SYMS CORP
Form 10-Q
October 03, 2006

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

**FORM 10-Q**

**(Mark One)**

**[ X ] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

for the quarterly period ended **August 26, 2006**

OR

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

for the transition period from ____________ to____________

**Commission File Number 1-8546**

# SYMS CORP

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| **NEW JERSEY** | **22-2465228** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| **Syms Way, Secaucus, New Jersey** | **07094** |
| (Address of Principal Executive Offices) | (Zip Code) |

**(201) 902-9600**
(Registrant's Telephone Number, Including Area Code)

**Not applicable**
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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

Large Accelerated Filer o    Accelerated Filer x    Non-Accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o    No x

At September 29, 2006 the latest practicable date, there were 14,403,912 shares outstanding of Common Stock, par value $0.05 per share.

**SYMS CORP AND SUBSIDIARIES**

## INDEX

**SYMS CORP AND SUBSIDIARIES**

# Condensed Consolidated Balance Sheets

**(In thousands except per share amounts)**

| | August 26, 2006 | February 25, 2006 | August 27, 2005 |
|---|---|---|---|
| | (Unaudited) | (NOTE) | (Unaudited) |
| ASSETS | | | |
| Current Assets | | | |
| Cash and cash equivalents | $ 37,543 | $ 30,007 | $ 16,345 |
| Receivables | 2,323 | 3,158 | 4,113 |
| Merchandise inventories | 68,846 | 57,469 | 76,239 |
| Deferred income taxes | 6,325 | 6,325 | 6,382 |
| Assets held for sale | - | 5,882 | 8,009 |
| Prepaid expenses and other current assets | 3,559 | 6,056 | 3,795 |
| TOTAL CURRENT ASSETS | 118,596 | 108,897 | 114,883 |
| PROPERTY AND EQUIPMENT - Net | 105,784 | 106,702 | 106,636 |
| DEFERRED INCOME TAXES | 5,511 | 5,511 | 7,213 |
| OTHER ASSETS | 19,083 | 18,009 | 16,741 |
| TOTAL ASSETS | $ 248,974 | $ 239,119 | $ 245,473 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| CURRENT LIABILITIES: | | | |
| Accounts payable | $ 30,150 | $ 15,496 | $ 26,537 |
| Accrued expenses | 8,119 | 7,631 | 6,148 |
| Accrued insurance | 273 | 313 | 492 |
| Obligations to customers | 3,614 | 3,625 | 3,233 |
| TOTAL CURRENT LIABILITIES | 42,156 | 27,065 | 36,410 |
| OTHER LONG TERM LIABILITIES | 1,740 | 1,520 | 1,563 |
| COMMITMENTS AND CONTINGENCIES | | | |
| SHAREHOLDERS' EQUITY | | | |
| Preferred stock, par value $100 per share. Authorized 1,000 | | | |

| | | | |
|---|---|---|---|
| shares; none outstanding | - | - | - |
| Common stock, par value $0.05 per share. Authorized 30,000 shares; 14,404 shares outstanding (net of 3,879 treasury shares) on August 26, 2006; 14,934 shares outstanding as of February 25, 2006 (net of 3,328 treasury shares) and 14,991 shares outstanding (net of 3,250 treasury shares) on August 27, 2005 | 770 | 769 | 768 |
| Additional paid-in capital | 16,810 | 16,656 | 16,149 |
| Treasury stock | (39,625) | (29,649) | (28,591) |
| Retained earnings | 227,123 | 222,758 | 219,174 |
| TOTAL SHAREHOLDERS' EQUITY | 205,078 | 210,534 | 207,500 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $ 248,974 | $ 239,119 | $ 245,473 |

NOTE: The balance sheet at February 25, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See Notes to Condensed Consolidated Financial Statements

**SYMS CORP AND SUBSIDIARIES**

# Condensed Consolidated Statements of Operations

**(In thousands, except per share amounts)**

| | 13 Weeks Ended | | 26 Weeks Ended | |
|---|---|---|---|---|
| | August 26, 2006 | August 27, 2005 | August 26, 2006 | August 27, 2005 |
| | (Unaudited) | | (Unaudited) | |
| Net sales | $ 62,683 | $ 61,457 | $ 128,876 | $ 128,889 |
| Cost of goods sold | 39,498 | 37,472 | 77,980 | 76,062 |
| Gross profit | 23,185 | 23,985 | 50,896 | 52,827 |
| Expenses: | | | | |
| Selling, general and administrative | 18,449 | 18,460 | 37,139 | 36,735 |
| Advertising | 1,084 | 914 | 4,135 | 3,749 |
| Occupancy | 4,653 | 4,567 | 9,109 | 8,608 |
| Depreciation and amortization | 2,022 | 2,202 | 4,238 | 4,417 |
| Gain on sale of real estate | - | - | (10,424) | - |
| Net income (loss) from operations | (3,023) | (2,158) | 6,699 | (682) |
| Other income | (7) | (15) | (167) | (25) |
| Interest income | (547) | (170) | (991) | (414) |
| Net income (loss) before income taxes | (2,469) | (1,973) | 7,857 | (243) |
| Provision (benefit) for income taxes | (1,096) | (770) | 3,492 | (95) |
| Net income (loss) | $ (1,373) | $ (1,203) | $ 4,365 | $ (148) |
| Net income (loss) per share-basic | $ (0.09) | $ (0.08) | $ 0.30 | $ (0.01) |
| Weighted average shares outstanding-basic | 14,495 | 14,961 | 14,710 | 14,990 |
| Net income (loss) per share-diluted | $ (0.09) | $ (0.08) | $ 0.29 | $ (0.01) |
| Weighted average shares outstanding- diluted | 14,495 | 14,961 | 15,085 | 14,990 |

See Notes to Condensed Consolidated Financial Statements

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**SYMS CORP AND SUBSIDIARIES**

# Condensed Consolidated Statements of Cash Flows

**(In thousands)**

| | 26 Weeks Ended August 26, 2006 | August 27, 2005 |
|---|---|---|
| | (Unaudited) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | $ 4,365 | $ (148) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,238 | 4,417 |
| Deferred income tax | - | (1) |
| Gain on disposal of assets | (10,432) | (7) |
| (Increase) decrease in operating assets: | | |
| Receivables | 255 | (638) |
| Merchandise inventories | (11,377) | (10,115) |
| Prepaid expenses and other current assets | 2,497 | 1,707 |
| Other assets | (1,061) | (797) |
| Increase (decrease) of operating liabilities: | | |
| Accounts payable | 15,234 | 10,423 |
| Accrued expenses | 448 | (1,465) |
| Obligations to customers | (11) | (150) |
| Other long term liabilities | 220 | (47) |
| Net cash provided by operating activities | 4,376 | 3,179 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Expenditures for property and equipment | (3,273) | (1,562) |
| Proceeds from sale of assets | 16,254 | 7 |
| Net cash provided by (used in) investing activities | 12,981 | (1,555) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payment of dividends | - | (15,028) |
| Exercise of options | 155 | 658 |
| Stock repurchase | (9,976) | (2,578) |
| Net cash used in financing activities | (9,821) | (16,948) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 7,536 | (15,324) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 30,007 | 31,669 |

| | | |
|---|---|---|
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 37,543 | $ 16,345 |
| | | |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid during the period for: | | |
| Interest | $ 106 | $ 72 |
| | | |
| Income taxes paid (net of refunds) | $ 2,367 | $ 33 |

See Notes to Condensed Consolidated Financial Statements

**SYMS CORP AND SUBSIDIARIES**

# Notes to Condensed Consolidated Financial Statements 13 and 26 Weeks Ended August 26, 2006 and August 27, 2005

## (Unaudited)

**Note 1 - The Company**

Syms Corp (the Company) operates a chain of 36 off-price retail clothing stores located throughout the United States in Northeastern and Middle Atlantic regions and in the Midwest, Southeast and Southwest. Each Syms store offers a broad range of first quality, in season merchandise bearing nationally recognized designer or brand-name labels for men, women and children.

**Note 2 - Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the 13-week and 26-week periods ended August 26, 2006 are not necessarily indicative of the results that may be expected for the entire fiscal year ending March 3, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Companys annual report on Form 10-K for the fiscal year ended February 25, 2006.

**Note 3 - Accounting Period**

The Companys fiscal year ends the Saturday nearest to the end of February. The fiscal year ending March 3, 2007 will be comprised of 53 weeks. The fiscal year ended February 25, 2006 was comprised of 52 weeks.

**Note 4 - Merchandise Inventories**

Merchandise inventories are stated at the lower of cost (first in, first out) or market, as determined by the retail inventory method.

**Note 5 - Bank Credit Facilities**

The Company has a revolving credit agreement with a bank for a line of credit not to exceed $30,000,000 through May 1, 2008. The agreement contains financial covenants, with respect to consolidated tangible net worth, as defined as working capital and maximum capital requirements, including dividends (defined to include cash repurchases of capital stock), as well as other financial ratios. The Company is in compliance with all covenants as of August 26, 2006. Except for funds provided from this revolving credit agreement, the Company has satisfied its operating and capital expenditure requirements, including those for the operations and expansion of stores, from internally generated funds. As of August 26, 2006, February 25, 2006 and August 27, 2005, there were no outstanding borrowings under this agreement. At August 26, 2006, February 25, 2006 and August 27, 2005, the Company had $1,391,097, $1,189,234 and $2,194,063 respectively, in outstanding letters of credit under this agreement.

**Note 6 - Net Income/(Loss) Per Share**

In accordance with SFAS 128, basic net income/(loss) per share has been computed based upon the weighted average common shares outstanding. Diluted net income/(loss) per share gives effect to outstanding stock options.

Net income/(loss) per share has been computed as follows:

| | 13 Weeks Ended | | 26 Weeks Ended | |
|---|---|---|---|---|
| | August 26, 2006 | August 27, 2005 | August 26, 2006 | August 27, 2005 |
| **Basic net loss per share:** | | | | |
| Net income (loss) | $ (1,373) | $ (1,203) | $ 4,365 | $ (148) |
| Average shares outstanding | 14,495 | 14,961 | 14,710 | 14,990 |
| Basic net loss per share | $ (0.09) | $ (0.08) | $ 0.30 | $ (0.01) |
| **Diluted net loss per share:** | | | | |
| Net income (loss) | $ (1,373) | $ (1,203) | $ 4,365 | $ (148) |
| Average shares outstanding | 14,495 | 14,961 | 14,710 | 14,990 |
| Stock options | - | - | 375 | - |
| Total average equivalent shares | 14,495 | 14,961 | 15,085 | 14,990 |
| Diluted net income (loss) per share | $ (0.09) | $ (0.08) | $ 0.29 | $ (0.01) |

In periods with losses, options were excluded from the computation of diluted net income per share because the effect would be anti-dilutive.

Options to purchase 716,907 and 760,827 shares of common stock at prices ranging from $5.21 to $15.01 per share were outstanding as of August 26, 2006 and August 27, 2005.

**Note 7  Recent Accounting Pronouncements**

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments  an amendment of FASB Statements No. 133 and 140 which is effective for fiscal years beginning after September 15, 2006. The statement was issued to clarify the application of FASB Statement No. 133 to beneficial interests in securitized financial assets and to improve the consistency of accounting for similar financial instruments, regardless of the form of the instruments. We have evaluated the new statement and have determined that it will not have a significant impact on the determination of our financial results.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, Accounting for Servicing of Financial Assets  an amendment of FASB Statement No. 140 which is effective for fiscal years beginning after September 15, 2006. This statement was issued to simplify the accounting for servicing rights and to reduce the volatility that results from using different measurement attributes. We have evaluated the new statement and have determined that it will not have a significant impact on the determination of our financial results.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109. The objective of this interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for the fiscal years beginning after December 15, 2006. The adoption of this statement is not expected to have a material effect on our financial position or results of operations.

**SYMS CORP AND SUBSIDIARIES**

**Note 8  Accounting for Stock-Based Compensation**

The Companys Amended and Restated Stock Option and Appreciation Plan allows for the granting of incentive stock options, as defined in Section 422A of the Internal Revenue Code of 1986 (as amended), non-qualified stock options or stock appreciation rights. The plan requires that incentive stock options be granted at an exercise price not less than the fair market value of the Common Stock on the date the option is granted. The exercise price of the option for holders of more than 10% of the voting rights of the Company must be not less than 110% of the fair market value of the Common Stock on the date of grant. Non-qualified options and stock appreciation rights may be granted at any exercise price. The Company has reserved 1,500,000 shares of common stock for issuance thereunder. The Company is no longer issuing options under its Amended and Restated Incentive Stock Option and Appreciation Plan.

No option or stock appreciation rights may be granted under the Amended and Restated Incentive Stock Option Plan after July 28, 2013. The maximum exercise period for any option or stock appreciation right under the plan is ten years from the date the option is granted (five years for any optionee who holds more than 10% of the voting rights of the Company).

On July 14, 2005, at the annual meeting of shareholders of the Company, the shareholders of the Company approved the 2005 Stock Option Plan (the "2005 Plan"), which 2005 Plan was adopted by the Board of Directors of the Company on April 7, 2005 subject to shareholder approval. The 2005 Plan permits the grant of options, share appreciation rights, restricted shares, restricted share units, performance units, performance shares, cash-based awards and other share-based awards. Key employees, non-employee directors, and third party service providers of the Company who are selected by a committee designated by the Board of Directors of the Company are eligible to participate in the 2005 Plan. The maximum number of shares issuable under the Plan is 850,000, subject to certain adjustments in the event of changes to the Companys capital structure.

The 2005 Plan requires that incentive stock options be granted at an exercise price not less than the fair market value of the Common Stock on the date the option is granted. The exercise price of such options for holders of more than 10% of the voting stock of the Company must be not less than 110% of the fair market value of the Common Stock on the date of grant. The exercise price of non-qualified options and stock appreciation rights must not be less than fair market value.

The maximum exercise period for any option or stock appreciation right under the 2005 Plan is ten years from the date the option is granted (five years for any incentive stock options issued to a person who holds more than 10% of the voting stock of the Company).

The 2005 Plan permits the Company to issue restricted shares, restricted share units, performance units, cash-based awards and other share-based awards with such term and conditions (including applicable vesting conditions) as the Company shall determine, subject to certain terms and conditions set forth in the 2005 Plan.

Effective February 25, 2006, the Company adopted the provisions of FAS No. 123(R), Share-Based Payment (FAS123(R)). Under FAS123(R), share-based compensation cost is measured at grant date, based on the estimated fair value of the award, and is recognized as expense over the requisite service period. The Company adopted the provisions of FAS123(R) using a modified prospective application. Under this method, compensation cost is recognized for all share-based payments granted, modified or settled after the date of adoption, as well as for any unvested awards that were granted prior to the date of adoption. Prior periods are not revised for comparative purposes. Because the Company previously adopted only the pro forma disclosure provisions of SFAS 123, it will recognize compensation cost relating to the unvested portion of awards granted prior to the date of adoption using the same estimate of the grant-date fair value and the same attribution method used to determine the pro forma disclosures under SFAS 123, except that forfeitures rates will be estimated for all options, as required by FAS123(R).

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model. Expected volatility is based on the historical volatility of the price of the Company's stock. The risk-free interest rate is based on U.S. Treasury issues with a term equal to the expected life of the option. The Company uses historical data to estimate expected dividend yield, expected life and forfeiture rates. There were no options granted during the six months ended August 26, 2006, and all options previously issued are fully vested.

Stock option activity during the six months ended August 26, 2006 is as follows:
(In thousands, except per share amounts)

| | Number Of options | Weighted Average Exercise Price | Weighted Average Remaining Contracted Term (years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at February 25, 2006 | 739 | $8.08 | - | - |
| Options granted | - | - | - | - |
| Options exercised | (22) | $6.94 | - | - |
| Options forfeited | - | - | - | - |
| Options outstanding at August 26, 2006 | 717 | $8.11 | 3.55 | $7,983 |
| Options exercisable at August 26, 2006 | 717 | $8.11 | 3.55 | $7,983 |

As of August 26, 2006, there was no total unrecognized stock-based compensation cost related to options granted under our plans that will be recognized in future periods.

Awards granted prior to the adoption of FAS 123(R) were accounted for under the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and its related interpretations. Under this intrinsic value method there was no compensation expense recognized for the three month and six month periods ended August 27, 2005 because all options had exercise prices equal to the market value of the underlying stock on the date of grant. The following table illustrates the effect on net income (loss) and net income (loss) per common share if the fair value method had been applied (in thousands except per share amounts):

| | **13 Weeks Ended 8/27/05** | **26 Weeks Ended 8/27/05** |
|---|---|---|
| Net loss: | $ ( 1,203) | $ ( 148) |
| Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | 773 | 773 |
| Pro forma net loss | $ (1,976) | $ ( 921) |
| Earnings per share: | | |

| | | |
|---|---|---|
| Basic, as reported | (0.08) | ($0.01) |
| Basic, pro forma | (0.13) | ($0.06) |
| Diluted, as reported | (0.08) | ($0.01) |
| Diluted, pro forma | (0.13) | ($0.06) |

This pro forma information may not be representative of the amounts to expected in future years as the fair value method of accounting prescribed by SFAS No. 123 has not been applied to options granted prior to fiscal 1996.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

**Special Note Regarding Forward-Looking Statements**

The Quarterly Report (including but not limited to factors discussed below, in the "Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as those discussed elsewhere in this Quarterly Report on Form 10-Q) includes forward-looking statements (within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934) and information relating to the Company that are based on the beliefs of the management of the Company as well as assumptions made by and information currently available to the management of the Company. When used in this Quarterly Report, the words "anticipate," "believe," "estimate," "expect," "intend," "plan," and similar expressions, as they relate to the Comp or the management of the Company, identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events, the outcome of which is subject to certain risks, including among others general economic and market conditions, decreased consumer demand for the Company's products, possible disruptions in the Company's computer or telephone systems, possible work stoppages, or increases in labor costs, effects of competition, possible disruptions or delays in the opening of new stores or inability to obtain suitable sites for new stores, higher than anticipated store closings or relocation costs, higher interest rates, unanticipated increases in merchandise or occupancy costs and other factors which may be outside the Company's control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results or outcomes may vary materially from those described herein as anticipated, believed, estimated, expected, intended or planned. Subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere described in this Quarterly Report and other reports filed with the Securities and Exchange Commission.

**Critical Accounting Policies and Estimate**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in the financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the consolidated financial statements.

The Company believes application of accounting policies, and the estimates inherently required by the policies, are reasonable. These accounting policies and estimates are constantly reevaluated, and adjustments are made when facts and circumstances dictate a change. Historically, the Company has found the application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

The Company's accounting policies are more fully described in Note 1 to the Consolidated Financial Statements, located in the Annual Report on Form 10-K for the fiscal year ended February 25, 2006. The Company has identified certain critical accounting policies that are described below.

***Merchandise Inventory*** - Inventories are valued at lower of cost or market using the retail first-in, first-out ("FIFO") inventory method. Under the retail inventory method ("RIM"), the valuation of inventories at cost and the resulting gross margins are calculated by applying a calculated cost to retail ratio to the retail value of inventories. RIM is an averaging method that has been widely used in the retail industry due to its practicality. Additionally, it is recognized that the use of RIM will result in valuing inventories at the lower of cost or market if markdowns are currently taken as a reduction of the retail value of inventories. Inherent in the RIM calculation are certain significant management judgments and estimates including, among others, merchandise markon, markups, and markdowns, which significantly impact the ending inventory valuation at cost as well as resulting gross margins. Management believes that the Company's RIM and application of FIFO provides an inventory valuation which reasonably approximates cost using a first-in, first-out assumption and results in a carrying value at the lower of cost or market. If actual market conditions are less favorable than those projected by management, additional markdowns may be required.

***Long-Lived Assets*** - In evaluation of the fair value and future benefits of long-lived assets, the Company performs analyses of the anticipated undiscounted future net cash flows of the related long-lived assets. If the carrying value of the related asset exceeds the undiscounted cash flows, the Company reduces the carrying value to its fair value, which is generally calculated using discounted cash flows. Various factors including future sales growth and profit margins are included in this analysis. To the extent these future projections or our strategies change, the conclusion regarding impairment may differ from the Company's current estimates.

***Deferred Tax Valuation Allowance*** – The Company records a valuation allowance to reduce its deferred tax assets to the amount that is not likely to be realized. The Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance. If the Company were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should the Company determine that it would not be able to realize all or part of the Company's net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

***Self-Insurance Accruals*** – The Company had been self-insured for workers' compensation liability claims. The Company is responsible for the payment of claims from prior years. In estimating the obligation associated with incurred losses, the Company utilizes loss development factors. These development factors utilize historical data to project incurred losses. Loss estimates are adjusted based upon actual claims settlements and reported claims.

**Results of Operations**

*13 Weeks and 26 Weeks Ended August 26, 2006 Compared to 13 and 26 Weeks Ended August 27, 2005*

Net sales for the 13 weeks ended August 26, 2006 were $62,683,000, an increase of $1,226,000 (2.0%) as compared to the net sales of $61,457,000 for the 13 weeks ended August 27, 2005. For the 26 weeks ended August 26, 2006 net sales were $128,876,000 as compared to net sales of $128,889,000 for the 26 weeks ended August 27, 2005. Comparable store sales increased 3.2% for the 13 weeks and .5% for the 26 weeks ended August 26, 2006 as compared to the comparable periods in the prior fiscal year. In our comparable store computation, we only include stores that have been opened for a period of at least 12 months and stores that were open during both fiscal years. We did not have any expansion in square footage in the 26 weeks ended August 26, 2006. The Company changed the timing and length of its Bash promotion in the second quarter of 2006. In the second quarter 2006 the Bash promotion took place for an 11 day period in July compared to 21 selling (12 days in August 2005 and 9 days in September 2005). The 9 days in September 2005 were part of the third quarter of 2005. This change in calendar largely accounts for the sales increase in the second quarter of 2006 as compared to 2005.

Gross profit for the 13 weeks ended August 26, 2006 was $23,185,000 (37.0% as a percentage of net sales for the 13 weeks ended August 27, 2005. Gross profit for the 26 weeks ended August 26, 2006 was $50,896,000 (39.5% as a percentage of net sales) a decrease of $1,931,000 as compared to $52,827,000 (41.0% as a percentage of net sales) for the 26 weeks ended August 27, 2005. The Company's gross profit may not be comparable to those of other entities, since other entities may include all of those costs related to their distribution network in cost of goods sold and others, like the Company, exclude a portion of those costs from gross profit and, instead, include them in other line items; such as selling and administrative expenses and occupancy costs. The decrease in gross profit in the 13 and 26 week periods is primarily due to higher markdowns on merchandise sold as compared to the same periods in the prior fiscal years.

Selling, general and administrative expense decreased $11,000 to $18,449,000 (29.5% as a percentage of net sales) for the 13 weeks ended August 26, 2006 as compared to $18,460,000 (30.0% as a percentage of net sales) for the 13 weeks ended August 27, 2005. Selling, general and administrative expense increased $404,000 to $37,139,000 (28.8% as a percentage of net sales) for the 26 weeks ended August 26, 2006 as compared to $36,735,000 (28.5% as a percentage of net sales) for the 26 weeks ended August 27, 2005. The increased expense in the 26 week period is largely attributable to increased health care costs.

Advertising expense for the 13 weeks ended August 26, 2006 was $1,084,000 (1.7% as a percentage of net sales) as compared to $914,000 (1.5% as a percentage of net sales) for the 26 weeks ended August 27, 2005. Advertising expense for the 26 weeks ended August 26, 2006 was $4,135,000 (3.2% as a percentage of net sales) as compared to $3,749,000 (2.9% as a percentage of net sales) for the 26 weeks ended August 27, 2005.

Occupancy costs were $4,653,000 (7.4% as a percentage of net sales) for the 13 weeks ended August 26, 2006 as compared to $4,567,000 (7.4% as a percentage of net sales) for the 13 weeks ended August 27, 2005. Occupancy costs were $9,109,000 (7.1% as a percentage of net sales for the 26 week period ended August 26, 2006 as compared to $8,608,000 (6.7% as a percentage of net sales) for the 26 week period ended August 27, 2005. The increased expense in the 13 and 26 week periods in 2006 is largely the result of higher utility costs due to higher fuel prices.

Depreciation and amortization expense was $2,022,000 (3.2% as a percentage of net sales) for the 13 weeks ended August 26, 2006 as compared to $2,202,000 (3.6% as a percentage of net sales) for the 13 weeks ended August 27, 2005. Depreciation and amortization expense for the 26 weeks ended August 26, 2006 was $4,238,000 (3.3% as a percentage of net sales) as compared to $4,417,000 (3.4% as a percentage of net sales) for the 26 weeks ended August 27, 2005.

The results for the 26 weeks ended August 26, 2006 reflects a gain of $10,424,000 resulting from the sale of its two stores located in Rochester, New York and Dallas, Texas. These two stores, which closed in May 2006, included the land and buildings occupied by these stores. The Dallas store was replaced by a store located in Plano, Texas which opened in May 2006 and is a leased property.

The loss before income taxes for the 13 weeks August 26, 2006 was $2,469,000 as compared to a loss of $1,973,000 for the 13 weeks ended August 27, 2005. The net income before taxes for the 26 weeks ended August 26, 2006 was $7,857,000 as compared to a loss before taxes of $243,000 for the 26 weeks ended August 27, 2005. The improvement in net income before taxes for the 26 weeks ended August 26, 2006 resulted largely from the gain on the sale of real estate of $10,424,000 as noted above.

For the 26 week period ended August 26, 2006 the effective income tax rate was 44.4 as compared to 39% for the comparable period a year ago.

**Liquidity and Capital Resources**

Working capital as of August 26, 2006 was $76,440,000, a decrease of $2,033,000 as compared to $78,473,000 as of August 27, 2005. The ratio of current assets to current liabilities was 2.81 to 1 as of August 26, 2006 as compared to 3.16 to 1 as of August 27, 2005.

Net cash provided by operating activities totaled $4,376,000 for the 26 weeks ended August 26, 2006, as compared to $3,179,000 for the 26 weeks ended August 27, 2005.

Net cash provided by investing activities was $12,981,000 for the 26 weeks ended August 26, 2006, as compared to $1,555,000 used in investing activities for the 26 weeks ended August 27, 2005. Expenditures for property and equipment were $3,273,000 and $1,562,000 for the 26 weeks ended August 26, 2006 and August 27, 2005, respectively. The sale of the Dallas, Texas and Rochester, New York properties largely accounts for this increase.

Net cash used in financing activities was $9,821,000 for the 26 weeks ended August 26, 2006, as compared to net cash used in financing activities of $16,948,000 for the 26 weeks ended August 27, 2005. On May 12, 2005, the Company paid a one-time cash dividend to its shareholders of record amounting to $15,028,000. In May 2006, the Company had a tender offer of its stock of 418,474 shares of common stock at a total cost of $7,533,000.

The Company has a revolving credit agreement with a bank for a line of credit not to exceed $30,000,000 through May 1, 2008. The agreement contains financial covenants, with respect to consolidated tangible net worth, as defined as working capital and maximum capital requirements, including dividends (defined to include cash repur