	56,314	58,636
<b>Diluted</b> .....	54,857	57,956	60,689
<b>Dividends declared per common share</b> .....	\$ 0.79	\$ 0.555	\$ 0.125

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

**HSN, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands)

	Years Ended December 31,		
	2013	2012	2011
Net income .....	\$ 178,449	\$ 130,675	\$ 123,070
Other comprehensive income (loss), net of tax:			
Change in fair value of derivative instrument .....	825	(471)	—
<b>Other comprehensive income (loss), net of tax</b> .....	<b>825</b>	<b>(471)</b>	<b>—</b>
<b>Comprehensive income</b> .....	<b>\$ 179,274</b>	<b>\$ 130,204</b>	<b>\$ 123,070</b>

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

**HSN, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

ASSETS	December 31,	
	2013	2012
<b>Current assets:</b>		
Cash and cash equivalents .....	\$ 196,433	\$ 222,092
Accounts receivable, net of allowance of \$16,863 and \$14,537, respectively .....	265,115	249,890
Inventories .....	327,319	330,936
Deferred income taxes .....	29,761	27,603
Prepaid expenses and other current assets .....	48,630	46,172
Total current assets .....	867,258	876,693
Property and equipment, net .....	178,720	171,303
Intangible assets, net .....	262,460	266,876
Goodwill .....	9,858	9,858
Other non-current assets .....	19,627	7,222
<b>TOTAL ASSETS</b> .....	<b>\$ 1,337,923</b>	<b>\$ 1,331,952</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable, trade .....	\$ 255,627	\$ 267,061
Current maturities of long-term debt .....	12,500	9,375
Accrued expenses and other current liabilities .....	207,984	215,389
Total current liabilities .....	476,111	491,825
Long-term debt, less current maturities .....	228,125	240,625
Deferred income taxes .....	88,034	79,002
Other long-term liabilities .....	16,572	15,986
Total liabilities .....	808,842	827,438
Commitments and contingencies (Note 13)		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock \$0.01 par value; 25,000,000 authorized shares; no issued shares .....	—	—
Common stock \$0.01 par value; 300,000,000 authorized shares; 53,002,368 and 54,853,684 issued shares as of December 31, 2013 and 2012, respectively .....	530	549
Additional paid-in capital .....	1,810,072	1,964,760
Accumulated deficit .....	(1,281,875)	(1,460,324)
Accumulated other comprehensive income (loss) .....	354	(471)
Total shareholders' equity .....	529,081	504,514
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> .....	<b>\$ 1,337,923</b>	<b>\$ 1,331,952</b>

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

**HSN, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(In thousands)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Total
	Shares	Amount	Shares	Amount				
<b>Balance as of December 31, 2010</b>	—	\$ —	57,967	\$ 580	\$ 2,189,952	\$ (1,714,069)	\$ —	\$ 476,463
Net income .....	—	—	—	—	—	123,070	—	123,070
Stock-based compensation expense for equity awards .....	—	—	—	—	18,908	—	—	18,908
Cash dividend declared on common stock .....	—	—	—	—	(7,384)	—	—	(7,384)
Issuance of common stock from stock-based compensation awards, including tax benefit of \$9,330 .....	—	—	1,238	12	6,689	—	—	6,701
Repurchases of common stock ..	—	—	(791)	(8)	(28,053)	—	—	(28,061)
<b>Balance as of December 31, 2011.</b>	—	—	58,414	584	2,180,112	(1,590,999)	—	589,697
Net income .....	—	—	—	—	—	130,675	—	130,675
Other comprehensive loss .....	—	—	—	—	—	—	(471)	(471)
Stock-based compensation expense for equity awards .....	—	—	—	—	14,440	—	—	14,440
Cash dividend declared on common stock .....	—	—	—	—	(31,049)	—	—	(31,049)
Issuance of common stock from stock-based compensation awards, including tax benefit of \$18,900 .....	—	—	1,901	19	21,797	—	—	21,816
Repurchases of common stock ..	—	—	(5,461)	(54)	(220,540)	—	—	(220,594)
<b>Balance as of December 31, 2012</b>	—	—	54,854	549	1,964,760	(1,460,324)	(471)	504,514
Net income .....	—	—	—	—	—	178,449	—	178,449
Other comprehensive income ..	—	—	—	—	—	—	825	825
Stock-based compensation expense for equity awards .....	—	—	—	—	14,043	—	—	14,043
Cash dividend declared on common stock .....	—	—	—	—	(42,281)	—	—	(42,281)
Issuance of common stock from stock-based compensation awards, including tax benefit of \$9,788 .....	—	—	885	9	20,416	—	—	20,425
Repurchases of common stock ..	—	—	(2,737)	(28)	(146,866)	—	—	(146,894)
<b>Balance as of December 31, 2013</b>	—	\$ —	53,002	\$ 530	\$ 1,810,072	\$ (1,281,875)	\$ 354	\$ 529,081

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

**HSN, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	Years Ended December 31,		
	2013	2012	2011
<b>Cash flows from operating activities attributable to continuing operations:</b>			
Net income	\$ 178,449	\$ 130,675	\$ 123,070
Loss from discontinued operations, net of tax	—	(5,822)	(4,582)
<b>Income from continuing operations</b>	<b>178,449</b>	<b>136,497</b>	<b>127,652</b>
Adjustments to reconcile income from continuing operations to net cash provided by operating activities attributable to continuing operations:			
Depreciation and amortization	40,589	38,005	35,822
Stock-based compensation expense	14,043	19,056	26,401
Loss on debt extinguishment	—	18,627	—
Amortization of debt issuance costs	1,130	1,777	2,941
Deferred income taxes	6,370	(2,146)	2,238
Bad debt expense	22,773	24,186	19,758
Excess tax benefits from stock-based awards	(10,360)	(19,004)	(9,835)
Fair value adjustment to contingent consideration obligation	(3,600)	—	—
Asset impairment	3,040	—	—
Other	1,140	764	2,343
Changes in assets and liabilities:			
Accounts receivable	(38,211)	(51,995)	(46,201)
Inventories	3,617	(36,117)	(1,385)
Prepaid expenses and other assets	(6,318)	(3,724)	(3,213)
Accounts payable, accrued expenses and other current liabilities	19,245	21,487	8,834
<b>Net cash provided by operating activities attributable to continuing operations</b>	<b>231,907</b>	<b>147,413</b>	<b>165,355</b>
<b>Cash flows from investing activities attributable to continuing operations:</b>			
Capital expenditures	(51,952)	(45,803)	(42,069)
Acquisition of business, net of cash received	—	(22,875)	—
Advance payment of capital expenditure	(9,100)	—	—
Proceeds from sale of discontinued operations	—	6,580	—
<b>Net cash used in investing activities attributable to continuing operations</b>	<b>(61,052)</b>	<b>(62,098)</b>	<b>(42,069)</b>
<b>Cash flows from financing activities attributable to continuing operations:</b>			
Redemption of Senior Notes	—	(253,500)	(69,841)
Borrowing under term loan	—	250,000	—
Repayments of long-term debt	(9,375)	—	—
Payments of debt issuance costs	—	(4,607)	—
Repurchase of common stock	(146,894)	(221,835)	(26,821)
Cash dividends paid	(42,281)	(31,049)	(7,384)
Proceeds from issuance of common stock	8,396	20,688	8,845
Tax withholdings related to stock-based awards	(14,395)	(18,209)	(11,430)
Excess tax benefits from stock-based awards	10,360	19,004	9,835
Payment of contingent consideration obligation	(2,172)	—	—
<b>Net cash used in financing activities attributable to continuing operations</b>	<b>(196,361)</b>	<b>(239,508)</b>	<b>(96,796)</b>
<b>Total cash (used in) provided by continuing operations</b>	<b>(25,066)</b>	<b>(154,193)</b>	<b>26,490</b>
<b>Cash flows from discontinued operations:</b>			
Net cash (used in) provided by operating activities attributable to discontinued operations	(153)	(5,361)	1,309
Net cash used in investing activities attributable to discontinued operations	—	(162)	(250)
<b>Total cash (used in) provided by discontinued operations</b>	<b>(153)</b>	<b>(5,523)</b>	<b>1,059</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(25,659)</b>	<b>(159,716)</b>	<b>27,549</b>
Cash and cash equivalents at beginning of period	222,092	381,808	354,259
<b>Cash and cash equivalents at end of period</b>	<b>\$ 196,433</b>	<b>\$ 222,092</b>	<b>\$ 381,808</b>

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



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1—ORGANIZATION

#### Company Overview

HSN, Inc. (“HSNi”) is an interactive multi-channel retailer that markets and sells a wide range of third party and private label merchandise directly to consumers through various platforms including (i) television home shopping programming broadcast on the HSN television networks; (ii) catalogs, which consist primarily of the Cornerstone portfolio of leading print catalogs which includes, Ballard Designs, Chasing Fireflies, Frontgate, Garnet Hill, Grandin Road, Improvements and TravelSmith; (iii) websites, which consist primarily of HSN.com and the eight branded websites operated by Cornerstone; (iv) retail and outlet stores; and (v) mobile devices. HSNi’s television home shopping business, related digital sales and outlet stores are referred to herein as “HSN” and all catalog operations, including related digital sales and stores, are collectively referred to herein as “Cornerstone.” Smith+Noble, a Cornerstone brand that specialized in window treatments, was sold in May 2012 and The Territory Ahead, a Cornerstone brand that specialized in casual apparel, was sold in July 2012.

HSN offerings primarily consist of jewelry, fashion (apparel & accessories), beauty & health, and home & other (including household, home design, electronics, culinary and other). Merchandise offered by Cornerstone primarily consists of home furnishings (including indoor/outdoor furniture, home décor, tabletop, textiles, window treatments and other home related goods) and apparel & accessories.

#### Basis of Presentation

HSNi was incorporated in Delaware in May 2008 in connection with the spin-off of several businesses previously owned by IAC/InterActiveCorp, or IAC. The spin-off from IAC occurred August 20, 2008 concurrent with the spin-offs from IAC of Interval Leisure Group, Inc., Ticketmaster Entertainment, Inc. (now a wholly-owned subsidiary of Live Nation Entertainment, Inc.), and Tree.com, Inc. Throughout these financial statements, the separation transaction is referred to as the “Spin-off” and each of these companies as “Spincos.” In connection with the Spin-off, HSNi's shares began trading on the NASDAQ Global Select Market under the symbol “HSNI.”

The consolidated financial statements include the accounts of HSN, Inc. and its subsidiaries. Intercompany accounts and transactions have been eliminated. The operating results of Smith+Noble and The Territory Ahead are presented as discontinued operations in the consolidated statements of operations and the consolidated statements of cash flows for all periods presented. See Note 17 for further discussion of discontinued operations.

#### Fiscal Year

HSNi’s consolidated financial results are reported on a calendar year basis ending on December 31. HSN’s reporting period is the same as HSNi. Cornerstone has a 4-4-5 week accounting cycle with the fiscal year ending on the Saturday on or immediately preceding December 31. Cornerstone’s fiscal years 2013, 2012, and 2011 include 52, 52 and 53 weeks, respectively.

### NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Revenue Recognition

Revenue primarily consists of merchandise sales and is reduced by incentive discounts and sales returns to arrive at net sales. Revenue is recorded when delivery to the customer has occurred. Delivery is considered to have occurred when the customer takes title and assumes the risks and rewards of ownership, which is on the date of shipment. HSNi's sales policy allows customers to return merchandise for a full refund or exchange, subject to pre-established time restrictions. Allowances for returned merchandise and other adjustments (including reimbursed shipping and handling costs) are provided based upon past experience. Actual returns of product sales have not materially varied from estimates in any of the periods presented. HSNi's estimated return rates were 17.0%, 17.8%, and 18.5% in 2013, 2012, and 2011, respectively. Sales taxes collected are not included in revenue.

#### Shipping and Handling Fees and Costs

Shipping and handling fees billed to customers are recorded as revenue. The costs associated with shipping goods to customers are recorded as cost of sales.

## Cash and Cash Equivalents

Cash and cash equivalents include cash and money market instruments with an original maturity of three months or less when purchased and are stated at cost.

## Accounts Receivable

Accounts receivable are principally comprised of amounts due from customers and credit card companies, net of an allowance for doubtful accounts. HSN provides extended payment terms to its customers on certain products known as Flexpay. Revenue is recorded when delivery to the customer has occurred, at which time HSN collects the first payment, sales tax and all shipping and handling fees. Subsequent collections are due from customers in 30-day increments, payable automatically upon authorization of the customer's method of payment. HSN accepts most credit and select debit cards. HSN offers Flexpay programs ranging from two to six interest-free monthly payments. Flexpay receivables consist of outstanding balances owed by customers, less a reserve for uncollectible balances.

The balance of accounts receivable, net of allowances, is as follows (in thousands):

	December 31,	
	2013	2012
Flexpay and other customer-related .....	\$ 222,983	\$ 200,989
Credit card companies .....	21,447	29,393
Other .....	20,685	19,508
Accounts receivable, net .....	<u>\$ 265,115</u>	<u>\$ 249,890</u>

Accounts receivable outstanding longer than the contractual payment terms are considered past due. HSNi determines its allowance by considering a number of factors, including the length of time accounts receivable are past due, HSNi's previous loss history and the condition of the general economy. HSNi writes off accounts receivable when they are deemed uncollectible.

## Inventories

Inventories, which primarily consist of finished goods, are valued at the lower of cost or market, with the cost being determined based upon the first-in, first-out method. Cost includes inbound freight and duties and, in the case of HSN, certain allocable costs, including certain warehouse costs. Inventories include approximately \$6.0 million and \$6.2 million of these allocable general and administrative overhead costs at December 31, 2013 and 2012, respectively, and approximately \$23.9 million, \$24.3 million, and \$20.9 million of such costs were included in the accompanying consolidated statements of operations for the years ended December 31, 2013, 2012 and 2011, respectively. Market is determined on the basis of net realizable value, giving consideration to obsolescence and other factors.

## Property and Equipment

Property and equipment, including significant improvements, are recorded at cost. Repairs and maintenance and any gains or losses on dispositions are included in the consolidated statement of operations.

Depreciation is recorded on a straight-line basis to allocate the cost of depreciable assets to operations over the shorter of the estimated service life or lease period.

<u>Asset Category</u>	<u>Depreciation Period</u>
Computer and broadcast equipment and capitalized software .....	3 to 6 Years
Buildings, leasehold improvements and land improvements .....	3 to 40 Years
Furniture and other equipment .....	2 to 10 Years

HSNi capitalizes certain qualified costs incurred in connection with the development of internal use software. Capitalization of internal use software costs begins when the preliminary project stage is completed; management with the relevant authority authorizes and commits to the funding of the software project; and it is probable that the project will be completed and the software will be used to perform the function intended. Capitalized internal use software is amortized on a straight-line basis over the estimated useful life of the software, not to exceed five years. Capitalized software costs, net of accumulated amortization, totaled \$37.3 million and \$21.6 million at December 31, 2013 and 2012, respectively, and are included in "Property and equipment, net" in the accompanying consolidated balance sheets. Amortization expense related to

the capitalized software costs was \$15.1 million, \$12.7 million and \$13.1 million for the years ended December 31, 2013, 2012 and 2011, respectively, and is included in "Depreciation and amortization" expense in the consolidated statements of operations.

### **Goodwill and Indefinite-Lived Intangible Assets**

Goodwill acquired in business combinations is assigned to the reporting units that are expected to benefit from the combination as of the acquisition date. Goodwill and indefinite-lived intangible assets, primarily trade names and trademarks, are assessed annually for impairment as of October 1 or upon the occurrence of certain events or substantive changes in circumstances. See Note 3 for a further discussion on goodwill and indefinite-lived intangible assets.

### **Long-Lived Assets and Intangible Assets with Definite Lives**

Long-lived assets, including property and equipment and intangible assets with definite lives, are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the carrying amount is deemed to not be recoverable, an impairment loss is recorded as the amount by which the carrying amount of the long-lived asset exceeds its fair value. Amortization of definite-lived intangible assets is generally recorded on a straight-line or accelerated basis over their estimated lives.

### **Cable and Satellite Distribution Fees**

Cable and satellite distribution fees relate to fees paid in connection with annual or multi-year cable and satellite contracts for carriage of HSN's programming. Fees that are paid upfront for annual contracts are included in "Prepaid expenses and other current assets" in the accompanying consolidated balance sheets and are amortized on a straight-line basis over the terms of the respective contracts. Unpaid fees are accrued and included in the line item "Accrued expenses and other current liabilities" in the accompanying consolidated balance sheets. Cable and satellite distribution fees and amortization are included in "Selling and marketing" expense in the accompanying consolidated statements of operations.

### **Advertising**

Advertising costs include catalog production and distribution costs. Advertising costs are expensed in the period incurred, except for Cornerstone's direct costs of producing and distributing its catalogs, which are capitalized. These capitalized costs are amortized over the expected future revenue stream, which is generally three months from the date catalogs are mailed. Such capitalized costs totaled \$18.8 million and \$19.1 million as of December 31, 2013 and 2012, respectively, and are included in "Prepaid expenses and other current assets" in the accompanying consolidated balance sheets. Of these amounts, \$13.0 million and \$10.2 million as of December 31, 2013 and 2012, respectively, related to catalogs that had not yet been mailed. Advertising expense was \$268.0 million, \$245.0 million, and \$215.5 million for the years ended December 31, 2013, 2012 and 2011, respectively.

### **Income Taxes**

HSNi accounts for income taxes under the liability method, and deferred tax assets and liabilities are recognized for the future tax consequences attributable to 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 rates in effect for the year in which those temporary differences are expected to be recovered or settled. A valuation allowance is provided on deferred tax assets if it is determined that it is more likely than not that the deferred tax asset will not be realized. HSNi records interest and penalties on potential tax contingencies as a component of income tax expense and records interest net of any applicable related income tax benefit.

HSNi recognizes liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on its technical merits. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement.

### **Stock-Based Compensation**

HSNi recognizes compensation expense for stock-based awards, reduced for estimated forfeitures, on a straight-line basis over the requisite service period of the award, which is generally the vesting term of the outstanding stock awards. Tax benefits resulting from tax deductions in excess of the stock-based compensation expense recognized in the consolidated statements of cash flows are reported as a component of financing cash flows. HSNi issues new shares to satisfy equity vestings and exercises. See Note 11 for a further description of our stock compensation plans.

## **Earnings Per Share**

HSNi computes basic earnings per share by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the treasury stock method.

## **Derivative Instruments**

HSNi uses derivatives in the management of interest rate risk with respect to interest expense on variable rate debt. Such instruments are not held or used for trading purposes. HSNi is party to an interest rate swap agreement with one major financial institution that will fix the variable benchmark component (LIBOR) of HSNi's interest rate on a portion of its term loan beginning January 2014. See Note 8 for further discussion of derivative instruments.

## **Share Repurchases**

Shares repurchased pursuant to HSNi's share repurchase program are immediately retired upon purchase. Repurchased common stock is reflected as a reduction of shareholders' equity. HSNi's accounting policy related to its share repurchases is to reduce its common stock based on the par value of the shares and to reduce its capital surplus for the excess of the repurchase price over the par value. Since the inception of its share repurchase program in September 2011, HSNi has had an accumulated deficit balance; therefore, the excess over the par value has been applied to additional paid-in capital. Once HSNi has retained earnings, the excess will be charged entirely to retained earnings.

## **Accounting Estimates**

HSNi prepares its financial statements in conformity with generally accepted accounting principles in the United States ("GAAP"). These principles require management to make certain estimates and assumptions during the preparation of its consolidated financial statements. These estimates and assumptions impact the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the consolidated financial statements. They also impact the reported amount of net earnings during any period. Actual results could differ from those estimates.

Significant estimates underlying the accompanying consolidated financial statements include: the determination of the lower of cost or market adjustment for inventory; sales returns and other revenue allowances; the allowance for doubtful accounts; the recoverability of long-lived assets; the impairment of intangible assets; the determination of deferred income taxes, including related valuation allowances; the accrual for actual, pending or threatened litigation, claims and assessments; and assumptions related to the determination of stock-based compensation and contingent consideration related to acquisitions.

## **Certain Risks and Concentrations**

HSNi's business is subject to certain risks and concentrations including dependence on third-party technology providers, exposure to risks associated with online commerce security, consumer credit risk and credit card fraud. HSNi also depends on third-party service providers for processing certain fulfillment services.

## **NOTE 3—INTANGIBLE ASSETS AND GOODWILL**

HSNi assesses the impairment of goodwill and indefinite-lived identifiable intangible assets, principally trademarks and trade names, at least annually during the fourth quarter and whenever events or circumstances indicate that the carrying value may not be fully recoverable. In performing this review, HSNi has the option of performing a qualitative assessment to determine whether it is more likely than not that the fair values of the reporting unit and/or indefinite-lived intangible assets are less than the carrying values. If HSNi determines that it is not more likely that the fair value is less than its carrying value, then the goodwill and/or the indefinite-lived intangible assets are deemed to be not impaired and no further testing is required until the next annual test date (or sooner if conditions or events before that date raise concerns of potential impairment in the business). If HSNi determines that it is more likely than not that the fair value is less than its carrying value, then the quantitative goodwill and/or indefinite-lived intangible asset impairment tests (as discussed below) must be completed.

If necessary, HSNi performs a quantitative assessment of the fair values of its goodwill and intangible assets. If it is determined that the implied fair value of goodwill and/or indefinite-lived intangible assets is less than the carrying amount, an impairment charge, equal to the excess, is recorded. The implied fair value of goodwill is determined in the same manner as in a business combination. The estimated fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the estimated fair value of the reporting unit was the purchase price paid. The fair value of the reporting unit

is determined by using a discounted cash flow analysis with consideration of an equity analysis based on the trading value of its common stock. The discounted cash flow analysis indicates the fair value of the reporting units based on the present value of the cash flows expected to be generated in the future. The equity analysis is based on the trading value of its common stock as of the valuation date or the average stock price over a range of dates prior to the valuation date, plus an estimated control premium. HSNi utilizes a relief from royalty method to assess the fair values of its trademarks and trade names.

In assessing fair value, HSNi considers, among other indicators, differences between estimated and actual cash flows and revenue streams; changes in the related discount, royalty and terminal growth rate; and the relationship between the trading price of its common stock and its per-share book value. Determining fair value requires the exercise of significant judgments. These factors used in the determination of fair value are sensitive to, among other things, changes in the retail consumer market and the general economy.

### Intangible Assets

Intangible assets with indefinite lives relate principally to trade names and trademarks. Definite-lived intangible assets consist primarily of customer relationships which are amortized on an accelerated basis over their useful lives. When definite-lived intangible assets are sold or expire, the cost of the asset and the related accumulated amortization are eliminated and any gain or loss is recognized at such time.

In the second quarter of 2012, \$9.7 million of indefinite-lived intangible assets (excluding goodwill) and \$3.8 million of definite-lived intangible assets were recorded in connection with the acquisition of substantially all of the assets and liabilities of Chasing Fireflies. The total balance of HSNi's intangible assets, net, is as follows (in thousands):

	December 31,	
	2013	2012
Intangible assets with indefinite lives .....	\$ 261,809	\$ 264,849
Intangible assets with definite lives, net .....	651	2,027
Total intangible assets, net .....	<u>\$ 262,460</u>	<u>\$ 266,876</u>

In the fourth quarter of 2013, HSNi performed qualitative and quantitative assessments (as applicable) of its intangible assets and concluded an adjustment was necessary related to trademarks associated with the 2012 acquisition of Chasing Fireflies. An impairment charge of \$3.0 million was recorded in the fourth quarter of 2013 within the Cornerstone segment and is included in "General and administrative" expense in the accompanying consolidated statements of operations. In the fourth quarter of 2012, HSNi elected to perform qualitative and quantitative assessments (as applicable) of its indefinite-lived intangible assets and concluded there were no impairments.

Amortization expense for the definite-lived intangible assets was \$1.4 million, \$1.8 million, and \$0.4 million for the years ended December 31, 2013, 2012 and 2011, respectively. At December 31, 2013 and 2012, the following is information on intangible assets with definite lives (in thousands):

	Cost	Accumulated Amortization	Net	Weighted Average Amortization Life (Years)
As of December 31, 2013 .....	\$ 3,800	\$ (3,149)	\$ 651	1.1
As of December 31, 2012 .....	\$ 3,800	\$ (1,773)	\$ 2,027	1.4

### Goodwill

In the second quarter of 2012, \$9.9 million of goodwill was recorded in connection with the acquisition of Chasing Fireflies which was allocated to the Cornerstone reporting unit. No adjustments have been made to the goodwill balance subsequent to the acquisition. In the fourth quarter of 2013 and 2012, HSNi performed a qualitative assessment of its goodwill and concluded there was no impairment.

The following tables present the balance of goodwill by reporting unit, including changes in the carrying amount of goodwill, for the years ended December 31, 2013 and 2012 (in thousands):

	Gross Balance as of January 1, 2013	Accumulated Impairment	Net Balance as of January 1, 2013	Additions	Impairment	Net Balance as of December 31, 2013
HSN	\$ 2,391,594	\$ (2,391,594)	\$ —	\$ —	\$ —	\$ —
Cornerstone	502,464	(492,606)	9,858	—	—	9,858
Total	<u>\$ 2,894,058</u>	<u>\$ (2,884,200)</u>	<u>\$ 9,858</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 9,858</u>

	Gross Balance as of January 1, 2012	Accumulated Impairment	Net Balance as of January 1, 2012	Additions	Impairment	Net Balance as of December 31, 2012
HSN	\$ 2,391,594	\$ (2,391,594)	\$ —	\$ —	\$ —	\$ —
Cornerstone	492,606	(492,606)	—	9,858	—	9,858
Total	<u>\$ 2,884,200</u>	<u>\$ (2,884,200)</u>	<u>\$ —</u>	<u>\$ 9,858</u>	<u>\$ —</u>	<u>\$ 9,858</u>

#### NOTE 4—PROPERTY AND EQUIPMENT

The balance of property and equipment, net, is as follows (in thousands):

	December 31,	
	2013	2012
Capitalized software	\$ 215,893	\$ 196,529
Computer and broadcast equipment	85,521	83,038
Buildings and leasehold improvements	102,437	98,241
Furniture and other equipment	83,779	79,748
Projects in progress	12,528	18,494
Land and land improvements	10,460	10,734
	510,618	486,784
Less: accumulated depreciation and amortization	(331,898)	(315,481)
Total property and equipment, net	<u>\$ 178,720</u>	<u>\$ 171,303</u>

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. As a result of the impairment charge recognized in the fourth quarter of 2013 related to the indefinite-lived intangible assets of Chasing Fireflies, HSNi assessed if there was an impairment of any of this brand's long-lived assets and determined that there was none. As we periodically reassess estimated future cash flows and asset fair values, changes in our estimates and assumptions may cause us to realize additional impairment charges in the future.

#### NOTE 5—ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following (in thousands):

	December 31,	
	2013	2012
Accrued sales returns	\$ 40,072	\$ 40,554
Accrued cable and satellite distribution fees	30,452	23,874
Accrued freight and fulfillment expenses	32,646	23,979
Accrued compensation and benefits	36,567	53,635
Other accrued expenses and current liabilities	68,247	73,347
Total accrued expenses and other current liabilities	<u>\$ 207,984</u>	<u>\$ 215,389</u>

## NOTE 6—SEGMENT INFORMATION

HSNi presents its operating segments and related financial information in a manner consistent with how the chief operating decision maker and executive management view the businesses, how the businesses are organized as to segment management, and the focus of the businesses with regards to the types of products or services offered or the target market. HSNi has two operating segments, HSN and Cornerstone. The accounting policies of the segments are the same as those described in Note 2 – Summary of Significant Accounting Policies. Intercompany accounts and transactions have been eliminated in consolidation.

HSNi's primary metric is Adjusted EBITDA, which is defined as operating income excluding, if applicable: (1) non-cash charges including: (a) stock-based compensation expense, (b) amortization of intangibles, (c) depreciation and gains and losses on asset dispositions, and (d) goodwill, long-lived asset and intangible asset impairments; (2) pro forma adjustments for significant acquisitions; and (3) other significant items. Significant items, while periodically affecting our results, may vary significantly from period to period and have a disproportionate effect in a given period, thereby affecting the comparability of results. Adjusted EBITDA is not a measure determined in accordance with GAAP, and should not be considered in isolation or as a substitute for operating income, net income or any other measure determined in accordance with GAAP. Adjusted EBITDA is used as a measurement of operating efficiency and overall financial performance and HSNi believes it to be a helpful measure for those evaluating companies in the retail and media industries. Adjusted EBITDA has certain limitations in that it does not take into account the impact to HSNi's consolidated statements of operations of certain expenses, including stock-based compensation, amortization of intangibles, depreciation, gains and losses on asset dispositions, asset impairment charges, acquisition-related accounting expenses and other significant items.

The following tables reconcile Adjusted EBITDA to operating income for HSNi's operating segments and to HSNi's consolidated net income (in thousands):

	Year Ended December 31, 2013		
	HSN	Cornerstone	Total
<b>Adjusted EBITDA</b> .....	\$ 261,292	\$ 76,574	\$ 337,866
Stock-based compensation expense .....	(10,657)	(3,386)	(14,043)
Depreciation and amortization .....	(28,372)	(12,217)	(40,589)
Assets impairment .....	—	(3,040)	(3,040)
Fair value adjustment to contingent consideration obligation .....	—	3,600	3,600
Loss on disposition of fixed assets .....	(1,079)	(61)	(1,140)
<b>Operating income</b> .....	<u>\$ 221,184</u>	<u>\$ 61,470</u>	282,654
Total other expense, net. ....			(6,513)
Income from continuing operations before income taxes .....			276,141
Income tax provision .....			(97,692)
Income from continuing operations .....			178,449
Loss from discontinued operations, net of tax .....			—
<b>Net income</b> .....			<u>\$ 178,449</u>

	Year Ended December 31, 2012		
	HSN	Cornerstone	Total
<b>Adjusted EBITDA</b> .....	\$ 250,836	\$ 73,441	\$ 324,277
Stock-based compensation expense .....	(11,167)	(7,889)	(19,056)
Depreciation and amortization .....	(26,486)	(11,519)	(38,005)
Sales tax settlement .....	—	(7,750)	(7,750)
Loss on disposition of fixed assets .....	(680)	(42)	(722)
<b>Operating income</b> .....	<u>\$ 212,503</u>	<u>\$ 46,241</u>	258,744
Total other expense, net. ....			(38,874)
Income from continuing operations before income taxes .....			219,870
Income tax provision .....			(83,373)
Income from continuing operations .....			136,497
Loss from discontinued operations, net of tax .....			(5,822)
<b>Net income</b> .....			<u>\$ 130,675</u>

**Year Ended December 31, 2011**

	<b>HSN</b>	<b>Cornerstone</b>	<b>Total</b>
<b>Adjusted EBITDA</b> .....	\$ 235,163	\$ 67,595	\$ 302,758
Stock-based compensation expense .....	(13,101)	(13,300)	(26,401)
Depreciation and amortization .....	(27,652)	(8,170)	(35,822)
Loss on disposition of fixed assets .....	(1,482)	(11)	(1,493)
<b>Operating income</b> .....	<u>\$ 192,928</u>	<u>\$ 46,114</u>	239,042
Total other expense, net. ....			(31,284)
Income from continuing operations before income taxes .....			207,758
Income tax provision .....			(80,106)
Income from continuing operations .....			127,652
Loss from discontinued operations, net of tax .....			(4,582)
<b>Net income</b> .....			<u>\$ 123,070</u>

Financial information by segment is as follows (thousands):

**Year Ended December 31,**

	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Net sales:</b>			
HSN .....	\$ 2,312,382	\$ 2,265,026	\$ 2,160,341
Cornerstone .....	1,091,601	1,001,713	909,015
<b>Total</b> .....	<u>\$ 3,403,983</u>	<u>\$ 3,266,739</u>	<u>\$ 3,069,356</u>
<b>Identifiable assets:</b>			
HSN .....	\$ 1,058,573	\$ 1,083,714	\$ 1,178,565
Cornerstone .....	279,350	248,238	216,408
<b>Total</b> .....	<u>1,337,923</u>	<u>1,331,952</u>	<u>1,394,973</u>
<b>Capital expenditures:</b>			
HSN .....	\$ 36,156	\$ 33,566	\$ 30,155
Cornerstone .....	15,796	12,237	11,914
<b>Total</b> .....	<u>\$ 51,952</u>	<u>\$ 45,803</u>	<u>\$ 42,069</u>

HSNi does not report revenue from external customers for each product or each group of similar products as it is impracticable to do so. HSNi maintains operations principally in the United States with no long-lived assets and insignificant net sales in all other countries.

**NOTE 7—LONG-TERM DEBT**

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
Secured credit agreement expiring April 24, 2017:		
Term loan .....	\$ 240,625	\$ 250,000
Revolving credit facility .....	—	—
Total long-term debt .....	240,625	250,000
Less: current maturities .....	(12,500)	(9,375)
Long-term debt, less current maturities .....	<u>\$ 228,125</u>	<u>\$ 240,625</u>

On April 24, 2012, HSNi entered into a \$600 million five-year syndicated credit agreement ("Credit Agreement") which is secured by 100% of the voting equity securities of HSNi's U.S. subsidiaries and 65% of HSNi's first-tier foreign subsidiaries. This Credit Agreement replaced the credit agreement that was set to expire in July 2013. Certain HSNi subsidiaries have unconditionally guaranteed HSNi's obligations under the Credit Agreement. The Credit Agreement, which includes a \$350 million revolving credit facility and a \$250 million term loan, may be increased up to \$850 million subject to certain conditions and expires April 24, 2017. HSNi drew \$250 million from its term loan on July 31, 2012 to fund the redemption of the Senior



Notes, as discussed below. HSNi capitalized \$5.5 million in financing costs related to the Credit Agreement and is amortizing these costs to interest expense over the Credit Agreement's five-year term.

The Credit Agreement includes various covenants, limitations and events of default customary for similar facilities including a maximum leverage ratio of 3.00x and a minimum interest coverage ratio of 3.00x. HSNi was in compliance with all such covenants as of December 31, 2013, with a leverage ratio of 0.73x and an interest coverage ratio of 60.68x. The Credit Agreement also contains covenants that limit our ability and the ability of our subsidiaries to, among other things, incur additional indebtedness, pay dividends or make other distributions to third parties, repurchase or redeem our stock, make investments, sell assets, incur liens, enter into agreements restricting our subsidiaries' ability to pay dividends, enter into transactions with affiliates and consolidate, merge or sell all or substantially all of our assets. Dividends, loans or advances to HSNi by its subsidiaries are not restricted by the Credit Agreement.

Loans under the Credit Agreement bear interest at a per annum rate equal to LIBOR plus a predetermined margin that ranges from 1.50% to 2.25% or the Base Rate (as defined in the Credit Agreement) plus a predetermined margin that ranges from 0.50% to 1.25%. HSNi can elect to borrow at either LIBOR or the Base Rate and the predetermined margin is based on HSNi's leverage ratio. The term loan interest rate as of December 31, 2013 was 1.66%. HSNi pays a commitment fee ranging from 0.25% to 0.40% (based on the leverage ratio) on the unused portion of the revolving credit facility.

The amount available to HSNi under the revolving credit facility portion of the Credit Agreement is reduced by the amount of outstanding letters of credit issued under the revolving credit facility, which totaled \$31.7 million as of December 31, 2013. The ability to draw funds under the revolving credit facility is dependent upon meeting the aforementioned financial covenants. As of December 31, 2013, the amount that could be borrowed under the revolving credit facility, in consideration of the financial covenants and the outstanding letters of credit, was approximately \$318.3 million. As of December 31, 2013, there was no outstanding balance due under the revolving credit facility.

On July 28, 2008, HSNi issued \$240 million of 11.25% senior notes due 2016 (the "Senior Notes"). The Senior Notes were fully redeemed on August 1, 2012 for \$253.5 million, or 105.625% of the principal amount, plus accrued and unpaid interest to the redemption date, at which time the Senior Notes were no longer deemed to be outstanding, interest ceased to accrue thereon and all rights of the holders of the Senior Notes ceased to exist, except for the right to receive the redemption price. HSNi drew \$250 million from its term loan on July 31, 2012 and used its cash on hand to fund the redemption. HSNi reported approximately \$18.6 million in pre-tax charges primarily associated with redemption of the Senior Notes. These charges resulted from the redemption premium of \$13.5 million and \$5.1 million related to the write-off of unamortized issuance costs and original issue discount.

Aggregate contractual maturities of long-term debt are as follows (in thousands):

Years Ending December 31,	
2014.....	\$ 12,500
2015.....	17,188
2016.....	18,750
2017.....	192,187
	\$ 240,625

## NOTE 8—DERIVATIVE INSTRUMENTS

HSNi uses derivatives in the management of its interest rate risk with respect to its variable rate debt. HSNi's strategy is to eliminate the cash flow risk on a portion of its variable rate debt caused by changes in the benchmark interest rate (LIBOR). Derivative instruments are not entered into for speculative purposes.

HSNi entered into a forward-starting interest rate swap agreement on December 20, 2012 with a notional amount of \$187.5 million at a fixed rate of 0.8525%, resulting in an all-in fixed rate of 2.3525% based on HSNi's leverage ratio as of December 31, 2013. The interest rate swap takes effect on January 31, 2014 with a maturity date in April 2017. Under this swap, HSNi pays at a fixed rate and receives payments at a variable rate based on one-month LIBOR. The swap effectively fixes the floating LIBOR-based interest of our outstanding LIBOR-based debt. The interest rate swap was designated and qualified as a cash flow hedge; therefore, the effective portion of the changes in fair value is recorded in accumulated other comprehensive income. Any ineffective portions of the changes in fair value of the interest rate swap will be immediately recognized directly to earnings in the consolidated statement of operations. The change in fair value of the interest rate swap was a gain of \$0.8 million and a loss of \$0.5 million, net of tax, for the years ended December 2013 and 2012, respectively, and

were reflected in "Accumulated other comprehensive income (loss)" in the consolidated balance sheets. As of December 31, 2013, HSNi estimates that approximately \$1.1 million of unrealized losses included in accumulated other comprehensive income (loss) related to this swap will be realized and reported in earnings within the next twelve months.

The fair value of the interest rate swap asset as of December 31, 2013 was \$0.6 million and was recorded in "Other non-current assets" in the consolidated balance sheets. The fair value of the interest rate swap liability as of December 31, 2012 was a liability of \$0.8 million and was recorded in "Other long-term liabilities" in the consolidated balance sheets. See Note 9 for discussion of the fair value measurements concerning this interest rate swap.

**NOTE 9—FAIR VALUE MEASUREMENTS**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value assumptions are made at a specific point in time and changes in underlying assumptions could significantly affect these estimates. HSNi applies the following framework for measuring fair value which is based on a three-level hierarchy:

**Level 1**—Valuations based on quoted prices for identical assets and liabilities in active markets.

**Level 2**—Valuations based on observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

**Level 3**—Valuations based on unobservable inputs reflecting our own assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short maturity of these items. The following table summarizes the fair value of HSNi's other financial assets and liabilities which are measured at fair value on a recurring basis in the consolidated balance sheets (in thousands):

		December 31, 2013		
		Fair Value Measurement Category		
Total Fair Value and Carrying Value on Balance Sheet		Level 1	Level 2	Level 3
Assets:				
Interest rate swap . . . . .	\$ 574	\$ —	\$ 574	\$ —
Liabilities:				
Contingent consideration . . . . .	1,032	—	—	1,032

		December 31, 2012		
		Fair Value Measurement Category		
Total Fair Value and Carrying Value on Balance Sheet		Level 1	Level 2	Level 3
Liabilities:				
Interest rate swap . . . . .	\$ 755	\$ —	\$ 755	\$ —
Contingent consideration . . . . .	6,832	—	—	6,832

HSNi's interest rate swap was carried on the balance sheet at fair value as of December 31, 2013 and December 31, 2012. The swap was entered into for the purpose of hedging the variability of interest expense and interest payments on HSNi's long-term variable rate debt. Because this swap is not actively traded, the fair value was based on a valuation model. Interest rate yield curves and credit spreads are the significant inputs included in the valuation model. These inputs are observable in active markets (level 2 criteria). HSNi considers credit risk associated with its own standing as well as the credit standing of any counterparties involved in the valuation of its financial instruments.

In connection with the 2012 acquisition of Chasing Fireflies, the purchase price included contingent consideration of \$7.8 million. Based on achieving specific annual performance targets or a cumulative three-year performance target, the sellers can receive payments in each of the three years following the acquisition up to a maximum total payout of \$7.8 million. The estimated fair value of the contingent consideration at the date of acquisition was \$6.5 million and was included as part of the purchase price allocation. HSNi determined the fair value of the contingent consideration based on a probability-weighted discounted cash flow approach (level 3 criteria). Key inputs used in this calculation included estimates related to each of the three year's operating performance. In each period, HSNi reassesses its current estimates of performance relative to the stated targets and adjusts the liability to fair value. Performance targets were achieved for the year ended December 31, 2012; therefore, a payment of \$2.6 million was paid to the sellers in 2013.

During the year ended December 31, 2013, performance targets were not achieved. As a result, during the fourth quarter ended December 31, 2013, HSNi determined Chasing Fireflies is also less likely to achieve the necessary performance targets in 2014 to earn the full amount of the contingent consideration. Therefore, HSNi adjusted the fair value of the contingent consideration in the fourth quarter of 2013 to \$1.0 million, a decrease of \$3.6 million. HSNi also recognized a fair value adjustment of \$3.0 million for indefinite-lived intangible assets related to the acquisition of Chasing Fireflies. The fair value of the intangible assets, consisting of trademarks and trade names, was determined using the relief from royalty method (level 3 criteria). Key inputs used in this calculation included revenue growth, discount, royalty and terminal growth rates. The net impact of the impairment charge and the contingent consideration adjustment was a reduction of expense of \$0.6 million and is included in "General and administrative expense" in the accompanying consolidated statements of operations.

The change in the fair value of the contingent consideration liability is summarized as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Beginning of the year .....	\$ 6,832	\$ —
Fair value of contingent consideration issued .....	—	6,500
Accretion .....	383	332
Payments .....	(2,583)	—
Fair value adjustments .....	(3,600)	—
End of the year .....	<u>\$ 1,032</u>	<u>\$ 6,832</u>

The following table summarizes the fair value of HSNi's financial assets and liabilities which are carried at cost (in thousands):

	<b>December 31, 2013</b>				
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Fair Value Measurement Category</b>		
			<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Term Loan .....	\$ 240,625	\$ 240,625	\$ —	\$ 240,625	\$ —

	<b>December 31, 2012</b>				
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Fair Value Measurement Category</b>		
			<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Term Loan .....	\$ 250,000	\$ 250,000	\$ —	\$ 250,000	\$ —

The fair value of the term loan was estimated by discounting expected cash flows at the rates currently offered to HSNi for debt of the same remaining maturities, as advised by HSNi's bankers (level 2 criteria).

HSNi measures certain assets, such as property and equipment and definite-lived intangible assets, at fair value on a non-recurring basis. These assets are recognized at fair value if they are deemed to be impaired. On July 1, 2012, substantially all of the assets and certain liabilities of The Territory Ahead were sold. An impairment charge of \$5.9 million was recorded in the second quarter of 2012 to reduce the carrying value of the net assets to their estimated net realizable value based on the known selling price of \$1.1 million and the estimated costs to sell the business. See Note 17 for further discussion of the sale of The Territory Ahead. There were no other fair value adjustments to the carrying values of HSNi's property and equipment and definite-lived intangible assets during December 31, 2013 or 2012.

## NOTE 10—EARNINGS PER SHARE

HSNi computes basic earnings per share using the weighted average number of common shares outstanding for the period. HSNi computes diluted earnings per share using the treasury stock method, which includes the weighted average number of common shares outstanding for the period plus the potential dilution that could occur if various equity awards to issue common stock were exercised or restricted equity awards were vested resulting in the issuance of common stock that could share in HSNi's earnings.

### Basic Earnings Per Share

For the years ended December 31, 2013, 2012 and 2011, basic earnings per share was computed using the number of weighted average shares of common stock outstanding for the period.

### Diluted Earnings Per Share

For the years ended December 31, 2013, 2012 and 2011, diluted earnings per share was computed using the number of shares of common stock outstanding for the year and, if dilutive, the incremental common stock that HSNi would issue upon the assumed exercise of stock options and stock appreciation rights and the vesting of restricted stock units using the treasury stock method.

The following table presents HSNi's basic and diluted earnings per share (in thousands, except per share data):

	Year Ended December 31,		
	2013	2012	2011
<b>Net income</b>			
Continuing operations . . . . .	\$ 178,449	\$ 136,497	\$ 127,652
Discontinued operations . . . . .	—	(5,822)	(4,582)
Net income . . . . .	<u>\$ 178,449</u>	<u>\$ 130,675</u>	<u>\$ 123,070</u>
<b>Weighted average number of shares outstanding:</b>			
Basic . . . . .	53,640	56,314	58,636
Dilutive effect of stock-based compensation awards . . . . .	1,217	1,642	2,053
Diluted . . . . .	<u>54,857</u>	<u>57,956</u>	<u>60,689</u>
<b>Net income (loss) per share - basic:</b>			
Continuing operations . . . . .	\$ 3.33	\$ 2.42	\$ 2.18
Discontinued operations . . . . .	—	(0.10)	(0.08)
Net income . . . . .	<u>\$ 3.33</u>	<u>\$ 2.32</u>	<u>\$ 2.10</u>
<b>Net income (loss) per share - diluted:</b>			
Continuing operations . . . . .	\$ 3.25	\$ 2.36	\$ 2.10
Discontinued operations . . . . .	—	(0.11)	(0.07)
Net income . . . . .	<u>\$ 3.25</u>	<u>\$ 2.25</u>	<u>\$ 2.03</u>
Unexercised employee stock options and stock appreciation rights and unvested restricted stock units excluded from the diluted EPS calculation because their effect would have been antidilutive . . . . .	<u>432</u>	<u>1,276</u>	<u>911</u>

## NOTE 11—STOCK-BASED AWARDS

Stock-based compensation expense is included in the following line items in the accompanying consolidated statements of operations (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Selling and marketing .....	\$ 3,793	\$ 3,515	\$ 4,722
General and administrative .....	10,250	15,541	21,679
Stock-based compensation expense before income taxes .....	14,043	19,056	26,401
Income tax benefit .....	(4,835)	(6,494)	(8,792)
Stock-based compensation expense after income taxes .....	<u>\$ 9,208</u>	<u>\$ 12,562</u>	<u>\$ 17,609</u>

As of December 31, 2013, there was approximately \$22.1 million of unrecognized compensation cost, net of estimated forfeitures, related to all equity-based awards, which is currently expected to be recognized on a straight-line basis over a weighted average period of approximately 2.5 years.

### Second Amended and Restated 2008 Stock and Annual Incentive Plan

The Second Amended and Restated 2008 Stock and Annual Incentive Plan, as amended (the “Plan”), authorizes the issuance of 8.0 million shares of HSNi common stock for new awards granted by HSNi. The purpose of the Plan is to assist HSNi in attracting, retaining and motivating officers, employees, directors and consultants, and to provide HSNi with the ability to provide incentives more directly linked to the profitability of HSNi’s business and increases in shareholder value. As of December 31, 2013, there were approximately 2.7 million shares of common stock available for grants under the Plan.

HSNi can grant restricted stock units (“RSUs”), market stock units (“MSUs”), stock options, stock appreciation rights (“SARs”), dividend equivalents and other stock-based awards under the Plan. Stock-based awards have a maximum term of 10 years. The exercise price of options and SARs granted under the Plan is required to be at, or above, the fair market value of HSNi’s stock on the date of grant. RSUs have rights to receive dividend equivalents that vest at the same time the underlying RSUs vest once the requisite service has been rendered. HSNi elects to issue shares of its common stock for RSU vestings and SAR exercises net of the employees’ minimum tax withholding obligation. The payments made by HSNi to the taxing authorities for these taxes were \$14.4 million, \$18.2 million, and \$11.4 million for the years ended December 31, 2013, 2012 and 2011, respectively.

### Restricted Stock Units

RSUs are awards that are denominated in a hypothetical equivalent number of shares of HSNi’s common stock. At the time of grant, HSNi determines if the RSUs will be settled in cash, stock or both. The value to the holder of the RSU is based upon the market value of HSNi’s stock when the RSUs vest. Compensation expense for RSUs granted under the Plan is measured at the grant date as the fair market value of HSNi’s common stock and expensed ratably over the vesting term. The RSUs are generally subject to service-based vesting over a term of 3 years to 5 years.

A summary of the status of the nonvested RSUs, as of December 31, 2013 and changes during the year ended December 31, 2013 is as follows:

	Number of RSUs	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2013 .....	872,109	\$ 28.02
Granted .....	495,881	58.83
Vested .....	(634,512)	38.23
Forfeited .....	(109,769)	38.56
Nonvested at December 31, 2013 .....	<u>623,709</u>	40.25

The weighted average per share fair value of RSUs granted during the years ended December 31, 2013, 2012 and 2011 based on market prices of HSNi's common stock on the grant date was \$58.83, \$36.51, and \$30.32, respectively.

The total fair value of RSUs held by employees of all five Spincos that vested during the years ended December 31, 2013, 2012 and 2011 and settled in HSNi common stock was \$36.2 million, \$33.9 million, and \$21.9 million, respectively. HSNi realizes a tax benefit for RSUs held by its employees in the year in which the award vests. The tax benefit realized by HSNi related to RSUs was approximately \$12.5 million, \$10.9 million, and \$6.7 million for the years ended December 31, 2013, 2012 and 2011, respectively.

As of December 31, 2013, there was approximately \$10.1 million of unrecognized compensation cost, net of estimated forfeitures, related to RSUs, which is currently expected to be recognized on a straight-line basis over a weighted average period of approximately 2.2 years.

## Stock Options and SARs

SARs are similar to traditional stock options, except, upon exercise, holders of SARs will only receive a value equal to the spread between the current market price per share of the common stock and the exercise price. The SARs granted by HSNi may be settled in cash or common stock of HSNi, in the sole discretion of HSNi. All SARs exercised by employees of HSNi have been settled in stock. For all SARs currently outstanding, HSNi intends to settle these awards in stock upon exercise. The exercise price for awards granted under the Plan is required to be priced at, or above, the fair market value of HSNi's stock at the date of grant. Awards typically vest ratably over a term of 3 years.

A summary of the status of the outstanding stock options and SARs as of December 31, 2013 is as follows:

	Number of options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2013 . . . . .	2,776,693	\$ 28.28		
Granted . . . . .	346,301	59.18		
Exercised . . . . .	(474,855)	16.07		
Forfeited . . . . .	(58,936)	53.73		
Expired . . . . .	(8,314)	10.74		
Outstanding at December 31, 2013 (1) . . . . .	<u>2,580,889</u>	34.15	5.7	\$ 72,660,432
Vested and expected to vest at December 31, 2013 . . . . .	<u>2,518,015</u>	33.73	5.7	\$ 71,932,319
Exercisable at December 31, 2013 . . . . .	<u>1,944,153</u>	30.35	4.9	\$ 62,119,059

(1) Approximately 0.3 million stock options outstanding as of December 31, 2013 were held by employees of the other Spincos.

The aggregate intrinsic value in the table above represents the pre-tax difference between the closing price of HSNi's common stock on December 31, 2013 of \$62.30 and the exercise price for all "in the money" awards at December 31, 2013. This amount changes based on the fair market value of HSNi's common stock. The intrinsic value of the stock options and SARs exercised during the years ended December 31, 2013, 2012 and 2011 was approximately \$19.3 million, \$45.7 million, and \$20.5 million, respectively. Cash received from stock option exercises for the years ended December 31, 2013, 2012 and 2011 was \$6.5 million, \$19.1 million, and \$7.5 million, respectively. The tax benefit realized from stock option exercises for the years ended December 31, 2013, 2012 and 2011 was \$7.3 million, \$11.7 million, and \$7.4 million, respectively.

The fair value of each stock option and SAR award, which HSNi intends to settle in stock, is estimated on the grant date using the Black-Scholes option pricing model. The Black-Scholes option pricing model incorporates various assumptions, including expected volatility and expected term. Expected stock price volatilities are estimated based on HSNi's historical volatility and the historical and implied volatilities of comparable publicly-traded companies. The risk-free interest rates are based on U.S. Treasury yields for notes with comparable terms as the awards in effect at the grant date. The expected term of options and SARs granted is based on an analysis of historical employee termination rates and option exercise patterns, giving consideration to expectations of future employee behavior. Dividends yields are estimated based on HSNi's historical and anticipated dividend payments.

The weighted average assumptions used in the Black-Scholes option pricing model are as follows:

	Year Ended December 31,		
	2013	2012	2011
Volatility factor .....	49.1%	46.5%	46.5%
Risk-free interest rate .....	0.85%	0.91%	2.33%
Expected term .....	4.8	5.0	5.0
Dividend yield .....	1.2%	1.4%	0.0%

The weighted average fair values of stock options and SARs granted from the Plan during the years ended December 31, 2013, 2012 and 2011 at market prices equal to HSNi's common stock on the grant date were \$22.57, \$12.96, and \$12.84, respectively.

At the date of the Spin-off, HSNi granted approximately 719,000 stock options to its Chief Executive Officer at exercise prices greater than market value on the date of grant with a term of 10 years and graded vesting over 4 years. The weighted average exercise price and the weighted average fair value related to these grants were \$39.84 and \$3.36, respectively. All other awards granted under the Plan have exercise prices based on the fair market value of HSNi's common stock at the date of grant.

As of December 31, 2013, there was approximately \$5.9 million of unrecognized compensation cost, net of estimated forfeitures, related to stock options and SARs, which is currently expected to be recognized on a straight-line basis over a weighted average period of approximately 1.8 years.

The following table summarizes the information about stock options and SARs outstanding and exercisable as of December 31, 2013:

	Outstanding			Exercisable	
	Number Outstanding at December 31, 2013	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Number Exercisable at December 31, 2013	Weighted Average Exercise Price
\$0.00 to \$9.99 .....	116,787	\$ 5.50	4.7	116,787	\$ 5.50
\$10.00 to \$19.99 .....	161,745	17.60	4.5	161,745	17.60
\$20.00 to \$29.99 .....	658,778	24.80	6.5	551,814	23.84
\$30.00 to \$39.99 .....	973,046	34.93	5.0	743,252	34.69
\$40.00 to \$49.99 .....	370,555	44.71	4.6	370,555	44.71
\$50.00 to \$59.99 .....	299,978	59.16	9.1	—	—
	<u>2,580,889</u>			<u>1,944,153</u>	

### Performance-Based Awards

During the first quarter of 2010, HSNi implemented a performance-based equity compensation program for certain key members of Cornerstone's management. The amount payable was based on the extent to which certain pre-established performance goals for Cornerstone were achieved during the three years ending December 31, 2012. These equity awards were accounted for as liabilities which were remeasured each reporting period based on the probability of achievement of the performance conditions. The amount earned pursuant to the award at the end of the December 31, 2012 service period was \$16.8 million which was settled in shares of HSNi common stock in the first quarter of 2013.

During the third quarter of 2013, HSNi granted approximately 101,000 MSUs to its Chief Executive Officer. The MSUs vest over respective 3 years and 5 years performance periods (50% for each period). Payout percentages range between 0% and 200% of the target award depending on the awards' market condition, the future price of HSNi's stock at the end of each performance period as compared to HSNi's stock price at the date of grant (as defined in the MSU agreement). The fair value of the MSUs was \$8.3 million, or an average of \$82.67 per unit, and were measured on the grant date by applying a Monte Carlo simulation pricing model which estimates the potential outcome of reaching the market condition based on simulated future stock prices and is recognized over the performance period. The weighted average assumptions used in the valuation of the MSUs were the following: volatility factor of 39.7%, risk-free interest rate of 1.00%, expected term of 4.0 years and dividend yield of 1.1%.

During the years ended December 31, 2013 and 2012, HSNi granted performance-based cash awards to certain executive employees (“Performance Cash”). Performance Cash vests over a three year performance period. Payout percentages range between 0% and 200% of the target award based on the award’s market condition, HSNi’s Total Shareholder Return relative to a peer group at the end of the performance period. Performance Cash is accounted for as a liability-based award as it will be settled in cash. For the years ended December 31, 2013 and 2012, HSNi granted Performance Cash with an aggregate target value \$2.7 million and \$1.6 million, respectively, with a grant date fair value of \$2.6 million and \$1.1 million, respectively. Fair value is measured using a Monte-Carlo simulation and is remeasured at the end of each reporting period. As of December 31, 2013 and 2012, a liability of \$1.6 million and \$0.5 million, respectively, was recorded for these awards.

### Employee Stock Purchase Plan

The HSN, Inc. 2010 Employee Stock Purchase Plan (“ESPP”) was approved May 2010 and 750,000 shares of HSNi common stock were reserved for issuance under the ESPP. The ESPP permits employees to purchase shares of HSNi’s common stock during semi-annual purchase periods. Under the terms of the ESPP, eligible employees accumulate funds through payroll deductions and purchase shares at a price equal to the lesser of 85% of the fair market value of the common stock at the grant date or purchase date, provided the resulting purchase price cannot be less than 75% of the fair market value at the end of the purchase period. All shares purchased under the ESPP must be held for a period of 6 months.

For the years ended December 31, 2013 and 2012, HSNi granted approximately 45,000 and 50,000 options, respectively, under the ESPP. The fair value of each option granted under the ESPP is determined on the grant date using the Black-Scholes option pricing model. The following are the weighted average assumptions used in the valuation of the ESPP options for the years ended December 31, 2013 and 2012:

	Year Ended December 31,	
	2013	2012
Volatility factor .....	23.3%	41.7%
Risk-free interest rate .....	0.10%	0.09%
Expected term .....	0.5	0.5
Dividend yield.....	1.3%	1.3%

For the years ended December 31, 2013, 2012 and 2011, approximately \$0.5 million of expense was included in the consolidated statements of operations. For the years ended December 31, 2013, 2012 and 2011, HSNi received cash proceeds from the participating employees of approximately \$1.9 million, \$1.6 million and \$1.4 million, respectively.

### Restricted Common Equity in Cornerstone Brands

In connection with the acquisition of Cornerstone Brands by IAC in 2005 certain members of Cornerstone Brand’s management were granted restricted common equity in Cornerstone Brands. These awards were granted on April 1, 2005 and were initially measured at fair value, which was amortized to expense over the vesting period. These awards vested ratably over 4 years, or earlier based upon the occurrence of certain prescribed events. The awards vest in non-voting restricted common shares of Cornerstone Brands.

These shares are subject to a put right by the holders, some of which became exercisable in the first quarter of 2010 and others of which become exercisable annually thereafter, and a call right by HSNi, which was not exercisable until the first quarter of 2012 and annually thereafter. The value of these shares upon exercise of the put or call is equal to their fair value, determined by negotiation or arbitration, reduced by the accreted value of the preferred interest that was taken by IAC upon the purchase of Cornerstone Brands. The initial value of the preferred interest was equal to the acquisition price of Cornerstone Brands. The preferred interest accretes value at a 15% annual rate. Upon exercise of the put or call the consideration is payable in HSNi shares or cash or a combination thereof at HSNi’s option. As of December 31, 2013, these awards were significantly out of the money and are not expected to result in any cost should HSNi exercise its call right.



## NOTE 12—INCOME TAXES

The components of the provision for income taxes are as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
<b>Current income tax provision:</b>			
Federal.....	\$ (81,521)	\$ (76,992)	\$ (68,593)
State.....	(9,990)	(8,904)	(9,217)
Current income tax provision.....	<u>(91,511)</u>	<u>(85,896)</u>	<u>(77,810)</u>
<b>Deferred income tax (provision) benefit:</b>			
Federal.....	(6,489)	1,814	(1,900)
State.....	308	709	(396)
Deferred income tax (provision) benefit.....	<u>(6,181)</u>	<u>2,523</u>	<u>(2,296)</u>
Income tax provision.....	<u>\$ (97,692)</u>	<u>\$ (83,373)</u>	<u>\$ (80,106)</u>

Current income taxes payable has been reduced by \$19.8 million, \$22.7 million, and \$14.1 million for the years ended December 31, 2013, 2012 and 2011, respectively, for tax deductions attributable to stock-based compensation. The related income tax benefits of this stock-based compensation were recorded as amounts charged or credited to the income tax provision and additional paid-in capital.

The tax effects of cumulative temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2013 and 2012 are presented below (in thousands). The valuation allowance is related to items for which it is more likely than not that the tax benefit will not be realized.

	December 31,	
	2013	2012
<b>Deferred tax assets:</b>		
Provision for accrued expenses.....	\$ 33,647	\$ 38,548
Inventories.....	13,125	11,927
Stock-based compensation.....	10,888	16,036
Net operating losses.....	1,531	1,369
Other.....	4,078	2,024
Total deferred tax assets.....	<u>63,269</u>	<u>69,904</u>
Less valuation allowance.....	(1,495)	(5,293)
Net deferred tax assets.....	<u>61,774</u>	<u>64,611</u>
<b>Deferred tax liabilities:</b>		
Intangible and other assets.....	(91,018)	(91,783)
Prepaid expenses.....	(13,574)	(11,692)
Property and equipment.....	(15,455)	(12,535)
Total deferred tax liabilities.....	<u>(120,047)</u>	<u>(116,010)</u>
Net deferred tax liability.....	<u>\$ (58,273)</u>	<u>\$ (51,399)</u>

At December 31, 2013, HSNi had \$4.8 million of net operating loss carryforwards which begin expiring in 2014. As of December 31, 2013 and 2012, HSNi had a valuation allowance of approximately \$1.5 million and \$5.3 million, respectively. Valuation allowances are recorded for certain deferred tax assets related to foreign and separate state net operating losses.

A reconciliation of the income tax provision to the amounts computed by applying the statutory federal income tax rate to earnings before income taxes is shown as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Income tax provision at the federal statutory rate of 35% .....	\$ (96,649)	\$ (76,955)	\$ (72,715)
State income taxes, net of effect of federal tax benefit .....	(6,293)	(5,327)	(6,386)
Other, net. ....	5,250	(1,091)	(1,005)
Income tax provision .....	<u>\$ (97,692)</u>	<u>\$ (83,373)</u>	<u>\$ (80,106)</u>

A reconciliation of the beginning and ending amount of unrecognized tax benefits, excluding interest, is as follows (in thousands):

	2013	2012	2011
Balance at beginning of year .....	\$ 682	\$ 664	\$ 630
Additions based on tax positions related to the current year. ....	417	—	225
Additions for tax positions of prior years .....	—	18	—
Reductions for tax positions of prior years .....	(189)	—	(191)
Balance at end of year .....	<u>\$ 910</u>	<u>\$ 682</u>	<u>\$ 664</u>

As of December 31, 2013 and 2012, the unrecognized tax benefits, including interest, were \$1.1 million and \$0.9 million, respectively. At December 31, 2013 and 2012, there are approximately \$0.9 million and \$0.5 million of unrecognized tax benefits that, if recognized, would affect the annual effective tax rate.

HSNi recognizes interest and, if applicable, penalties related to unrecognized tax benefits in income tax expense. There is no material interest on unrecognized tax benefits included in income tax expense for the years ended December 31, 2013, 2012 and 2011. At December 31, 2013 and 2012, HSNi has no material accrual for the payment of interest or penalties.

HSNi believes that it is reasonably possible that its unrecognized tax benefits could decrease by an immaterial amount within twelve months of the current reporting date due to settlement with the taxing authority.

HSNi is routinely under audit by federal, state, local and foreign tax authorities. These audits include questioning the timing and the amount of deductions and the allocation of income among various tax jurisdictions. Income taxes payable include amounts considered sufficient to pay assessments that may result from examination of prior year returns; however, the amount paid upon resolution of issues raised may differ from the amount provided. Differences between the reserves for tax contingencies and the amounts owed by HSNi are recorded in the period they become known.

The Internal Revenue Service ("IRS") has concluded its examination of HSNi's consolidated federal income tax return for the year ended December 31, 2010 and its limited scope examination of HSNi's consolidated federal income tax return for the year ended December 31, 2011. No material adjustments resulted from these IRS examinations. In addition, various state income tax examinations are in process. HSNi does not anticipate any material adjustments to our tax liabilities resulting from any of these examinations.

HSNi and several companies previously owned by IAC, were spun-off from IAC on August 20, 2008. In connection with the spin-off, HSNi entered into a Tax Sharing Agreement with IAC pursuant to which, among other things, each of the Spincos has indemnified IAC and the other Spincos for any taxes resulting from the Spin-off of such Spinco (and any related interest, penalties, legal and professional fees, and all costs and damages associated with related shareholder litigation or controversies) to the extent such amounts result from (i) any act or failure to act by such Spinco described in the covenants in the Tax Sharing Agreement, (ii) any acquisition of equity securities or assets of such Spinco or a member of its group, and (iii) any breach by such Spinco or any member of its group of any representation or covenant contained in the separation documents or in the documents relating to the IRS private letter ruling and/or tax opinions. In the event an adjustment with respect to a pre-spin-off period for which IAC is responsible results in a tax benefit to HSNi in a post-spin-off period, HSNi will be required to pay such tax benefit to IAC. In general, IAC controls all audits and administrative matters and other tax proceedings relating to the consolidated federal income tax return of the IAC group and any other tax returns for which the IAC group is responsible. The provisions set forth in the Tax Sharing Agreement could subject HSNi to future tax contingencies.

The IRS has completed its review of the IAC consolidated tax returns for the years ended December 31, 2001 through 2009, which includes the operations of HSNi. The settlement for these years has been submitted to and approved by the Joint Committee on Taxation. The statute of limitations for the years 2001 through 2009 is extended through June 30, 2014. Various IAC consolidated tax returns filed with state, local and foreign jurisdictions are currently under examination, the most significant of which are California, New York and New York City, for various tax years beginning with 2006. By virtue of the Tax Sharing Agreement with IAC, HSNi is indemnified with respect to additional tax liabilities for consolidated or combined federal and state tax returns prepared and filed by IAC prior to the Spin-off, but is liable for any additional tax liabilities for HSNi separately filed state income tax returns.

**NOTE 13—COMMITMENTS AND CONTINGENCIES**

In cooperation with the United States Consumer Product Safety Commission (“CPSC”), Frontgate, one of the Cornerstone brands, announced in January 2011 a voluntary recall of a product sold from December 2005 through July 2010. In June 2013, the CPSC notified the company that the CPSC is investigating whether the company complied with certain reporting requirements of the Consumer Product Safety Act. At this time it is not yet possible to determine what, if any, actions will be taken by the CPSC, whether a civil penalty will be assessed or, if assessed, the amount thereof.

In the ordinary course of business, HSNi is a party to various audits and lawsuits. These audits or litigation may relate to claims involving property, personal injury, contract, intellectual property (including patent infringement), sales tax, regulatory compliance and other claims. HSNi establishes reserves for specific legal or tax compliance matters that it has determined the likelihood of an unfavorable outcome is probable and the loss is reasonably estimable. Management has also identified certain other legal matters where it believes an unfavorable outcome is not probable and, therefore, no reserve is established. Although management currently believes that an unfavorable resolution of claims against HSNi, including claims where an unfavorable outcome is reasonably possible, will not have a material impact on its liquidity, results of operations, financial condition or cash flows, these matters are subject to inherent uncertainties and management’s view of these matters may change in the future and an unfavorable resolution of such a proceeding could have a material impact. Moreover, any claims or regulatory actions against HSNi, whether meritorious or not, could be time-consuming, result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources.

HSNi leases satellite transponders, warehouse and office space, equipment and services used in connection with its operations under various operating leases, many of which contain escalation clauses.

Future minimum payments under operating lease agreements are as follows (in thousands):

<u>Years Ending December 31,</u>	
2014 .....	\$ 24,756
2015 .....	21,050
2016 .....	17,235
2017 .....	14,046
2018 .....	12,620
Thereafter .....	13,700
Total .....	<u>\$ 103,407</u>

Expenses charged to continuing operations under these agreements were \$23.1 million, \$22.1 million, and \$20.8 million for the years ended December 31, 2013, 2012 and 2011, respectively.

HSNi also has funding commitments that could potentially require its performance in the event of demands by third parties or contingent events, as follows (in thousands):

	Amount of Commitments Expiration Per Period				
	Total Amounts Committed	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
Letters of credit and surety bonds . . . . .	\$ 35,711	\$ 35,561	\$ 150	\$ —	\$ —
Purchase obligations . . . . .	141,678	73,610	68,016	52	—
Total commercial commitments . . . . .	<u>\$ 177,389</u>	<u>\$ 109,171</u>	<u>\$ 68,166</u>	<u>\$ 52</u>	<u>\$ —</u>

The letters of credit (“LOCs”) primarily consist of trade LOCs, which are used for inventory purchases. Trade LOCs are guarantees of payment based upon the delivery of goods. The surety bonds primarily consist of customs bonds, which relate to the import of merchandise into the United States.

The purchase obligations primarily relate to cable contracts and include obligations for future cable distribution and commission guarantees.

## NOTE 14—RELATED PARTY TRANSACTIONS

### Relationship Between Liberty Media Corporation and HSNi

#### Spinco Agreement

In connection with the Spin-off, pursuant to a Spinco Assignment and Assumption Agreement (the “Spinco Agreement”), dated as of August 20, 2008, among HSNi, IAC, Liberty Media Corporation (“Liberty”) and a subsidiary of Liberty that held shares of IAC common stock and IAC Class B common stock (together with Liberty, the “Liberty Parties”), HSNi (i) assumed from IAC all rights and obligations providing for post-Spin-off governance and other arrangements at HSNi under the Spinco Agreement, dated May 13, 2008, among IAC, Liberty and affiliates of Liberty that held shares of IAC common stock and/or Class B common stock at the time such Spinco Agreement was entered into, and (ii) as required by the Spinco Agreement, entered into a registration rights agreement with the Liberty Parties. Following is a summary of the material terms of the Spinco Agreement:

#### *Representation of Liberty on the Spinco Boards of Directors*

The Spinco Agreement generally provides that so long as Liberty beneficially owns securities of HSNi representing at least 20% of the total voting power of HSNi’s equity securities, Liberty has the right to nominate up to 20% of the directors serving on HSNi’s Board of Directors (rounded up to the nearest whole number). Any director nominated by Liberty must be reasonably acceptable to a majority of the directors on HSNi’s Board who were not nominated by Liberty. All but one of Liberty’s nominees serving on the Board of Directors must qualify as “independent” under applicable stock exchange rules. In addition, the Nominating Committee of the Board may include only “Qualified Directors,” namely directors other than any who were nominated by Liberty, are officers or employees of HSNi or were not nominated by the Nominating Committee of the HSNi Board in their initial election to the Board and for whose election any Liberty Party voted shares.

#### *Acquisition Restrictions*

The Liberty Parties have agreed not to acquire beneficial ownership of any equity securities of HSNi (with specified exceptions) unless:

- the acquisition was approved by a majority of the Qualified Directors;
- the acquisition is permitted under the provisions described in “Competing Offers” below; or
- after giving effect to the acquisition, Liberty’s ownership percentage of the equity securities of HSNi, based on voting power, would not exceed the Applicable Percentage.

The “Applicable Percentage” is Liberty’s ownership percentage upon the Spin-off of HSNi, based on voting power (approximately 30%), plus 5%, but in no event more than 35%. Notwithstanding the foregoing, Liberty’s beneficial ownership may increase above the Applicable Percentage as a result of HSNi’s share repurchase program. Following the Spin-off, the Applicable Percentage for the Spinco is reduced for specified transfers of equity securities of the Spinco by the Liberty Parties. During the first two years following the Spin-off, acquisitions by the Liberty Parties were further limited to specified extraordinary transactions and, otherwise, to acquisitions representing no more than one-third of HSNi Common Stock received by the Liberty Parties in the Spin-off:

- transfers pursuant to a third party tender or exchange offer or in connection with any merger or other business combination, which merger or business combination has been approved by HSNi;
- transfers in a public offering in a manner designed to result in a wide distribution, provided that no such transfer is made, to the knowledge of the Liberty Parties, to any person whose ownership percentage (based on voting power) of HSNi’s equity securities, giving effect to the transfer, would exceed 15%;
- a transfer of all of the equity securities of HSNi beneficially owned by the Liberty Parties and their affiliates in a single transaction if the transferee’s ownership percentage (based on voting power), after giving effect to the transfer, would not exceed the Applicable Percentage and only if the transferee assumes all of the rights and obligations (subject to limited exceptions) of the Liberty Parties under the Spinco Agreement;
- specified transfers in connection with changes in the beneficial ownership of the ultimate parent company of a Liberty Party or a distribution of the equity interests of a Liberty Party or certain similar events; and
- specified transfers relating to certain hedging transactions or stock lending transactions in respect of the Liberty Parties’ equity securities in HSNi, subject to specified restrictions.

#### *Competing Offers*

During the period when Liberty continues to have the right to nominate directors to HSNi’s Board of Directors, if the Board of Directors determines to pursue certain types of transactions on a negotiated basis (either through an “auction” or with a single bidder), Liberty is granted certain rights to compete with the bidder or bidders, including the right to receive certain notices and information, subject to specified conditions and limitations. In connection with any such transaction that HSNi is negotiating with a single bidder, the Board of Directors must consider any offer for a transaction made in good faith by Liberty but is not obligated to accept any such offer or to enter into negotiations with Liberty.

If a third party (x) commences a tender or exchange offer for at least 35% of the capital stock of HSNi other than pursuant to an agreement with HSNi or (y) publicly discloses that its ownership percentage (based on voting power) exceeds 20% and HSNi’s Board fails to take certain actions to block such third party from acquiring an ownership percentage of HSNi (based on voting power) exceeding the Applicable Percentage, the Liberty Parties generally will be relieved of the obligations described under “Standstill Restrictions” and “Acquisition Restrictions” above to the extent reasonably necessary to permit Liberty to commence and consummate a competing offer. If Liberty’s ownership percentage (based on voting power) as a result of the consummation of a competing offer in response to a tender or exchange offer described in (x) above exceeds 50%, any consent or approval requirements of the Qualified Directors in the Spinco Agreement will be terminated, and, following the later of the second anniversary of the Spin-off and the date that Liberty’s ownership percentage (based on voting power) exceeds 50%, the obligations described under “Acquisition Restrictions” will be terminated.

#### *Other*

Following the Spin-off, amendments to the Spinco Agreement and determinations required to be made thereunder (including approval of transactions between a Liberty Party and HSNi that would be reportable under the proxy rules) will require the approval of the Qualified Directors.

#### **Registration Rights Agreement**

Under the registration rights agreement, the Liberty Parties and their permitted transferees (the “Holders”) will be entitled to three demand registration rights (and unlimited piggyback registration rights) in respect of the shares of HSNi common stock received by the Liberty Parties as a result of the Spin-off and other shares of HSNi common stock acquired by the Liberty Parties consistent with the Spinco Agreement (collectively, the “Registrable Shares”). The Holders will be permitted to exercise their registration rights in connection with certain hedging transactions that they may enter into with respect to the Registrable Shares.

HSNi will be obligated to indemnify the Holders, and each selling Holder will be obligated to indemnify HSNi, against specified liabilities in connection with misstatements or omissions in any registration statement.

## NOTE 15—SUPPLEMENTAL CASH FLOW INFORMATION

### Supplemental Disclosure of Cash Flow Information:

	Year Ended December 31,		
	2013	2012	2011
	(in thousands)		
Cash paid during the period for:			
Income tax payments	\$ 92,502	\$ 52,709	\$ 73,847
Income tax refunds	(2,061)	(10)	(1,806)
Interest payments	5,230	29,985	29,198
Non-cash financing activities:			
Effective portion of change in interest rate swap	1,296	755	—

## NOTE 16—SHAREHOLDERS' EQUITY

### Stock Purchase Rights

In December 2008, HSNi's Board of Directors approved the creation of a Series A Junior Participating Preferred Stock, adopted a shareholders rights plan and declared a dividend of one right for each outstanding share of common stock held by our shareholders of record as of the close of business on January 5, 2009. The rights attached to any additional shares of common stock issued after January 5, 2009. Initially, these rights, which trade with the shares of HSNi's common stock, will not be exercisable. Under the rights plan, these rights will be exercisable if a person or group acquires or commences a tender or exchange offer for 15% or more of HSNi's common stock (except for certain grandfathered persons, such as Liberty, to which higher thresholds apply). If the rights become exercisable, each right will permit its holder, other than the "acquiring person," to purchase from us shares of common stock at a 50% discount to the then prevailing market price. As a result, the rights will cause substantial dilution to a person or group that becomes an "acquiring person" on terms not approved by HSNi's Board of Directors.

### Share Repurchase Program

On September 27, 2011, HSNi's Board of Directors approved a share repurchase program which allows HSNi to purchase 10 million shares of its common stock from time to time through privately negotiated and/or open market transactions. The timing of any repurchases and actual number of shares repurchased will depend on a variety of factors, including the stock price, corporate and regulatory requirements, restrictions under HSNi's debt obligations and other market and economic conditions. The repurchase program may be suspended or discontinued by HSNi at any time. For the year ended December 31, 2013, HSNi acquired approximately 2.7 million shares of outstanding common stock for \$146.9 million under the program at an average price of \$53.67. For the year ended December 31, 2012, HSNi acquired approximately 5.5 million shares of outstanding common stock for \$220.6 million under the program at an average price of \$40.40. All shares were immediately retired upon purchase.

### Dividend Policy

During the year ended December 31, 2013, HSNi's Board of Directors approved four quarterly cash dividends totaling \$0.79 per common share resulting in aggregate dividend payments of approximately \$42.3 million. During the year ended December 31, 2012, HSNi's Board of Directors approved the initial quarterly cash dividend of \$0.555 per common share resulting in a dividend payment of approximately \$31.0 million.

In February 2014, HSNi's Board of Directors approved a quarterly cash dividend of \$0.25 per common share. The dividend will be paid on March 19, 2014 to HSNi's record holders as of March 5, 2014.

## NOTE 17—DISCONTINUED OPERATIONS

In May 2012, substantially all of the assets and certain liabilities of Smith+Noble, a Cornerstone brand specializing in window treatments, were sold for \$5.5 million. HSNi does not expect to have any significant continuing involvement or cash flows from Smith+Noble; therefore, the results of operations for Smith+Noble are presented separately as “Loss from discontinued operations, net of tax” in the consolidated statements of operations for all periods presented, and the cash flows from Smith+Noble are presented separately as discontinued operations in the consolidated statements of cash flows for all periods presented. Cornerstone recorded an after-tax loss on the sale of \$0.1 million in the second quarter of 2012, which is included in “Loss from discontinued operations, net of tax” in the accompanying consolidated statements of operations.

In July 2012, substantially all of the assets and certain liabilities of The Territory Ahead, a Cornerstone brand specializing in casual apparel for men and women, were sold for approximately \$1.1 million. HSNi does not expect to have any significant continuing involvement or cash flows from The Territory Ahead; therefore, the results of operations for The Territory Ahead are presented separately as “Loss from discontinued operations, net of tax” in the consolidated statements of operations for all periods presented, and the cash flows from The Territory Ahead are presented separately as discontinued operations in the consolidated statements of cash flows for all periods presented. An impairment charge of \$5.9 million, or \$3.7 million net of taxes, was recorded in the second quarter of 2012 to reduce the carrying value of the net assets to their estimated net realizable value and is included in “Loss from discontinued operations, net of tax” in the accompanying statements of operations.

The following table reflects the results of Smith+Noble and The Territory Ahead that are reported as discontinued operations for all periods presented (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Net sales	\$ —	\$ 40,154	\$ 107,798
Loss from discontinued operations (including loss on sale of \$6.0 million recognized in the second quarter of 2012)	\$ —	\$ (9,370)	\$ (7,353)
Income tax benefit	—	3,548	2,771
Loss from discontinued operations, net of tax	\$ —	\$ (5,822)	\$ (4,582)

## NOTE 18—ACQUISITION

In April 2012, HSNi, through Cornerstone, acquired substantially all of the assets and liabilities of Chasing Fireflies, LLC, a leading direct-to-consumer premium children's and family lifestyle brand. The purchase price was \$22.9 million in cash and contingent consideration valued at \$6.5 million as of the acquisition date. The fair value of the contingent consideration was estimated by applying a probability-weighted income approach. The acquisition has been accounted for as a business combination and the total purchase consideration has been assigned to the assets acquired, primarily inventory and other assets totaling \$8.6 million and liabilities assumed totaling \$2.6 million, at their estimated fair value as of the acquisition date. The allocation of the identifiable intangible assets and goodwill includes \$13.5 million primarily for trade names and customer relationships and \$9.9 million for goodwill. Proforma information has not been presented for this acquisition as it was not material to HSNi's consolidated results of operations or financial position.

HSNi performed its annual impairment testing in the fourth quarter of fiscal 2013 for the goodwill and indefinite-lived intangible assets related to the acquisition of Chasing Fireflies. Based on this analysis, HSNi determined the fair value of the indefinite-lived intangible assets was lower than its carrying value; therefore, an impairment charge of \$3.0 million was recorded during the fourth quarter of fiscal 2013. See Note 3 for a further discussion on goodwill and indefinite-lived intangible assets. Based on the revised plan financial results, HSNi also determined Chasing Fireflies is less likely to achieve the targets necessary to earn the full amount of the contingent consideration associated with the acquisition. Therefore, HSNi adjusted the fair value of the previously recorded contingent consideration in the fourth quarter of 2013 by \$3.6 million. The net impact of the impairment charge and the contingent consideration adjustment is a reduction of expense of \$0.6 million and is included in "General and administrative expense" in the accompanying consolidated statements of operations.

**NOTE 19—QUARTERLY RESULTS (UNAUDITED)**

	Quarter Ended			
	March 31,	June 30,	September 30,	December 31,
	(a)	(b)(c)	(d)	
	(In thousands, except per share data)			
<b>Year Ended December 31, 2013</b>				
Net sales	\$ 772,651	\$ 812,606	\$ 798,890	\$ 1,019,835
Gross profit	280,147	308,777	288,590	352,300
Operating income	52,518	71,299	61,085	97,752
Income from continuing operations	31,553	43,271	42,052	61,573
(Loss) income from discontinued operations, net of tax	(9)	9	—	—
Net income	31,544	43,280	42,052	61,573
Income from continuing operations per share:				
Basic	\$ 0.58	\$ 0.81	\$ 0.79	\$ 1.16
Diluted	\$ 0.56	\$ 0.79	\$ 0.77	\$ 1.14
Net income per share:				
Basic	\$ 0.58	\$ 0.81	\$ 0.79	\$ 1.16
Diluted	\$ 0.56	\$ 0.79	\$ 0.77	\$ 1.14
Dividends declared per common share	\$ 0.18	\$ 0.18	\$ 0.18	\$ 0.25
<b>Year Ended December 31, 2012</b>				
Net sales	\$ 737,908	\$ 767,187	\$ 778,769	\$ 982,875
Gross profit	266,914	293,448	285,516	337,846
Operating income	51,259	65,342	49,312	92,832
Income from continuing operations	27,288	35,611	17,558	56,041
(Loss) income from discontinued operations, net of tax	(1,118)	(4,864)	128	32
Net income	26,170	30,747	17,686	56,073
Income from continuing operations per share:				
Basic	\$ 0.47	\$ 0.63	\$ 0.32	\$ 1.03
Diluted	\$ 0.45	\$ 0.61	\$ 0.31	\$ 1.00
Net income per share:				
Basic	\$ 0.45	\$ 0.54	\$ 0.32	\$ 1.03
Diluted	\$ 0.44	\$ 0.53	\$ 0.31	\$ 1.00
Dividends declared per common share	\$ 0.125	\$ 0.125	\$ 0.125	\$ 0.18

- (a) The second quarter of 2012 includes a loss of \$6.0 million, or \$3.8 million net of taxes, related to the sales of Smith +Noble and The Territory Ahead, two brands formerly included in the Cornerstone portfolio, and is included in the line item "(Loss) income from discontinued operations, net of tax." This loss decreased diluted earnings per share by \$0.06.
- (b) The third quarter of 2013 includes discrete tax benefits of \$3.7 million which increased diluted earnings per share by \$0.07.
- (c) The third quarter of 2012 includes a sales tax settlement of \$7.8 million, or \$4.8 million net of taxes, and costs associated with the redemption of Senior Notes of \$18.3 million, or \$11.4 million net of taxes. These charges decreased diluted earnings per share by \$0.28.
- (d) The fourth quarter of 2013 includes a \$3.6 million reduction to a previously recorded contingent consideration obligation and a \$3.0 million impairment charge of intangible assets related to a 2012 acquisition resulting in a net expense reduction of \$0.6 million, or \$1.7 million net of taxes. These fair value adjustments increased diluted earnings per share by \$0.03.



**NOTE 20—RETIREMENT AND SAVINGS PLANS**

Effective December 31, 2008, HSNi established the HSN, Inc. Retirement Savings Plan that qualifies under Section 401 (k) of the Internal Revenue Code. Participating employees may contribute up to 50% of their pretax salary, up to the statutory limits. For the year ended December 31, 2013, HSNi contributed fifty cents for each dollar a participant contributed of the first 6% of a participant's deferrals. For the years ended December 31, 2012 and December 31, 2011, HSNi contributed twenty-five cents for each dollar a participant contributed of the first 6% of a participant's deferrals. HSNi's matching contributions were \$4.6 million, \$2.0 million and \$1.9 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Effective January 1, 2014, HSNi initiated a nonqualified deferred compensation plan allowing salary and annual bonus deferrals for qualifying employees as permitted by the Internal Revenue Code. Participant deferrals will earn investment returns based on a select number of investment options, including equity and debt mutual funds. HSNi intends to invest comparable amounts in marketable securities through life insurance policies to mitigate the risk associated with the investment return on the employee deferrals. Assets related to the funded portion of the deferred compensation plan will be held in a rabbi trust which remains subject to claims of the Company's general creditors. HSNi remains liable to the participants for the unfunded portion of the plan. HSNi will record changes in the fair value of the asset and liability in the statement of operations.

**HSN, INC. AND SUBSIDIARIES**  
**VALUATION AND QUALIFYING ACCOUNTS**

Description	Balance at Beginning of Period	Charges to Earnings	Charges to Other Accounts	Deductions	Balance at End of Period
<b>2013</b>					
Allowance for doubtful accounts .....	\$ 14,537	\$ 23,414	\$ 13	\$ (21,101) (1)	\$ 16,863
Sales return accrual .....	40,554	648,381	—	(648,863)	40,072
Deferred tax valuation allowance .....	5,293	262	(4,060)	—	1,495
<b>2012</b>					
Allowance for doubtful accounts .....	\$ 13,127	\$ 24,186	\$ (137)	\$ (22,639) (1)	\$ 14,537
Sales return accrual .....	39,563	658,394	205	(657,608)	40,554
Deferred tax valuation allowance .....	14,274	23	(9,004)	—	5,293
<b>2011</b>					
Allowance for doubtful accounts .....	\$ 13,026	\$ 19,758	\$ 384	\$ (20,041) (1)	\$ 13,127
Sales return accrual .....	37,354	652,842	—	(650,633)	39,563
Deferred tax valuation allowance .....	17,242	(26)	(2,942)	—	14,274

(1) Write-off of uncollectible accounts receivable

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

We maintain a system of disclosure controls and procedures designed to provide reasonable assurance that the information required to be disclosed by HSNi in reports that it files and submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls also are designed to reasonably assure that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Disclosure controls include components of internal control over financial reporting, which consists of control processes designated to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with United States generally accepted accounting principles.

We monitor and evaluate on an ongoing basis our disclosure controls and procedures in order to improve their overall effectiveness. In the course of these evaluations, we modify and refine our internal processes as conditions warrant.

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our "disclosure controls and procedures" (as defined in Rule 13a-15(e) promulgated under the Exchange Act) as of December 31, 2013. Based on that evaluation, management has concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to ensure that information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

### **Management's Annual Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate "internal control over financial reporting" (as defined in Rule 13a-15(f) under the Exchange Act) for the Company. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Our management does not expect that our disclosure controls or our internal controls over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

As required by Rule 13a-15(b) under the Exchange Act, our management evaluated the effectiveness of our internal controls and procedures (as defined by Rule 13a-15(e) and 15d-15(e) under the Exchange Act). In making this assessment, our management used the criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework). Based upon that evaluation and criterion, we concluded that as December 31, 2013, our internal control over financial reporting was effective.

Our independent registered certified public accounting firm, Ernst & Young LLP, has issued an attestation report on our internal control over financial reporting. The attestation report is included herein.

### **Changes in Internal Control Over Financial Reporting**

We regularly monitor and evaluate on an ongoing basis our internal control over financial reporting in order to improve its effectiveness. In the course of these evaluations, we modify and refine our internal processes as conditions warrant.

As required by Rule 13a-15(d) under the Exchange Act, our management, including our Chief Executive Officer and our Chief Financial Officer, also conducted an evaluation of our internal control over financial reporting to determine whether any changes occurred during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, management has concluded that there were no such changes during this period.

## Report of Independent Registered Certified Public Accounting Firm

The Board of Directors and Shareholders of HSN, Inc.

We have audited HSN, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework)(the COSO criteria). HSN, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying management's annual report on internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, HSN, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of HSN, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013 of HSN, Inc. and subsidiaries and our report dated February 20, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Tampa, Florida  
February 20, 2014

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Incorporated by reference from our Proxy Statement for our 2014 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of the year ended December 31, 2013.

**ITEM 11. EXECUTIVE COMPENSATION**

Incorporated by reference from our Proxy Statement for our 2014 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of the year ended December 31, 2013.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS**

Incorporated by reference from our Proxy Statement for our 2014 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of the year ended December 31, 2013.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

Incorporated by reference from our Proxy Statement for our 2014 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of the year ended December 31, 2013.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Incorporated by reference from our Proxy Statement for our 2014 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of the year ended December 31, 2013.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this report:

1. Financial Statements.

Financial statements filed as part of this Form 10-K are listed under Item 8.

2. Financial Statement Schedules.

Financial statement schedules filed as part of this Form 10-K are listed under Item 8. All other schedules have been omitted because they are either not applicable or not required under the instructions contained in Regulation S-X because the information called for is contained in the financial statements and notes thereto.

3. Exhibits.

The documents set forth below, numbered in accordance with Item 601 of Regulation S-K, are filed herewith or incorporated herein by reference to the location indicated.

Exhibit No.	Description of Document	Method of Filing
3.1	Amended and Restated Certificate of Incorporation of HSN, Inc.	Exhibit 3.1 to the Company's Current Report on Form 8-K filed August 25, 2008
3.2	Amended and Restated By-laws of HSN, Inc.	Exhibit 3.2 to the Company's Current Report on Form 8-K filed August 25, 2008
3.3	Certificate of Designations, Preferences and Rights to Series A Junior Participating Preferred Stock	Exhibit 3.3 to the Company's Annual Report on Form 10-K filed March 31, 2009
4.1	Rights Agreement, dated as of December 23, 2008, between HSN, Inc. and The Bank of New York Mellon, as Rights Agent.	Exhibit 4.1 to the Company's Current Report on Form 8-K filed December 29, 2008
4.2	Indenture, dated as of July 28, 2008, between HSN, Inc., as Issuer, and the Bank of New York Mellon, as Trustee	Exhibit 10.13 to the Company's Registration Statement on Form S-1 (Registration No. 333-152697) filed August 1, 2008
4.3	First Supplemental Indenture, dated as of August 20, 2008, between HSN, Inc., as Issuer, and The Bank of New York Mellon, as Trustee	Exhibit 4.1 to the Company's Current Report on Form 8-K filed August 25, 2008
4.4	Second Supplemental Indenture dated as of January 1, 2010 between HSN, Inc., as Issuer, and The Bank of New York Mellon, as Trustee	Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed August 4, 2010
4.5	Third Supplemental Indenture, dated as of April 19, 2012, among HSN, Inc., as Issuer, the Guarantors listed on Appendix I and Appendix II, and The Bank of New York Mellon Trust Company, N.A., as Trustee	Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed May 2, 2012
10.1	Separation and Distribution Agreement, dated August 20, 2008, by and among HSN, Inc., Interval Leisure Group, Inc., Ticketmaster, Tree.com, Inc. and IAC/InterActiveCorp	Exhibit 10.1 to the Company's Current Report on Form 8-K filed August 25, 2008
10.2	Tax Sharing Agreement, dated August 20, 2008, among HSN, Inc., Interval Leisure Group, Inc., Ticketmaster, Inc., Tree.com and IAC/InterActive Corp	Exhibit 10.2 to the Company's Current Report on Form 8-K filed August 25, 2008
10.3	Employee Matters Agreement, dated August 20, 2008, among HSN, Inc., Interval Leisure Group, Inc., Ticketmaster, Tree.com, Inc. and IAC/InterActiveCorp	Exhibit 10.3 to the Company's Current Report on Form 8-K filed August 25, 2008

<b>Exhibit No</b>	<b>Description of Document</b>	<b>Method of Filing</b>
10.4	Registration Rights Agreement, dated as of August 20, 2008, among Liberty Media Corporation, the Liberty Parties (as defined in the Agreement) and HSN, Inc.	Exhibit 10.5 to the Company's Current Report on Form 8-K filed December 29, 2008
10.5	Spinco Assignment and Assumption Agreement, dated as of August 20, 2008, by and among IAC/InterActive Corp, HSN, Inc., Liberty Media Corporation and Liberty USA Holdings, LLC	Exhibit 10.6 to the Company's Current Report on Form 8-K filed August 25, 2008
10.6	Spinco Agreement, dated as of May 13, 2008, between IAC/InterActiveCorp, Liberty Media Corp., LMC Silver King, Inc., Liberty HSN II, Inc., LMC USA VIII, Inc., LMC USA IX, Inc., LMC USA XI, Inc., LMC USA XII, Inc., LMC USA XIII, Inc., LMC USA XIV, Inc., LMC USA XV, Inc., Liberty Tweety, Inc., BDTV Inc., BDTV II Inc., BDTV III Inc., BDTV IV Inc. and Barry Diller	Exhibit 10.1 to IAC/InterActiveCorp's Current Report on Form 8-K (SEC File No. 0-20570) dated May 16, 2008 and incorporated herein by reference
10.7	Credit Agreement dated as of April 24, 2012, among HSN, Inc., as Borrower; Bank of America, N.A., as Administrative Agent and Collateral Agent; JPMorgan Chase Bank, N.A., Wells Fargo Bank, National Association, and Barclays Bank PLC, each as a Syndication Agent; Branch Banking & Trust, Regions Bank, and Union Bank, each as a Documentation Agent; and Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, Wells Fargo Securities, LLC and Barclays Bank PLC, as Joint Lead Arrangers and Joint Book Managers	Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 25, 2012
10.8	Pledge Agreement dated as of April 24, 2012, by the Credit Parties (as defined in the New Credit Agreement) and Bank of America, N.A., as Collateral Agent	Exhibit 10.2 to the Company's Current Report on Form 8-K filed April 25, 2012
10.9	Credit Agreement among HSN, Inc., as Borrower, Certain Subsidiaries of the Borrower, as Guarantors, The Lenders Party thereto, Bank of America, N.A., as Administrative Agent and Collateral Agent, dated as of July 25, 2008	Exhibit 10.12 to the Company's Registration Statement on Form S-1 (Registration No. 333-152697) filed August 1, 2008
10.10	Employment Agreement between Mindy Grossman and HSN, Inc., dated as of July 29, 2008*	Exhibit 10.5 to the Company's Registration Statement on Form S-1 (Registration No. 333-152697) filed August 1, 2008
10.11	First Amendment to Employment Agreement between Mindy Grossman and HSN, Inc., dated as of August 5, 2010*	Exhibit 10.1 to the Company's Current Report on Form 8-K filed August 9, 2010
10.12	HSN, Inc. Amended and Restated 2008 Stock and Annual Incentive Plan*	Exhibit 10.13 to the Company's Annual Report on Form 10-K filed March 31, 2009
10.13	HSN, Inc. Second Amended and Restated 2008 Stock and Annual Incentive Plan*	Filed herewith
10.14	Amended and Restated Deferred Compensation Plan for Non-Employee Directors*	Exhibit 10.14 to the Company's Annual Report on Form 10-K filed March 31, 2009
10.15	Form of Stock Appreciation Rights Agreement*	Exhibit 10.19 to the Company's Annual Report on Form 10-K filed March 31, 2009

\* Reflects management contracts and management and director compensation plans.



<b>Exhibit No</b>	<b>Description of Document</b>	<b>Method of Filing</b>
10.16	Form of Stock Option Agreement*	Exhibit 10.20 to the Company's Annual Report on Form 10-K filed March 31, 2009
10.17	Form of Restricted Stock Units Agreement*	Exhibit 10.21 to the Company's Annual Report on Form 10-K filed March 31, 2009
10.18	Form of Restricted Stock Units Agreement (for Non-Employee Directors)*	Exhibit 10.22 to the Company's Annual Report on Form 10-K filed March 31, 2009
10.19	Form of Deferred Restricted Stock Unit Agreement*	Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed November 6, 2013
10.20	Named Executive Officer and EVP Severance Plan*	Exhibit 10.1 to the Company's Current Report on Form 8-K filed November 24, 2009
10.21	Executive Severance Plan*	Exhibit 10.25 to the Company's Annual Report on Form 10-K filed March 4, 2010
10.22	Form of Performance Cash Award Agreement*	Exhibit 10.21 to the Company's Annual Report on Form 10-K filed February 21, 2013
10.23	Employee Stock Purchase Plan	Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed August 4, 2010
10.24	Form of Deferred Share Unit Agreement*	Exhibit 10.23 to the Company's Annual Report on Form 10-K filed February 23, 2012
10.25	Form of Performance Award Agreement*	Exhibit 10.24 to the Company's Annual Report on Form 10-K filed February 21, 2013
10.26	Form of Market Stock Unit Agreement*	Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed November 6, 2013
10.27	HSN, Inc. Nonqualified Deferred Compensation Plan	Filed herewith
12.1	Computation of Ratio of Earnings to Fixed Charges	Filed herewith
14.1	Code of Ethics and Business Conduct	Exhibit 14.1 to the Company's Annual Report on Form 10-K filed March 31, 2009
21.1	Subsidiaries of HSN, Inc.	Filed herewith
23.1	Consent of Independent Registered Certified Public Accounting Firm	Filed herewith
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act	Filed herewith
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act	Filed herewith
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act	Filed herewith
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act	Filed herewith

\* Reflects management contracts and management and director compensation plans.

Exhibit No.	Description of Document	Method of Filing
101	<p>The following financial information from HSNi's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) Consolidated Statements of Operations for the Years Ended December 31, 2013, 2012, and 2011, (ii) Consolidated Balance Sheets as of December 31, 2013 and 2012, (iii) Consolidated Statements of Shareholders' Equity, (iv) Consolidated Statements of Cash Flows for the Years Ended December 31, 2013, 2012, and 2011, (v) Notes to the Consolidated Financial Statements, and (vi) financial statement schedule.</p>	



## EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description of Document</u>
10.13	HSN, Inc. Second Amended and Restated 2008 Stock and Annual Incentive Plan
10.27	HSN, Inc. Nonqualified Deferred Compensation Plan
12.1	Computation of Ratio of Earnings to Fixed Charges
21.1	Subsidiaries of HSN, Inc.
23.1	Consent of Independent Registered Certified Public Accounting Firm
31.1	Chief Executive Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Chief Financial Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial information from HSNi's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, formatted in XBRL (eXtensible Business Reporting Language) and filed electronically herewith: (i) Consolidated Statements of Operations for the Years Ended December 31, 2013, 2012, and 2011, (ii) Consolidated Balance Sheets as of December 31, 2013 and 2012, (iii) Consolidated Statements of Shareholders' Equity, (iv) Consolidated Statements of Cash Flows for the Years Ended December 31, 2013, 2012, and 2011, (v) Notes to the Consolidated Financial Statements, and (vi) financial statement schedule.

## HSN, Inc.

## Computation of Ratio of Earnings to Fixed Charges

	Year Ended December 31,				
	2013	2012	2011	2010	2009
	(unaudited)				
	(In thousands, except ratios)				
Income from continuing operations before income taxes . . .	\$ 276,141	\$ 219,870	\$ 207,758	\$ 166,618	\$ 128,512
Fixed charges:					
Interest expense (a) . . . . .	6,718	20,811	31,963	33,124	35,373
Estimated interest portion of rental expense . . . . .	7,614	7,301	6,860	6,788	6,791
Total fixed charges . . . . .	14,332	28,112	38,823	39,912	42,164
Income from continuing operations before income taxes and fixed charges . . . . .	\$ 290,473	\$ 247,982	\$ 246,581	\$ 206,530	\$ 170,676
Ratio of earnings to fixed charges . . . . .	20.3	8.8	6.4	5.2	4.0

Note: The Ratio of Earnings to Fixed Charges should be read in conjunction with the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-K.

- (a) Includes interest on debt and amortization of debt issuance costs. Excludes interest income and interest associated with unrecognized tax benefits, which is recorded within income tax expense.

**HSN, Inc. Subsidiaries**  
**As of December 31, 2013**

<u>Name</u>	<u>Jurisdiction of Organization</u>
AST Sub, Inc. . . . .	DE
Ballard Designs, Inc. . . . .	GA
Chasing Fireflies, LLC . . . . .	DE
Cinmar, LLC . . . . .	DE
Contract Décor, Inc. . . . .	DE
Cornerstone Brands, Inc. . . . .	DE
Cornerstone Services, Inc. . . . .	DE
Frontgate Marketing, Inc. . . . .	DE
Garnet Hill, Inc. . . . .	NH
H.O.T. Networks Holdings (Delaware) LLC . . . . .	DE
Home Shopping Network En Espanol, L.P. . . . .	DE
Home Shopping Network En Espanol, L.L.C. . . . .	DE
HSN Catalog Services, Inc. . . . .	DE
HSN Fulfillment LLC . . . . .	DE
HSN Holding LLC . . . . .	DE
HSN Improvements LLC . . . . .	DE
HSN Interactive LLC . . . . .	DE
HSNi, LLC . . . . .	DE
HSN of Nevada LLC . . . . .	DE
HSN Realty LLC . . . . .	DE
Ingenious Designs LLC . . . . .	DE
NLG Merger Corp. . . . .	DE
S&N Operations, LLC . . . . .	DE
The Cornertone Brands Group, Inc. . . . .	DE
The Cornerstone Holdings Group, Inc. . . . .	DE
TTA Operations, Inc. . . . .	DE
TravelSmith Outfitters, Inc. . . . .	CA
Ventana Television Holdings, Inc. . . . .	DE
Ventana Television, Inc. . . . .	DE
H.O.T. Home Order Television Belgium S.A. . . . .	Belgium
Home Shopping Espanol (Mexico) S. De. R.L. De. CV . . . . .	Mexico
Home Shopping Espanol Servicios (Mexico) S. De. R.L. De. CV . . . . .	Mexico

**Consent of Independent Registered Certified Public Accounting Firm**

We consent to the incorporation by reference in the following Registration Statements:

(1) Registration Statement (Post Effective Amendment No. 4 to Form S-1 on Form S-3 No. 333-152697) of HSN, Inc. and subsidiaries (HSN, Inc.) and

(2) Registration Statement (Form S-8 No. 333-168570) pertaining to the Employee Stock Purchase Plan of HSN, Inc.;

of our reports dated February 20, 2014, with respect to the consolidated financial statements and schedule of HSN, Inc., and the effectiveness of internal control over financial reporting of HSN, Inc., included in this Annual Report (Form 10-K) of HSN, Inc. for the year ended December 31, 2013.

/s/ Ernst & Young LLP

Tampa, Florida  
February 20, 2014

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mindy Grossman, certify that:

1. I have reviewed this Annual Report on Form 10-K of HSN, Inc.;
2. Based on my knowledge, this Annual Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Annual Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Annual Report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Annual Report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: February 20, 2014

By: /s/ Mindy Grossman  
Mindy Grossman  
Chief Executive Officer



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Judy A. Schmeling, certify that:

1. I have reviewed this Annual Report on Form 10-K of HSN, Inc.;
2. Based on my knowledge, this Annual Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Annual Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Annual Report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Annual Report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: February 20, 2014

By: /s/ Judy A. Schmeling  
Judy A. Schmeling  
Chief Financial Officer and Chief Operating Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mindy Grossman, certify pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that, to my knowledge:

(1) the Annual Report of HSN, Inc. on Form 10-K for the fiscal year ended December 31, 2013 of HSN, Inc. (the "Report"), which this statement accompanies fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of HSN, Inc.

Date: February 20, 2014

By: /s/ Mindy Grossman  
Mindy Grossman  
Chief Executive Officer

**AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Judy A. Schmeling, certify pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that, to my knowledge:

(1) the Annual Report of HSN, Inc. on Form 10-K for the fiscal year ended December 31, 2013 of HSN, Inc. (the "Report"), which this statement accompanies fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of HSN, Inc.

Date: February 20, 2014

By: /s/ Judy A. Schmeling  
Judy A. Schmeling  
Chief Financial Officer and Chief Operating Officer

