

CHARMING SHOPPES INC

Form 10-Q

December 07, 2007

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

**FORM 10-Q**

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

For the quarterly period ended November 3, 2007

**Or**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File No. 000-07258**

**CHARMING  
SHOPPES, INC.**

(Exact name of  
registrant as  
specified in its  
charter)

**PENNSYLVANIA**

(State or other jurisdiction of  
incorporation or organization)

**23-1721355**

(I.R.S. Employer Identification No.)

**450 WINKS LANE, BENSALEM, PA  
19020**

(Address of principal executive offices)  
(Zip Code)

**(215) 245-9100**

(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

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

Large Accelerated Filer ☒

Accelerated Filer ☐

Non-accelerated Filer ☐

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

Yes ☐ No ☒

The number of shares outstanding of the issuer's common stock (par value \$.10 per share) as of December 4, 2007 was 116,694,356 shares.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CHARMING SHOPPES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS**

|  | November<br>3,<br>2007<br>(Unaudited) | February<br>3,<br>2007 |
|--|---------------------------------------|------------------------|
| <i>(In thousands, except share amounts)</i>                      |                                       |                        |
| <b>ASSETS</b>  |                                       |                        |
| <b>Current assets</b>  |                                       |                        |
| Cash and cash equivalents  | \$ 36,389                             | \$ 143,838             |
| Available-for-sale securities                                    | 26,919                                | 1,997                  |
| Accounts receivable, net of allowances of \$1,440 and \$5,083    | 3,559                                 | 33,366                 |
| Investment in asset-backed securities                            | 113,458                               | 60,643                 |
| Merchandise inventories  | 498,196                               | 429,433                |
| Deferred advertising   | 32,130                                | 21,707                 |
| Deferred taxes   | 5,232                                 | 4,469                  |
| Prepayments and other  | 145,073                               | 145,385                |
| <b>Total current assets</b>                                      | <b>860,956</b>                        | <b>840,838</b>         |
| Property, equipment, and leasehold improvements – at cost        | 1,095,772                             | 996,430                |
| Less accumulated depreciation and amortization                   | 630,414                               | 573,984                |
| <b>Net property, equipment, and leasehold improvements</b>       | <b>465,358</b>                        | <b>422,446</b>         |
| Trademarks and other intangible assets                           | 247,171                               | 249,490                |
| Goodwill   | 152,811                               | 153,370                |
| Other assets   | 68,252                                | 44,798                 |
| <b>Total assets</b>  | <b>\$ 1,794,548</b>                   | <b>\$ 1,710,942</b>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                      |                                       |                        |
| <b>Current liabilities</b>                                       |                                       |                        |
| Accounts payable   | \$ 194,407                            | \$ 178,629             |
| Accrued expenses   | 192,321                               | 190,702                |
| Current portion – long-term debt                                 | 9,239                                 | 10,887                 |
| <b>Total current liabilities</b>                                 | <b>395,967</b>                        | <b>380,218</b>         |
| Deferred taxes   | 66,206                                | 57,340                 |
| Other non-current liabilities                                    | 160,666                               | 144,722                |
| Long-term debt   | 305,658                               | 181,124                |
| <b>Stockholders' equity</b>                                      |                                       |                        |
| Common stock \$.10 par value:                                    |                                       |                        |
| Authorized – 300,000,000 shares                                  |                                       |                        |
| Issued – 151,374,836 shares and 135,762,531 shares               | 15,137                                | 13,576                 |
| Additional paid-in capital                                       | 406,372                               | 285,159                |
| Treasury stock at cost – 34,224,114 shares and 12,265,993 shares | (324,425)                             | (84,136)               |

|   |                     |                     |
|---|---------------------|---------------------|
| Accumulated other comprehensive income            | <b>18</b>           | <b>1</b>            |
| Retained earnings                                 | <b>768,949</b>      | 732,938             |
| <b>Total stockholders' equity</b>                 | <b>866,051</b>      | <b>947,538</b>      |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 1,794,548</b> | <b>\$ 1,710,942</b> |

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

*See Notes to Condensed Consolidated Financial Statements*

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE INCOME**  
**(Unaudited)**

|   | <b>Thirteen Weeks Ended</b> |                   |
|---|-----------------------------|-------------------|
|   | <b>November</b>             | <b>October</b>    |
|   | <b>3,</b>                   | <b>28,</b>        |
|   | <b>2007</b>                 | <b>2006</b>       |
| <i>(In thousands, except per share amounts)</i>   |                             |                   |
| <b>Net sales</b>  | <b>\$ 669,389</b>           | <b>\$ 695,278</b> |
| Cost of goods sold, buying, catalog, and occupancy expenses                                     | <b>486,519</b>              | 480,818           |
| Selling, general, and administrative expenses   | <b>187,996</b>              | 183,435           |
| <b>Total operating expenses</b>   | <b>674,515</b>              | 664,253           |
| <b>Income/(loss) from operations</b>  | <b>(5,126)</b>              | 31,025            |
| Other income  | <b>2,686</b>                | 2,074             |
| Interest expense  | <b>(2,206)</b>              | (3,540)           |
| Income/(loss) before income taxes   | <b>(4,646)</b>              | 29,559            |
| Income tax provision/(benefit)  | <b>(1,078)</b>              | 10,202            |
| <b>Net income/(loss)</b>  | <b>(3,568)</b>              | 19,357            |
| <b>Other comprehensive income, net of tax</b>   |                             |                   |
| Unrealized gain on available-for-sale securities,<br>net of income tax provision of \$8 in 2007 | <b>15</b>                   | 0                 |
| <b>Comprehensive income/(loss)</b>  | <b>\$ (3,553)</b>           | <b>\$ 19,357</b>  |
| <b>Basic net income/(loss) per share</b>  | <b>\$ (.03)</b>             | <b>\$ .16</b>     |
| <b>Diluted net income/(loss) per share</b>  | <b>\$ (.03)</b>             | <b>\$ .15</b>     |

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

*See Notes to Condensed Consolidated Financial Statements*





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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE INCOME**  
**(Unaudited)**

|  | <b>Thirty-nine Weeks<br/>Ended</b> |                                 |
|--|------------------------------------|---------------------------------|
|  | <b>November<br/>3,<br/>2007</b>    | <b>October<br/>28,<br/>2006</b> |
| <i>(In thousands, except per share amounts)</i>  |                                    |                                 |
| <b>Net sales</b>   | <b>\$ 2,225,026</b>                | <b>\$ 2,193,553</b>             |
| Cost of goods sold, buying, catalog, and occupancy expenses  | <b>1,584,048</b>                   | 1,516,490                       |
| Selling, general, and administrative expenses  | <b>574,885</b>                     | 541,468                         |
| <b>Total operating expenses</b>  | <b>2,158,933</b>                   | <b>2,057,958</b>                |
| <b>Income from operations</b>  | <b>66,093</b>                      | 135,595                         |
| Other income   | <b>7,787</b>                       | 6,488                           |
| Interest expense   | <b>(8,287)</b>                     | (11,475)                        |
| Income before income taxes   | <b>65,593</b>                      | 130,608                         |
| Income tax provision   | <b>24,584</b>                      | 46,627                          |
| <b>Net income</b>  | <b>41,009</b>                      | 83,981                          |
| <b>Other comprehensive income, net of tax</b>  |                                    |                                 |
| Unrealized gain on available-for-sale securities,<br>net of income tax provision of \$11 in 2007 and \$3 in 2006 | <b>17</b>                          | 4                               |
| <b>Comprehensive income</b>  | <b>\$ 41,026</b>                   | <b>\$ 83,985</b>                |
| <b>Basic net income per share</b>  | <b>\$ .33</b>                      | <b>\$ .69</b>                   |
| <b>Diluted net income per share</b>  | <b>\$ .32</b>                      | <b>\$ .63</b>                   |

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

*See Notes to Condensed Consolidated Financial Statements*



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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

|  | <b>Thirty-nine Weeks<br/>Ended</b> |                                 |
|--|------------------------------------|---------------------------------|
|  | <b>November<br/>3,<br/>2007</b>    | <b>October<br/>28,<br/>2006</b> |
| <i>(In thousands)</i>  |                                    |                                 |
| <b>Operating activities</b>  |                                    |                                 |
| Net income   | \$ 41,009                          | \$ 83,981                       |
| Adjustments to reconcile net income to net cash provided by operating activities |                                    |                                 |
| Depreciation and amortization  | 69,492                             | 66,431                          |
| Stock-based compensation   | 8,494                              | 7,603                           |
| Deferred income taxes  | 8,856                              | (9,713)                         |
| Excess tax benefits related to stock-based compensation                          | (847)                              | (2,635)                         |
| Net loss from disposition of capital assets                                      | 1,926                              | 849                             |
| Net gain from securitization activities  | (7,486)                            | (1,139)                         |
| Changes in operating assets and liabilities                                      |                                    |                                 |
| Accounts receivable, net   | 29,807                             | 36,583                          |
| Merchandise inventories  | (68,763)                           | (105,040)                       |
| Accounts payable   | 15,778                             | 74,330                          |
| Deferred advertising   | (10,423)                           | (5,617)                         |
| Prepayments and other  | (591)                              | (17,932)                        |
| Income taxes payable   | 0                                  | 10,998                          |
| Accrued expenses and other   | 16,853                             | 2,135                           |
| Purchase of Lane Bryant credit card receivables portfolio                        | (230,975)                          | 0                               |
| Securitization of Lane Bryant credit card receivables portfolio                  | 230,975                            | 0                               |
| <b>Net cash provided by operating activities</b>                                 | <b>104,105</b>                     | <b>140,834</b>                  |
| <b>Investing activities</b>  |                                    |                                 |
| Investment in capital assets   | (108,775)                          | (92,524)                        |
| Gross purchases of securities  | (73,089)                           | (33,472)                        |
| Proceeds from sales of securities  | 3,777                              | 52,540                          |
| Increase in other assets   | (17,225)                           | (7,417)                         |
| <b>Net cash used by investing activities</b>                                     | <b>(195,312)</b>                   | <b>(80,873)</b>                 |
| <b>Financing activities</b>  |                                    |                                 |
| Proceeds from short-term borrowings  | 9,527                              | 142,212                         |
| Repayments of short-term borrowings  | (9,527)                            | (192,212)                       |
| Proceeds from issuance of senior convertible notes                               | 275,000                            | 0                               |
| Proceeds from long-term borrowings   | 986                                | 0                               |
| Repayments of long-term borrowings   | (9,044)                            | (11,491)                        |
| Payments of deferred financing costs   | (7,611)                            | 0                               |
| Excess tax benefits related to stock-based compensation                          | 847                                | 2,635                           |
| Purchase of hedge on senior convertible notes                                    | (90,475)                           | 0                               |
| Sale of common stock warrants  | 53,955                             | 0                               |
| Purchases of treasury stock  | (240,289)                          | 0                               |

|  |                  |                   |
|--|------------------|-------------------|
| Net proceeds from shares issued under employee stock plans | 389              | 7,001             |
| <b>Net cash used by financing activities</b>               | <b>(16,242)</b>  | <b>(51,855)</b>   |
| <b>Increase/(decrease) in cash and cash equivalents</b>    | <b>(107,449)</b> | <b>8,106</b>      |
| Cash and cash equivalents, beginning of period             | 143,838          | 130,132           |
| <b>Cash and cash equivalents, end of period</b>            | <b>\$ 36,389</b> | <b>\$ 138,238</b> |
| <b>Non-cash financing and investing activities</b>         |                  |                   |
| Common stock issued on redemption of convertible notes     | \$ 149,564       | \$ 0              |
| Assets acquired through capital leases                     | \$ 5,509         | \$ 0              |

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

*See Notes to Condensed Consolidated Financial Statements*

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**Note 1. Condensed Consolidated Financial Statements**

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission. Accordingly, we have condensed or omitted certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles. In our opinion, we have made all adjustments (which include only normal recurring adjustments) necessary to present fairly our financial position, results of operations and comprehensive income, and cash flows. Certain prior-year amounts in the condensed consolidated balance sheets and condensed consolidated statements of operations and comprehensive income have been reclassified to conform to the current-year presentation. These financial statements and related notes should be read in conjunction with our financial statements and related notes included in our February 3, 2007 Annual Report on Form 10-K. The results of operations for the thirteen weeks and thirty-nine weeks ended November 3, 2007 and October 28, 2006 are not necessarily indicative of operating results for the full fiscal year.

As used in these notes, “Fiscal 2008” refers to our fiscal year ending February 2, 2008 and “Fiscal 2007” refers to our fiscal year ended February 3, 2007. “Fiscal 2009” refers to our fiscal year ending January 31, 2009. “Fiscal 2008 Third Quarter” refers to our fiscal quarter ended November 3, 2007 and “Fiscal 2007 Third Quarter” refers to our fiscal quarter ended October 28, 2006. “Fiscal 2008 First Quarter” refers to our fiscal quarter ended May 5, 2007 and “Fiscal 2008 Second Quarter” refers to our fiscal quarter ended August 4, 2007. The term “Fiscal 2009 First Quarter” refers to our fiscal quarter ending May 3, 2008. The terms “Charming Shoppes, Inc.,” “the Company,” “we,” “us,” and “our” refer to Charming Shoppes, Inc. and its consolidated subsidiaries, except where the context otherwise requires or as otherwise indicated.

***Segment Reporting***

We operate and report in two segments: Retail Stores and Direct-to-Consumer. We determine our operating segments based on the way our chief operating decision-makers review our results of operations. We also consider the similarity of economic characteristics, production processes, and operations in aggregating our operating segments. Accordingly, we have aggregated our retail stores and store-related E-commerce operations into a single reporting segment (the “Retail Stores” segment). Our catalog and catalog-related E-commerce operations are reported under the Direct-to-Consumer segment. The Retail Stores segment derives its revenues from sales through retail stores and store-related E-commerce sales under our LANE BRYANT® (including LANE BRYANT OUTLET™), FASHION BUG®, CATHERINES PLUS SIZES®, and PETITE SOPHISTICATE® (including PETITE SOPHISTICATE OUTLET™) brands. The Direct-to-Consumer segment derives its revenues from catalog sales and catalog-related E-commerce sales under our Crosstown Traders catalogs. See “**Note 10. Segment Reporting**” below for further information regarding our segment reporting.

***Stock-based Compensation***

We have various stock-based compensation plans under which we are currently granting awards, which are more fully described in “**Item 8. Financial Statements and Supplementary Data; Note 11. Stock-Based Compensation Plans**” in our February 3, 2007 Annual Report on Form 10-K.



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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 1. Condensed Consolidated Financial Statements (Continued)**

Shares available for future grants under our stock-based compensation plans as of November 3, 2007:

|   |           |
|---|-----------|
| 2004 Stock Award and Incentive Plan           | 3,915,252 |
| 2003 Non-Employee Directors Compensation Plan | 122,968   |
| 1994 Employee Stock Purchase Plan             | 1,072,687 |
| 1988 Key Employee Stock Option Plan           | 105,055   |

Stock option activity for the thirty-nine weeks ended November 3, 2007:

|  | Option<br>Shares | Average<br>Option<br>Price | Option Prices<br>Per Share |   |          |           | Aggregate<br>Intrinsic<br>Value <sup>(1)</sup><br>(000's) |
|--|------------------|----------------------------|----------------------------|---|----------|-----------|---|
| <b>Outstanding at<br/>February 3, 2007</b>       | 2,217,790        | \$ 5.82                    | \$ 1.00                    | – | \$ 13.84 | \$ 16,473 |   |
| Granted – option price less<br>than market price | 18,000           | 1.00                       | 1.00                       | – | 1.00     |           |   |
| Canceled/forfeited                               | (7,502)          | 4.08                       | 1.00                       | – | 11.28    |           |   |
| Exercised  | (148,181)        | 5.26                       | 1.00                       | – | 8.46     |           | 884 <sup>(2)</sup>  |
| <b>Outstanding at<br/>November 3, 2007</b>       | 2,080,107        | \$ 5.82                    | \$ 1.00                    | – | \$ 13.84 | \$ 2,092  |   |
| <b>Exercisable at<br/>November 3, 2007</b>       | 2,015,680        | \$ 5.98                    | \$ 1.00                    | – | \$ 13.84 | \$ 1,717  |   |

(1) Aggregate market value less aggregate exercise price.

(2) As of date of exercise.

Stock-based compensation expense for the thirteen weeks and thirty-nine weeks ended November 3, 2007 and October 28, 2006 includes (i) compensation cost for all partially-vested stock-based awards granted prior to the beginning of Fiscal 2007, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), and (ii) compensation cost for all stock-based awards granted subsequent to the beginning of Fiscal 2007, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"), a revision of SFAS No. 123. Current grants of stock-based compensation consist primarily of restricted stock and restricted stock unit awards.

| Thirteen Weeks Ended |                | Thirty-nine Weeks Ended |                |
|----------------------|----------------|-------------------------|----------------|
| November<br>3,       | October<br>28, | November<br>3,          | October<br>28, |



| <i>(In thousands)</i>                  | 2007   | 2006     | 2007     | 2006     |
|--|--------|----------|----------|----------|
| Total stock-based compensation expense | \$ 734 | \$ 2,588 | \$ 8,494 | \$ 7,603 |

We use the Black-Scholes valuation model to estimate the fair value of stock options, and amortize stock-based compensation on a straight-line basis over the estimated life of a stock option or the vesting period of an award. Stock-based compensation for performance-based awards is initially determined using an estimate of performance levels expected to be achieved and is periodically reviewed and adjusted as required. Estimates or assumptions we used under the Black-Scholes model are consistent with those used in Fiscal 2007, as described in **“Item 8. Financial Statements and Supplementary Data; Note 1. Summary of Significant Accounting Policies; Stock-based Compensation”** in our February 3, 2007 Annual Report on Form 10-K.

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 1. Condensed Consolidated Financial Statements (Continued)**

Total stock-based compensation not yet recognized, related to the non-vested portion of stock options and awards outstanding, was \$18,334,000 as of November 3, 2007. The weighted-average period over which we expect to recognize this compensation is approximately 3 years. During the thirteen weeks ended November 3, 2007, we reduced our estimate of the number of shares expected to vest in connection with our performance-based awards.

***Crosstown Traders Integration Plan***

Concurrent with our acquisition of Crosstown Traders (see “**Item 8. Financial Statements and Supplementary Data; Note 2. Acquisition of Crosstown Traders, Inc.**” in our February 3, 2007 Annual Report on Form 10-K), we prepared a formal integration plan for Crosstown Traders’ operations that included exiting and consolidating certain activities of Crosstown Traders, lease terminations, severance, and certain other exit costs. As of January 28, 2006, we finalized the plan and recorded a liability for the costs of the plan, which we recorded as a component of the purchase price of the acquisition in accordance with FASB Emerging Issues Task Force (“EITF”) Issue 95-3, “*Recognition of Liabilities in Connection with a Purchase Business Combination.*”

Liabilities recorded in connection with the integration plan outstanding as of February 3, 2007, adjustments, payments, or settlements of these liabilities for the thirty-nine weeks ended November 3, 2007, and the remaining accrual as of November 3, 2007 were as follows:

|                                     | <b>Thirty-nine Weeks Ended</b>     |                    |                              | <b>Balance at November 3, 2007</b> |
|-------------------------------------|------------------------------------|--------------------|------------------------------|------------------------------------|
|                                     | <b>Balance at February 3, 2007</b> | <b>Adjustments</b> | <b>Payments/ Settlements</b> |                                    |
| <b><i>(In thousands)</i></b>        |                                    |                    |                              |                                    |
| Lease termination and related costs | \$ 1,820                           | \$ (746)           | \$ (1,074)                   | \$ 0                               |
| Other costs                         | 239                                | (153)              | (86)                         | 0                                  |
| Total                               | \$ 2,059                           | \$ (899)           | \$ (1,160)                   | \$ 0                               |

During the Fiscal 2008 Third Quarter, we reached an agreement with the landlord to terminate the lease on Crosstown Traders’ manufacturing facility for approximately \$570,000 and paid or settled the remaining liabilities in connection with the integration plan. Accordingly, the lease termination liability and related costs, other costs, goodwill, and deferred taxes were adjusted in the Fiscal 2008 Third Quarter to reflect the termination of the lease and the payment or settlement of the remaining liabilities.

**Note 2. Accounts Receivable**

Accounts receivable consist of trade receivables from sales through our FIGI'S® catalog. Details of our accounts receivable are as follows:

| <i>(In thousands)</i>           | <b>November<br/>3,<br/>2007</b> | <b>February<br/>3,<br/>2007</b> |
|---------------------------------|---------------------------------|---------------------------------|
| Due from customers              | \$ 4,999                        | \$ 38,449                       |
| Allowance for doubtful accounts | (1,440)                         | (5,083)                         |
| Net accounts receivable         | \$ 3,559                        | \$ 33,366                       |

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 3. Trademarks and Other Intangible Assets**

| <i>(In thousands)</i>  | <b>November<br/>3,<br/>2007</b> | <b>February<br/>3,<br/>2007</b> |
|--|---------------------------------|---------------------------------|
| Trademarks, tradenames, and internet domain names  | \$ 241,988                      | \$ 241,850                      |
| Customer lists, customer relationships, and covenant not to compete                                  | 16,400                          | 16,400                          |
| Total at cost  | 258,388                         | 258,250                         |
| Less accumulated amortization of customer lists, customer relationships, and covenant not to compete | 11,217                          | 8,760                           |
| Net trademarks and other intangible assets   | \$ 247,171                      | \$ 249,490                      |

**Note 4. Long-term Debt**

| <i>(In thousands)</i>  | <b>November<br/>3,<br/>2007</b> | <b>February<br/>3,<br/>2007</b> |
|--|---------------------------------|---------------------------------|
| 1.125% Senior Convertible Notes, due May 2014                | \$ 275,000                      | \$ 0                            |
| 4.75% Senior Convertible Notes, due June 2012 <sup>(1)</sup> | 0                               | 149,999                         |
| Capital lease obligations                                    | 12,876                          | 12,853                          |
| 6.07% mortgage note, due October 2014                        | 11,235                          | 11,696                          |
| 6.53% mortgage note, due November 2012                       | 7,000                           | 8,050                           |
| 7.77% mortgage note, due December 2011                       | 8,051                           | 8,496                           |
| Other long-term debt   | 735                             | 917                             |
| Total long-term debt   | 314,897                         | 192,011                         |
| Less current portion   | 9,239                           | 10,887                          |
| Long-term debt   | \$ 305,658                      | \$ 181,124                      |

*(1) On April 30, 2007, we called these notes for redemption on June 4, 2007 (see below).*

On April 30, 2007, we issued \$250,000,000 in aggregate principal amount of 1.125% Senior Convertible Notes due May 1, 2014 (the "1.125% Notes") in a private offering for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. On May 11, 2007, the initial purchasers of the 1.125% Notes exercised their over-allotment option and purchased an additional \$25,000,000 in aggregate principal amount of the notes. The 1.125% Notes were issued at par plus accrued interest, if any, from April 30, 2007, and interest is payable semiannually in arrears on May 1 and November 1, beginning November 1, 2007. The 1.125% Notes will mature on May 1, 2014, unless earlier repurchased by us or converted.

We received combined proceeds of approximately \$268,125,000 from the issuance, net of underwriting fees of approximately \$6,875,000. The underwriting fees, as well as additional transaction costs of \$736,000 incurred in connection with the issuance of the 1.125% Notes, are included in “Other assets” on our condensed consolidated balance sheets, and are being amortized to interest expense on an effective interest rate basis over the life of the notes (seven years).

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 4. Long-term Debt (Continued)**

Holders of the 1.125% Notes may convert their notes based on a conversion rate of 65.0233 shares of our common stock per \$1,000 principal amount of notes (the equivalent of \$15.379 per share), subject to adjustment upon certain events, only under the following circumstances as described in the Indenture for the 1.125% Notes (the “Indenture”): (1) during specified periods, if the price of our common stock reaches specified thresholds; (2) if the trading price of the 1.125% Notes is below a specified threshold; (3) at any time after November 15, 2013; or (4) upon the occurrence of certain corporate transactions.

Upon conversion, we intend to deliver an amount in cash equal to the lesser of the aggregate principal amount of notes to be converted or our total conversion obligation. If our conversion obligation exceeds the aggregate principal amount of the 1.125% Notes, we will deliver shares of our common stock in respect of the excess. However, we have the option, subject to the approval of our Board of Directors, to elect to satisfy our conversion obligation entirely in shares of our common stock. In connection with a “Fundamental Change” as defined in the Indenture, we also will deliver upon conversion of the notes additional shares of common stock as described in the Indenture. In addition, if we undergo a Fundamental Change before maturity of the 1.125% Notes, we may be required to repurchase for cash all or a portion of the 1.125% Notes at a repurchase price of 100% of the principal amount of the notes being repurchased, plus accrued and unpaid interest, including additional amounts, if any, up to but excluding the date of purchase. As of November 3, 2007, none of the conditions allowing holders of the 1.125% Notes to convert had been met.

Under a registration rights agreement that we entered into with the initial purchasers of the 1.125% Notes, we agreed to file a shelf registration statement with the Securities and Exchange Commission (“SEC”) covering re-sales of the 1.125% Notes and the shares of our common stock issuable on conversion of the notes. On August 24, 2007, we filed with the SEC an automatic shelf registration statement covering re-sales of the 1.125% Notes and the shares issuable on conversion of the notes.

We accounted for the issuance of the 1.125% Notes in accordance with the guidance in EITF Issue 90-19, “*Convertible Bonds with Issuer Option to Settle for Cash upon Conversion*” and EITF Issue 00-19, “*Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock*.” Accordingly, we have recorded the 1.125% Notes as long-term debt in our condensed consolidated balance sheet as of November 3, 2007.

Concurrent with the issuance of the 1.125% Notes, we entered into privately negotiated common stock call options with affiliates of the initial purchasers. The call options allow us to purchase up to approximately 17,881,000 shares of our common stock at an initial strike price of \$15.379 per share. The call options expire on May 1, 2014 and must be net-share settled. The cost of the call options was approximately \$90,475,000.

In addition, we sold warrants to affiliates of certain of the initial purchasers whereby they have the option to purchase up to approximately 18,775,000 shares of our common stock at an initial strike price of \$21.607 per share. The warrants expire on various dates from July 30, 2014 through December 18, 2014 and must be net-share settled. We received approximately \$53,955,000 in cash proceeds from the sale of these warrants.

The call options are intended to reduce the potential dilution to our common stock upon conversion of the 1.125% Notes by effectively increasing the initial conversion price of the notes to \$21.607 per share, representing a 73.0% conversion premium over the closing price of \$12.49 per share for our common stock on April 30, 2007.

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 4. Long-term Debt (Continued)**

Paragraph 11(a) of SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*," provides that contracts issued or held by an entity that are both (1) indexed to the entity's own common stock and (2) classified in stockholders' equity in its statement of financial position are not considered to be derivative instruments under SFAS No. 133 if the provisions of EITF Issue 00-19 are met.

We accounted for the call options and warrants in accordance with the guidance in EITF Issue 00-19. The call options and warrants meet the requirements of EITF Issue 00-19 to be accounted for as equity instruments. Accordingly, the cost of the call options and the proceeds from the sale of the warrants are included in additional paid-in capital in our accompanying condensed consolidated balance sheet as of November 3, 2007. We used a portion of the net proceeds from the 1.125% Notes to pay the \$36,520,000 net cost of the call options and warrants.

In accordance with SFAS No. 128, "*Earnings Per Share*," the 1.125% Notes will have no impact on our diluted net income per share until the price of our common stock exceeds the conversion price of \$15.379 per share because the principal amount of the 1.125% Notes will be settled in cash upon conversion. Prior to conversion, we will include the effect of the additional shares that may be issued if our common stock price exceeds \$15.379 per share using the treasury stock method. For the first \$1.00 by which the price of our common stock exceeds \$15.379 per share, there would be dilution of approximately 1,093,000 shares. Further increases in the share price would result in additional dilution at a declining rate, such that a price of \$21.607 per share would result in cumulative dilution of approximately 5,156,000 shares. Should the stock price exceed \$21.607 per share, we would also include the dilutive effect of the additional potential shares that may be issued related to the warrants, using the treasury stock method. The 1.125% Notes and warrants would have a combined dilutive effect such that, for the first \$1.00 by which the stock price exceeds \$21.607 per share, there would be cumulative dilution of approximately 6,552,000 shares prior to conversion. Further increases in the share price would result in additional dilution at a declining rate.

The call options are not included in the calculation of diluted net income per share because their effect would be anti-dilutive. Upon conversion of the 1.125% Notes, the call options will serve to neutralize the dilutive effect of the notes up to a stock price of \$21.607 per share. For the first \$1.00 by which the stock price exceeds \$21.607 per share, the call options would reduce the cumulative dilution of approximately 6,552,000 shares in the example above to approximately 833,000 shares.

The preceding calculations assume that the average price of our common stock exceeds the respective conversion prices during the period for which diluted net income per share is calculated, and exclude any potential adjustments to the conversion ratio provided under the terms of the 1.125% Notes.

On April 30, 2007, we called for the redemption on June 4, 2007 of our \$149,999,000 outstanding aggregate principal amount of 4.75% Senior Convertible Notes, due June 2012 (the "4.75% Notes"). The holders of the 4.75% Notes had the option to convert their notes into shares of our common stock at a conversion price of \$9.88 per share until the close of business on June 1, 2007. As of June 4, 2007, the holders of \$149,956,000 principal amount of the 4.75% Notes had exercised their right to convert their notes into an aggregate of 15,145,556 shares of our common stock and the remaining notes were redeemed for \$43,000. In addition, we paid \$392,000 in lieu of fractional shares.





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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 5. Stockholders' Equity**

|   | <b>Thirty-nine<br/>Weeks<br/>Ended<br/>November<br/>3,<br/>2007</b> |
|---|---|
| <i>(Dollars in thousands)</i>   |   |
| Total stockholders' equity, beginning of period                             | \$ 947,538  |
| Cumulative effect of adoption of FIN No. 48 <sup>(1)</sup>                  | (4,998)   |
| Net income  | 41,009  |
| Net proceeds from shares issued under employee stock plans (466,749 shares) | 389   |
| Purchase of treasury shares (21,958,121 shares)                             | (240,289)   |
| Common stock issued on redemption of convertible notes (15,145,556 shares)  | 149,564   |
| Sale of common stock warrants <sup>(2)</sup>                                | 53,955  |
| Purchase of common stock call options <sup>(2)</sup>                        | (90,475)  |
| Stock-based compensation expense  | 8,494   |
| Excess tax benefits related to stock-based compensation                     | 847   |
| Unrealized gain on available-for-sale securities, net of tax                | 17  |
| Total stockholders' equity, end of period                                   | \$ 866,051  |

(1) See "Note 8. Income Taxes" below.

(2) See "Note 4. Long-term Debt" above.

During the Fiscal 2008 First Quarter, we repurchased 10,315,000 shares of our common stock with \$131,102,000 of the proceeds from our issuance of 1.125% Senior Convertible Notes due May 1, 2014 (see "Note 4. Long-term Debt" above). In May 2007, we announced a program to use an additional \$80 to \$100 million of the proceeds to repurchase shares of common stock during Fiscal 2008. During the Fiscal 2008 Second Quarter and Fiscal 2008 Third Quarter, we repurchased an aggregate total of 10,416,000 shares of our common stock for \$100,000,000 under this program.

During the Fiscal 2008 Third Quarter, we also announced our intention to complete the repurchase of additional shares during the remainder of Fiscal 2008 under a prior authorization from our Board of Directors that allows us to repurchase up to approximately 4,980,000 shares of our common stock. During the Fiscal 2008 Third Quarter, we purchased an aggregate total of 1,227,000 shares for \$9,187,000 under this program (see "Note 12. Subsequent Events" below for information regarding additional purchases).

On November 8, 2007 (subsequent to the end of the Fiscal 2008 Third Quarter), we announced that our Board of Directors has authorized a new \$200 million share repurchase program (see "Note 12. Subsequent Events" below).

**Note 6. Customer Loyalty Card Programs**

We offer our customers various loyalty card programs. Customers that join these programs are entitled to various benefits, including discounts and rebates on purchases during the membership period. Customers generally join these programs by paying an annual membership fee. We recognize revenue from these loyalty programs as sales over the life of the membership period based on when the customer earns the benefits and when the fee is no longer refundable. We recognize costs in connection with administering these programs as cost of goods sold when incurred.

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 6. Customer Loyalty Card Programs (Continued)**

During the thirteen weeks ended November 3, 2007 we recognized revenues of \$5,438,000 and during the thirteen weeks ended October 28, 2006 we recognized revenues of \$4,871,000 in connection with our loyalty card programs. During the thirty-nine weeks ended November 3, 2007 we recognized revenues of \$16,449,000 and during the thirty-nine weeks ended October 28, 2006 we recognized revenues of \$14,042,000 in connection with our loyalty card programs.

At the end of the Fiscal 2008 Third Quarter, we began offering a loyalty program in connection with the issuance of our new LANE BRYANT proprietary credit card. Cardholders earn points for purchases using the credit card, which may be redeemed for merchandise coupons upon the accumulation of a specified number of points. No membership fees are charged in connection with this program. This program had no impact on our Fiscal 2008 Third Quarter results of operations.

**Note 7. Net Income per Share**

|   | <b>Thirteen Weeks Ended</b>     |                                 | <b>Thirty-nine Weeks Ended</b>  |                                 |
|---|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
|   | <b>November<br/>3,<br/>2007</b> | <b>October<br/>28,<br/>2006</b> | <b>November<br/>3,<br/>2007</b> | <b>October<br/>28,<br/>2006</b> |
| <i>(In thousands, except per share amounts)</i>   |                                 |                                 |                                 |                                 |
| Basic weighted average common shares outstanding  | 121,196                         | 122,586                         | 122,688                         | 122,174                         |
| Dilutive effect of assumed conversion of<br>4.75% Senior Convertible Notes  | 0 <sup>(1)</sup>                | 15,182                          | 6,674 <sup>(1)</sup>            | 15,182                          |
| Dilutive effect of stock options and awards   | 0 <sup>(2)</sup>                | 2,164                           | 1,478                           | 2,215                           |
| Diluted weighted average common shares<br>and equivalents outstanding   | 121,196                         | 139,932                         | 130,840                         | 139,571                         |
| Net income/(loss)   | \$ (3,568)                      | \$ 19,357                       | \$ 41,009                       | \$ 83,981                       |
| Decrease in interest expense from assumed<br>conversion of 4.75% Senior Convertible<br>Notes, net of income taxes                       | 0 <sup>(1)</sup>                | 1,128                           | 1,476 <sup>(1)</sup>            | 3,385                           |
| Net income/(loss) used to determine diluted<br>net income/(loss) per share  | \$ (3,568)                      | \$ 20,485                       | \$ 42,485                       | \$ 87,366                       |
| Options with weighted average exercise price<br>greater than market price, excluded from<br>computation of net income/(loss) per share: |                                 |                                 |                                 |                                 |
| Number of shares  | 193                             | 1                               | 77                              | 1                               |
| Weighted average exercise price per share   | \$ 7.71                         | \$ 13.84                        | \$ 9.30                         | \$ 13.84                        |

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(1) *The notes were converted or redeemed on June 4, 2007 (see “**Note 4. Long-term Debt**” above).*

(2) *All stock options and awards are excluded from the computation of diluted net loss per share as their effect would have been anti-dilutive.*

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
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**Note 7. Net Income per Share (Continued)**

Our 1.125% Notes have no impact on our diluted net income per share until the price of our common stock exceeds the conversion price of \$15.379 per share because we expect to settle the principal amount of the 1.125% Notes in cash upon conversion. The call options are not included in the calculation of diluted net income per share because their effect would be anti-dilutive. Should the price of our common stock exceed \$21.607 per share, we would also include the dilutive effect of the additional potential shares that may be issued related to the warrants, using the treasury stock method. See **“Note 4. Long-term Debt”** above for further information regarding the 1.125% Notes, related call options and warrants, and the conversion of our 4.75% Notes.

See **“Note 5. Stockholders’ Equity”** above and **“Note 12. Subsequent Events”** below for further information regarding repurchases of our common stock.

**Note 8. Income Taxes**

The effective income tax rate was 37.5% for the thirty-nine weeks ended November 3, 2007, as compared to 35.7% for the thirty-nine weeks ended October 28, 2006.

In July 2006, the FASB issued FASB Interpretation (“FIN”) No. 48, *“Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109.”* FIN No. 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, expanded disclosures regarding tax uncertainties, and transition.

FIN No. 48 applies to all tax positions related to income taxes subject to SFAS No. 109, *“Accounting for Income Taxes.”* Under FIN No. 48, recognition of a tax benefit occurs when a tax position is more-likely-than-not to be sustained upon examination, based solely on its technical merits. The recognized benefit is measured as the largest amount of benefit which is more-likely-than-not to be realized on ultimate settlement, based on a cumulative probability basis. A tax position failing to qualify for initial recognition is recognized in the first interim period in which it meets the FIN No. 48 recognition standard, or is resolved through negotiation, litigation, or upon expiration of the statute of limitations. De-recognition of a previously recognized tax position would occur if it is subsequently determined that the tax position no longer meets the more-likely-than-not threshold of being sustained. Differences between amounts recognized in balance sheets prior to the adoption of FIN No. 48 and amounts reported after adoption (except for items not recognized in earnings) are accounted for as a cumulative-effect adjustment to retained earnings as of the date of adoption of FIN No. 48, if material.

We adopted the provisions of FIN No. 48 effective as of February 4, 2007. In accordance with FIN No. 48, we recognized a cumulative-effect adjustment of \$4,998,000, increasing our liability for unrecognized tax benefits, interest, and penalties and reducing the February 4, 2007 balance of retained earnings.

As of February 4, 2007, we had \$44,203,000 of gross unrecognized tax benefits. If recognized, the portion of the liabilities for gross unrecognized tax benefits that would decrease our provision for income taxes and increase our net income is \$15,106,000. We record interest and penalties related to unrecognized tax benefits in income tax expense. As of the date of adoption of FIN No. 48, we had accrued interest and penalties of \$7,412,000.

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 8. Income Taxes (Continued)**

As of November 3, 2007, the gross unrecognized tax benefits were \$52,624,000. If recognized, the portion of the liabilities for gross unrecognized tax benefits that would decrease our provision for income taxes and increase our net income was \$17,201,000. The accrued interest and penalties as of November 3, 2007 were \$8,429,000. During the Fiscal 2008 Third Quarter, the gross unrecognized tax benefits increased by \$3,539,000 and the portion of the liabilities for gross unrecognized tax benefits that, if recognized, would increase our income tax benefit and decrease our net loss increased by \$963,000. Accrued interest and penalties increased during the Fiscal 2008 Third Quarter by \$463,000.

We expect that the amount of unrecognized tax benefits will change within the next 12 months. Although we cannot determine the amount of the change at this time, based on currently available information we do not expect the change to have a material impact on our financial position or results of operations.

Our U.S. Federal income tax returns for Fiscal 2005 and beyond remain subject to examination by the U.S. Internal Revenue Service ("IRS"). The IRS is not currently examining any of our tax returns. We file returns in numerous state jurisdictions, with varying statutes of limitations. Our state tax returns for Fiscal 2003 and beyond, depending upon the jurisdiction, remain subject to examination. The statute of limitations on a limited number of returns for years prior to Fiscal 2003 has been extended by agreement between us and the particular state jurisdiction. The earliest year still subject to examination by state tax authorities is Fiscal 1999.

**Note 9. Asset Securitization**

Our FASHION BUG, LANE BRYANT, CATHERINES, PETITE SOPHISTICATE, and Crosstown Traders proprietary credit card receivables are originated by Spirit of America National Bank (the "Bank"), our wholly-owned credit card bank, which transfers its interest in all the receivables other than Crosstown Traders receivables to the Charming Shoppes Master Trust (the "Trust") through Charming Shoppes Receivables Corp. ("CSRC"), a separate and distinct special-purpose entity. The Trust is an unconsolidated qualified special-purpose entity ("QSPE").

Through Fiscal 2007, our Crosstown Traders apparel-related catalog proprietary credit card receivables, which we securitized subsequent to our acquisition of Crosstown Traders, were originated in a non-bank program by Crosstown Traders. Crosstown Traders transferred its interest in the receivables to Catalog Receivables LLC, a separate and distinct unconsolidated QSPE, through a separate and distinct special-purpose entity. On February 5, 2007, the Bank acquired the account relationships of the Crosstown Traders catalog proprietary credit cards and all subsequent new receivables are originations of the Bank. This acquisition did not cause a change in the securitization entities used by the Crosstown Traders proprietary credit card program.

The QSPEs can sell interests in these receivables on a revolving basis for a specified term. At the end of the revolving period, an amortization period begins during which the QSPEs make principal payments to the parties that have entered into the securitization agreement with the QSPEs. All assets of the QSPEs (including the receivables) are isolated and support the securities issued by those entities. Our asset securitization program is more fully described in



**“Item 8. Financial Statements and Supplementary Data; Note 16. Asset Securitization”** in our February 3, 2007 Annual Report on Form 10-K.

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 9. Asset Securitization (Continued)**

We securitized \$679,198,000 of private label credit card receivables in the first three quarters of Fiscal 2008 and had \$595,473,000 of securitized credit card receivables outstanding as of November 3, 2007. We held certificates and retained interests in our securitizations of \$113,458,000 as of November 3, 2007, which are generally subordinated in right of payment to certificates issued by the QSPEs to third-party investors. Our obligation to repurchase receivables sold to the QSPEs is limited to those receivables that, at the time of their transfer, fail to meet the QSPE's eligibility standards under normal representations and warranties. To date, our repurchases of receivables pursuant to this obligation have been insignificant.

CSRC, Charming Shoppes Seller, Inc., and Catalog Seller LLC, our consolidated wholly-owned indirect subsidiaries, are separate special-purpose entities ("SPEs") created for the securitization program. As of November 3, 2007, our investment in asset-backed securities included \$41,510,000 of QSPE certificates, an I/O strip of \$24,275,000, and other retained interests of \$47,673,000. These assets are first and foremost available to satisfy the claims of the respective creditors of these separate corporate entities, including certain claims of investors in the QSPEs.

Additionally, with respect to certain Trust Certificates, if either the Trust or Charming Shoppes, Inc. does not meet certain financial performance standards, the Trust would be obligated to reallocate to third-party investors holding certain certificates issued by the Trust, collections in an amount up to \$9,450,000 that otherwise would be available to CSRC. The result of this reallocation would be to increase CSRC's retained interest in the Trust by the same amount, with the third-party investor retaining an economic interest in the certificates. Subsequent to such a transfer occurring, and upon certain conditions being met, these same investors would be required to repurchase these interests when the financial performance standards are again satisfied. Our net loss for the Fiscal 2008 Third Quarter has resulted in the requirement to begin the reallocation of collections as discussed above. We anticipate that \$9,450,000 of collections will be fully transferred on December 17, 2007. The requirement for the reallocation of these collections will cease and such investors would be required to repurchase such interests upon our announcement of a quarter with net income. As of November 3, 2007, the Trust was in compliance with its financial performance standards.

In addition to the above, we could be affected by certain other events that would cause the QSPEs to hold proceeds of receivables, which would otherwise be available to be paid to us with respect to our subordinated interests, within the QSPEs as additional enhancement. For example, if we or the QSPEs do not meet certain financial performance standards, a credit enhancement condition would occur, and the QSPEs would be required to retain amounts otherwise payable to us. In addition, the failure to satisfy certain financial performance standards could further cause the QSPEs to stop using collections on QSPE assets to purchase new receivables, and would require such collections to be used to repay investors on a prescribed basis, as provided in the securitization agreements. If this were to occur, it could result in our having insufficient liquidity; however, we believe we would have sufficient notice to seek alternative forms of financing through other third-party providers although we cannot provide assurance in that regard. As of November 3, 2007, we and the QSPEs were in compliance with the applicable financial performance standards referred to in this paragraph.

Amounts placed into enhancement accounts, if any, that are not required for payment to other certificate holders will be available to us at the termination of the securitization series. We have no obligation to directly fund the

enhancement account of the QSPEs, other than for breaches of customary representations, warranties, and covenants and for customary indemnities. These representations, warranties, covenants, and indemnities do not protect the QSPEs or investors in the QSPEs against credit-related losses on the receivables. The providers of the credit enhancements and QSPE investors have no other recourse to us.

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
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**Note 9. Asset Securitization (Continued)**

Prior to November 1, 2007, we had an agreement under which a third party provided a proprietary credit card sales accounts receivable funding facility for our LANE BRYANT retail and outlet stores. In accordance with the terms of the agreement, we exercised our option to purchase the LANE BRYANT portfolio on November 1, 2007 and assigned the right to purchase the LANE BRYANT portfolio to the Bank. Concurrent with the Bank's acquisition of the LANE BRYANT portfolio for \$230,975,000, it sold the receivables to CSRC, which transferred the receivables to the Trust. The purchase of the portfolio at par value and the subsequent securitization of the purchased portfolio resulted in the recognition of a benefit of approximately \$6,830,000, which is included in selling, general, and administrative expenses for the thirteen weeks and thirty-nine weeks ended November 3, 2007. In addition, we recognized approximately \$2,119,000 of selling, general, and administrative expenses in connection with the issuance of approximately 2.4 million new LANE BRYANT proprietary credit cards.

On October 17, 2007, the Trust issued \$320,000,000 of five-year asset-backed certificates ("Series 2007-1") in a private placement under Rule 144A. Of the \$320,000,000 of certificates issued, \$289,600,000 were sold to investors, and CSRC held \$30,400,000 as a retained interest. CSRC may in the future sell all or a portion of such retained interest. Of the certificates sold to investors, \$203,500,000 pay interest on a floating rate basis tied to one-month LIBOR, while the remaining \$86,100,000 of certificates were issued at fixed rates. The Trust used \$35,000,000 of the proceeds to fund receivables and to pay down other securitization series and placed the remaining proceeds of \$285,000,000 into a pre-funding cash account.

Concurrent with the issuance of Series 2007-1, the Trust entered into a series of fixed-rate interest-rate swap agreements with respect to \$174,700,000 of the floating-rate certificates sold to investors. The notional value of these swaps equals the face value of these certificates in excess of the certificate's pro-rata share of the outstanding pre-funding cash account at any measurement date. The blended weighted-average interest rate on the swapped certificates is 6.39%. The Trust also acquired an interest-rate cap with respect to \$28,800,000 of floating-rate certificates sold to investors. The interest-rate cap counterparty will make payments to the Trust when one-month LIBOR exceeds 10%. The fixed-rate certificates were sold at a discount and carry a blended weighted average-yield of 6.43% and a blended weighted average coupon of 6.34%.

The Trust paid for its acquisition of the LANE BRYANT proprietary credit card accounts receivable balances primarily by withdrawing \$227,500,000 of proceeds from the pre-funding cash account for the Series 2007-1 Certificates. The remainder of the funds in the pre-funding cash account will provide financing for additional receivables, including receivables made available for financing by the amortization of the Series 2002-1 certificates issued by the Trust. Series 2002-1 has been in amortization since July 2007 and we currently expect it to be repaid in full by May 2008.

**Note 10. Segment Reporting**

We operate and report in two segments: Retail Stores and Direct-to-Consumer (see "Note 1. Condensed Consolidated Financial Statements; *Segment Reporting*" above). The accounting policies of the segments are generally the same

as those described in **“Item 8. Financial Statements and Supplementary Data; Note 1. Summary of Significant Accounting Policies”** in our February 3, 2007 Annual Report on Form 10-K.

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
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**(Unaudited)**

**Note 10. Segment Reporting (Continued)**

Our chief operating decision-makers evaluate the performance of our operating segments based on a measure of their contribution to operations, which consists of net sales less the cost of merchandise sold and certain directly identifiable and allocable operating costs. We do not allocate certain corporate costs, such as shared services costs, information systems support costs, and insurance costs, to our Retail Stores or Direct-to-Consumer segments. Operating costs for our Retail Stores segment consist primarily of store-related selling, buying, occupancy, and warehousing costs. Operating costs for our Direct-to-Consumer segment consist primarily of catalog development, production, and circulation costs; E-commerce advertising costs; warehousing costs; and order processing costs.

“Corporate and Other” includes unallocated general and administrative costs; shared services costs; insurance costs; information systems support costs; corporate depreciation and amortization; corporate occupancy costs; the results of our proprietary credit card operations; and other non-routine charges. Operating contribution for the Retail Stores and Direct-to-Consumer segments less Corporate and Other net expenses equals income/(loss) before interest and income taxes.

Operating segment assets are those directly used in, or allocable to, that segment’s operations. Operating assets for the Retail Stores segment consist primarily of inventories, the net book value of store facilities, goodwill, and intangible assets. Operating assets for the Direct-to-Consumer segment consist primarily of trade receivables, inventories, deferred advertising costs, the net book value of catalog operating facilities, goodwill, and intangible assets. Corporate and Other assets include corporate cash and cash equivalents, the net book value of corporate facilities, deferred income taxes, and other corporate long-lived assets.

Selected financial information for our operations by reportable segment and a reconciliation of the information by segment to our consolidated totals is as follows:

| <i>(In thousands)</i>                           | <b>Retail<br/>Stores</b> | <b>Direct-to-<br/>Consumer</b> | <b>Corporate<br/>and Other</b> | <b>Consolidated</b> |
|---|--------------------------|--------------------------------|--------------------------------|---------------------|
| <b>Thirteen weeks ended November 3, 2007</b>    |                          |                                |                                |                     |
| Net sales                                       | \$ 588,777               | \$ 78,979                      | \$ 1,633                       | \$ 669,389          |
| Depreciation and amortization                   | 15,678                   | 401                            | 7,157                          | 23,236              |
| Loss before interest and income taxes           | 32,586                   | (4,529)                        | (30,497)                       | (2,440)             |
| Interest expense                                |                          |                                | (2,206)                        | (2,206)             |
| Income tax benefit                              |                          |                                | 1,078                          | 1,078               |
| Net loss  | 32,586                   | (4,529)                        | (31,625)                       | (3,568)             |
| Capital expenditures                            | 27,672                   | 1,484                          | 5,603                          | 34,759              |
| <b>Thirty-nine weeks ended November 3, 2007</b> |                          |                                |                                |                     |
| Net sales                                       | \$ 1,960,754             | \$ 259,044                     | \$ 5,228                       | \$ 2,225,026        |
| Depreciation and amortization                   | 42,459                   | 1,125                          | 25,908                         | 69,492              |

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|   |         |         |           |          |
|---|---------|---------|-----------|----------|
| Income before interest and income taxes | 177,430 | (7,440) | (96,110)  | 73,880   |
| Interest expense                        |         |         | (8,287)   | (8,287)  |
| Income tax provision                    |         |         | (24,584)  | (24,584) |
| Net income                              | 177,430 | (7,440) | (128,981) | 41,009   |
| Capital expenditures                    | 83,264  | 2,294   | 23,217    | 108,775  |

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 10. Segment Reporting (Continued)**

| <i>(In thousands)</i>                           | <b>Retail<br/>Stores</b> | <b>Direct-to-<br/>Consumer</b> | <b>Corporate<br/>and Other</b> | <b>Consolidated</b> |
|---|--------------------------|--------------------------------|--------------------------------|---------------------|
| <b>Thirteen weeks ended October 28, 2006</b>    |                          |                                |                                |                     |
| Net sales                                       | \$ 615,321               | \$ 79,826                      | \$ 131                         | \$ 695,278          |
| Depreciation and amortization                   | 10,216                   | 718                            | 10,368                         | 21,302              |
| Income before interest and income taxes         | 58,974                   | 346                            | (26,221)                       | 33,099              |
| Interest expense                                |                          |                                | (3,540)                        | (3,540)             |
| Income tax provision                            |                          |                                | (10,202)                       | (10,202)            |
| Net income                                      | 58,974                   | 346                            | (39,963)                       | 19,357              |
| Capital expenditures                            | 25,953                   | 2,033                          | 9,567                          | 37,553              |
| <b>Thirty-nine weeks ended October 28, 2006</b> |                          |                                |                                |                     |
| Net sales                                       | \$ 1,912,533             | \$ 279,579                     | \$ 1,441                       | \$ 2,193,553        |
| Depreciation and amortization                   | 36,693                   | 1,285                          | 28,453                         | 66,431              |
| Income before interest and income taxes         | 206,642                  | 8,416                          | (72,975)                       | 142,083             |
| Interest expense                                |                          |                                | (11,475)                       | (11,475)            |
| Income tax provision                            |                          |                                | (46,627)                       | (46,627)            |
| Net income                                      | 206,642                  | 8,416                          | (131,077)                      | 83,981              |
| Capital expenditures                            | 64,064                   | 3,221                          | 25,239                         | 92,524              |

**Note 11. Impact of Recent Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, “*Fair Value Measurements.*” SFAS No. 157 provides a single definition of fair value, along with a framework for measuring it, and requires additional disclosure about using fair value to measure assets and liabilities. SFAS No. 157 emphasizes that fair value measurement is market-based, not entity-specific, and establishes a fair value hierarchy which places the highest priority on the use of quoted prices in active markets to determine fair value. It also requires, among other things, that entities are to include their own credit standing when measuring their liabilities at fair value. In November 2007, the FASB drafted a proposed FASB Staff Position (“FSP”) that would partially defer the effective date of SFAS No. 157 for one year for non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. The proposed FSP would not defer recognition and disclosure requirements for financial assets and liabilities or for non-financial assets and liabilities that are re-measured at least annually. We will be required to adopt the provisions of SFAS No. 157 prospectively, effective as of the beginning of Fiscal 2009. We are evaluating the impact that adoption of SFAS No. 157 would have on our financial position or results of operations.

In September 2006, the FASB ratified the consensus of EITF Issue No. 06-4, “*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Agreements.*” EITF Issue No. 06-4 addresses accounting for separate agreements that split life insurance policy benefits between an employer and an



employee. EITF Issue No. 06-4 requires employers to recognize a liability for future benefits payable to the employee under such agreements. The effect of applying the provisions of Issue No. 06-4 should be recognized either through a change in accounting principle by a cumulative-effect adjustment to equity or through the retrospective application to all prior periods. The provisions of EITF Issue No. 06-4 will be effective as of the beginning of Fiscal 2009, with earlier application permitted. We are evaluating the impact that adoption of EITF Issue No. 06-4 would have on our financial position or results of operations.

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**CHARMING SHOPPES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Note 11. Impact of Recent Accounting Pronouncements (Continued)**

In May 2007, the FASB issued FSP FIN 48-1, “*Definition of Settlement in FASB Interpretation No. 48*,” which clarifies when a tax position is considered to be “settled” under FIN No. 48. Under FSP FIN 48-1, a tax position can be “effectively settled” upon completion of an examination by a taxing authority without being legally extinguished. For tax positions considered effectively settled, we would recognize the full amount of the tax benefit, even if (1) the tax position is not considered more-likely-than-not to be sustained solely on the basis of its technical merits, and (2) the statute of limitations remains open. In applying the provisions of the FSP, we are required to document our analyses and conclusions. The provisions of FSP FIN 48-1 are effective upon adoption of FIN No. 48. The adoption of FSP FIN 48-1 did not have a material effect on our financial position or results of operations.

**Note 12. Subsequent Events**

Subsequent to the end of the Fiscal 2008 Third Quarter, we repurchased an aggregate total of 500,000 additional shares of our common stock for \$3,529,000 under the prior authorization from our Board of Directors allowing us to repurchase up to approximately 4,980,000 shares of our common stock (see “**Note 5. Stockholders’ Equity**” above).

On November 8, 2007, we announced that our Board of Directors authorized a new \$200 million share repurchase program. We intend to make share purchases from time to time in the open market or through privately-negotiated transactions, and expect to fund the repurchases primarily from operating cash flow. The timing of such repurchases and the number of shares repurchased will depend on market conditions, and we intend to hold shares repurchased as treasury shares. We expect to complete the program over the next several years.

On November 8, 2007, we also announced our plan to relocate our CATHERINES operations located in Memphis, Tennessee to our corporate headquarters in Bensalem, Pennsylvania in conjunction with the consolidation of a number of its operating functions. We expect to complete the relocation by the end of March 2008. As a result, we expect to recognize one-time pre-tax charges of approximately \$4.0 million related to severance, retention, and relocation costs. We also expect to recognize approximately \$4.5 million of non-cash pre-tax charges for acceleration of depreciation related to the Memphis facility. On an after-tax basis, we expect the impact of the combined charges to be slightly cash-flow negative. We expect to recognize approximately \$5.4 million of these pre-tax charges during the Fiscal 2008 Fourth Quarter, and we expect to complete the relocation and recognize the remainder of the charges during the Fiscal 2009 First Quarter.



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

This management's discussion and analysis of financial condition and results of operations should be read in conjunction with the financial statements and accompanying notes included in Item 1 of this report. It should also be read in conjunction with the financial statements, accompanying notes, and management's discussion and analysis of financial condition and results of operations appearing in our Annual Report on Form 10-K for the fiscal year ended February 3, 2007 and in our Quarterly Reports on Form 10-Q for the fiscal periods ended May 5, 2007 and August 4, 2007. As used in this management's discussion and analysis, "Fiscal 2008" refers to our fiscal year ending February 2, 2008 and "Fiscal 2007" refers to our fiscal year ended February 3, 2007. "Fiscal 2008 Third Quarter" refers to our thirteen week fiscal period ended November 3, 2007 and "Fiscal 2007 Third Quarter" refers to our thirteen week fiscal period ended October 28, 2006. "Fiscal 2008 First Quarter" refers to our thirteen week fiscal period ended May 5, 2007, "Fiscal 2008 Second Quarter" refers to our thirteen-week fiscal period ended August 4, 2007, and "Fiscal 2008 Fourth Quarter" refers to our thirteen-week fiscal period ending February 2, 2008. The term "Fiscal 2009 First Quarter" refers to our fiscal quarter ending May 3, 2008. The terms "Charming Shoppes, Inc.," "the Company," "we," "us," and "our" refer to Charming Shoppes, Inc. and its consolidated subsidiaries, except where the context otherwise requires or as otherwise indicated.

### **FORWARD-LOOKING STATEMENTS**

With the exception of historical information, the matters contained in the following analysis and elsewhere in this report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995.

Such statements may include, but are not limited to, projections of revenues, income or loss, cost reductions, capital expenditures, liquidity, financing needs or plans, and plans for future operations, as well as assumptions relating to the foregoing. The words "expect," "could," "should," "project," "estimate," "predict," "anticipate," "plan," "intend," "believes" expressions are also intended to identify forward-looking statements.

We operate in a rapidly changing and competitive environment. New risk factors emerge from time to time and it is not possible for us to predict all risk factors that may affect us. Forward-looking statements are inherently subject to risks and uncertainties, some of which we cannot predict or quantify. Future events and actual results, performance, and achievements could differ materially from those set forth in, contemplated by, or underlying the forward-looking statements, which speak only as of the date on which they were made. We assume no obligation to update or revise any forward-looking statement to reflect actual results or changes in, or additions to, the factors affecting such forward-looking statements. Given those risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

Factors that could cause our actual results of operations or financial condition to differ from those described in this report include, but are not necessarily limited to, the following:

- Our business is dependent upon our ability to accurately predict rapidly changing fashion trends, customer preferences, and other fashion-related factors, which we may not be able to successfully accomplish in the future.
- Our business plan is largely dependent upon continued growth in the plus-size women's apparel market, which may not occur.
- A slowdown in the United States economy, an uncertain economic outlook, and escalating energy costs could lead to reduced consumer demand for our products in the future.

- The women's specialty retail apparel and direct-to-consumer markets are highly competitive and we may be unable to compete successfully against existing or future competitors.
- We depend on key personnel, particularly our Chief Executive Officer, Dorrit J. Bern, and we may not be able to retain or replace these employees or recruit additional qualified personnel.

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- We depend on our distribution and fulfillment centers and third-party freight consolidators and service providers, and could incur significantly higher costs and longer lead times associated with distributing our products to our stores and shipping our products to our E-commerce and catalog customers if operations at any of these locations were to be disrupted for any reason.
- Natural disasters, as well as war, acts of terrorism, or other armed conflict, or the threat of either may negatively impact availability of merchandise and customer traffic to our stores, or otherwise adversely affect our business.
- Our manufacturers may be unable to manufacture and deliver merchandise to us in a timely manner or to meet our quality standards.
- We rely significantly on foreign sources of production and face a variety of risks generally associated with doing business in foreign markets and importing merchandise from abroad. Such risks include (but are not necessarily limited to) political instability; imposition of, or changes in, duties or quotas; trade restrictions; increased security requirements applicable to imports; delays in shipping; increased costs of transportation; and issues relating to compliance with domestic or international labor standards.
- We depend on the availability of credit for our working capital needs, including credit we receive from our suppliers and their agents, and on our credit card securitization facilities.
  - We may be unable to obtain adequate insurance for our operations at a reasonable cost.
- We may be unable to protect our trademarks and other intellectual property rights, which are important to our success and our competitive position.
- Inadequate systems capacity, a disruption or slowdown in telecommunications services, changes in technology, changes in government regulations, systems issues, security breaches, a failure to integrate order management systems, or customer privacy issues could result in reduced sales or increases in operating expenses as a result of our efforts or our inability to remedy such issues.
- We cannot assure the successful implementation of our business plan for increased profitability and growth in our Retail Stores or Direct-to-Consumer segments. Recent changes in management may fail to achieve improvement in our operating results. We cannot assure the realization of our anticipated annual expense savings from the consolidation of operations and new organizational structure at our CATHERINES brand.
- We may be unable to successfully implement our plan to improve merchandise assortments in our Retail Stores or Direct-to-Consumer segments.
- Our Retail Stores and Direct-to-Consumer segments experience seasonal fluctuations in net sales and operating income. Any decrease in sales or margins during our peak sales periods, or in the availability of working capital during the months preceding such periods, could have a material adverse effect on our business. In addition, extreme or unseasonable weather conditions may have a negative impact on our sales.
- We may be unable to hire and retain a sufficient number of suitable sales associates at our stores. In addition, we are subject to the Fair Labor Standards Act and various state and Federal laws and regulations governing such matters as minimum wages, exempt status classification, overtime, and employee benefits. Changes in Federal or state laws or regulations regarding minimum wages or other employee benefits could cause us to incur additional wage and benefit costs, which could adversely affect our results of operations.

- Our Retail Stores segment sales are dependent upon a high volume of traffic in the strip centers and malls in which our stores are located, and our future retail store growth is dependent upon the availability of suitable locations for new stores.
- We cannot assure the successful implementation of our business plans for our outlet store distribution channel and expansion of our CACIQUE® product line through new store formats.
- We cannot assure the realization of our anticipated benefits from the re-launch of our LANE BRYANT credit card program.

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- We cannot assure the successful implementation of our business plan for Crosstown Traders, including the successful launch of our LANE BRYANT catalog.
- Successful operation of our E-commerce websites and our catalog business is dependent on our ability to maintain efficient and uninterrupted customer service and fulfillment operations.
- We may be unable to manage significant increases in certain costs vital to catalog operations, including postage, paper, and acquisition of prospects, which could adversely affect our results of operations.
- Response rates to our catalogs and access to new customers could decline, which would adversely affect our net sales and results of operations.
- We make certain significant assumptions, estimates, and projections related to the useful lives of our property, plant, and equipment and the valuation of intangible assets related to acquisitions. The carrying amount and/or useful life of these assets are subject to periodic valuation tests for impairment. Impairment results when the carrying value of an asset exceeds the undiscounted (or for goodwill and indefinite-lived intangible assets the discounted) future cash flows associated with the asset. If actual experience were to differ materially from the assumptions, estimates, and projections used to determine useful lives or the valuation of property, plant, equipment, or intangible assets, a write-down for impairment of the carrying value of the assets, or acceleration of depreciation or amortization of the assets, could result. Such a write-down or acceleration of depreciation or amortization would have an adverse impact on our reported results of operations.
- Changes to existing accounting rules or the adoption of new rules could have an adverse impact on our reported results of operations.
- Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include our assessment of the effectiveness of our internal control over financial reporting in our annual reports. Our independent registered public accounting firm is also required to report on whether or not they believe that we maintained, in all material respects, effective internal control over financial reporting. If we are unable to maintain effective internal control over financial reporting we could be subject to regulatory sanctions and a possible loss of public confidence in the reliability of our financial reporting. Such a failure could result in our inability to provide timely and/or reliable financial information and could adversely affect our business.
- The holders of our 1.125% Senior Convertible Notes due May 1, 2014 (the “1.125% Notes”) could require us to repurchase the principal amount of the notes for cash before maturity of the notes under certain circumstances (see **“Notes to Condensed Consolidated Financial Statements; Note 4. Long-term Debt”** above). Such a repurchase would require significant amounts of cash and could adversely affect our financial condition.
- The Financial Accounting Standards Board (“FASB”) has issued a proposed Staff Position (“FSP”) that, if adopted, would apply to any convertible debt instrument that may be settled in whole or in part with cash upon conversion, which would include our 1.125% Notes. We would be required to adopt the proposal as of February 3, 2008 (the beginning of Fiscal 2009), with retrospective application to financial statements for periods prior to the date of adoption. As compared to our current accounting for the 1.125% Notes, adoption of the proposal would reduce long-term debt, increase stockholders’ equity, and reduce net income and earnings per share. Adoption of the proposal would not affect our cash flows.

## **CRITICAL ACCOUNTING POLICIES**



We have prepared the financial statements and accompanying notes included in Item 1 of this report in conformity with United States generally accepted accounting principles. This requires us to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. These estimates and assumptions are based on historical experience, analysis of current trends, and various other factors that we believe to be reasonable under the circumstances. Actual results could differ from those estimates under different assumptions or conditions.

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We periodically reevaluate our accounting policies, assumptions, and estimates and make adjustments when facts and circumstances warrant. Historically, actual results have not differed materially from those determined using required estimates. Our critical accounting policies are discussed in the notes and management's discussion and analysis of financial condition and results of operations accompanying the consolidated financial statements that appear in our Annual Report on Form 10-K for the fiscal year ended February 3, 2007.

We perform a review of our goodwill and other intangible assets for possible impairment on an annual basis during the fourth quarter of our fiscal year. Our fourth quarter operating results are significant to us and are therefore integral to our ability to prepare our annual impairment analyses. In addition, we prepare our financial plan for the following fiscal year, which is an important part of our impairment analyses, during the fourth quarter of our fiscal year.

Except as disclosed below and in the financial statements and accompanying notes included in Item 1 of this report, there were no material changes in, or additions to, our critical accounting policies or in the assumptions or estimates we used to prepare the financial information appearing in this report.

### ***Senior Convertible Notes***

On April 30, 2007, we issued \$250.0 million in aggregate principal amount of our 1.125% Notes in a private offering for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. On May 11, 2007, the initial purchasers of the 1.125% Notes exercised their over-allotment option and purchased an additional \$25.0 million in aggregate principal amount of the notes. See **"Notes to Condensed Consolidated Financial Statements; Note 4. Long-term Debt"** above for further details of the transaction.

We will be required on a quarterly basis to monitor the 1.125% Notes, call options, and warrants for compliance with the provisions of EITF Issue 00-19 and paragraph 11(a) of SFAS No. 133. Should the issuance of the 1.125% Notes, the purchase of the call options, or the sale of the warrants fail to qualify under the provisions of EITF Issue 00-19 or paragraph 11(a) of SFAS No. 133, we would be required to recognize derivative instruments in connection with the transaction, include the effects of the transaction in assets or liabilities instead of equity, and recognize changes in the fair values of the assets or liabilities in consolidated net income as they occur until the provisions of EITF Issue 00-19 and paragraph 11(a) of SFAS No. 133 are met.

### ***Income Taxes***

We adopted the provisions of FASB Interpretation ("FIN") No. 48, *"Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109"* effective as of February 4, 2007 (see **"Notes to Condensed Consolidated Financial Statements; Note 8. Income Taxes"** above).

## **RECENT DEVELOPMENTS**

In October 2007, we announced our intention to complete the repurchase of additional shares of our common stock during the remainder of Fiscal 2008 under a prior authorization from our Board of Directors that allows us to repurchase up to approximately 4,980,000 shares of our common stock. During the Fiscal 2008 Third Quarter, we purchased an aggregate total of 1.2 million shares for \$9.2 million under this program. Subsequent to the end of the Fiscal 2008 Third Quarter, we repurchased an aggregate total of 0.5 million additional shares of our common stock for \$3.5 million under this program.

On November 8, 2007, we announced that our Board of Directors has authorized a new \$200 million share repurchase program. We intend to make share purchases from time to time in the open market or through privately-negotiated transactions, and expect to fund the repurchases primarily from operating cash flow. The timing of such repurchases and the number of shares repurchased will depend on market conditions, and we intend to hold shares repurchased as treasury shares. We expect to complete the program over the next several years.

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See “**Notes to Condensed Consolidated Financial Statements; Note 5. Stockholders’ Equity and Note 12. Subsequent Events**” above for further details of the repurchases.

On November 8, 2007, we also announced our plan to relocate our CATHERINES operations located in Memphis, Tennessee to our corporate headquarters in Bensalem, Pennsylvania in conjunction with the consolidation of a number of its operating functions. We expect to complete the relocation by the end of March 2008. As a result, we expect to recognize one-time pre-tax charges of approximately \$4.0 million related to severance, retention, and relocation costs. We also expect to recognize approximately \$4.5 million of non-cash pre-tax charges for acceleration of depreciation related to the Memphis facility. On an after-tax basis, we expect the impact of the combined charges to be slightly cash-flow negative. We expect to recognize approximately \$5.4 million of these pre-tax charges during the Fiscal 2008 Fourth Quarter and to complete the relocation and recognize the remainder of the charges during the Fiscal 2009 First Quarter. We anticipate that the execution of the new organizational structure will result in approximately \$8 million of annual expense savings, primarily in the areas of payroll and occupancy costs.

On October 21, 2007, the LANE BRYANT catalog trademark, which had been licensed to a third party, reverted to us and we launched our Lane Bryant Woman catalog. During the Fiscal 2008 Third Quarter we also launched the Lane Bryant Woman website. Revenues from the Lane Bryant Woman catalog will be included in our Direct-to-Consumer segment.

## **RESULTS OF OPERATIONS**

### **Overview**

During the Fiscal 2008 Third Quarter, we continued to face a number of challenges that are negatively impacting our short-term results. These challenges, which include continuing pressure on our consumers’ disposable income, unseasonably warm weather, and the lack of a current fashion driver in our industry, resulted in a difficult retail sales environment. The downward-trending store traffic levels we experienced during the Fiscal 2008 Second Quarter at our Retail Stores segment continued throughout the Fiscal 2008 Third Quarter, particularly at our LANE BRYANT brand. As a result, we continued to be more aggressive in clearing seasonal Retail Stores inventory, leading to deeper-than-planned markdowns and continued pressure on our merchandise margins. At our Direct-to-Consumer segment, the changes that we have implemented have led to a significant moderation of the downward-trending catalog sales that we experienced during the first half of Fiscal 2008.

The initiatives we put in place in response to our first half performance continued throughout our Fiscal 2008 Third Quarter. Accordingly, we continued to focus on reducing selling, general, and administrative expenses, managing to lower inventory levels, and reducing our capital budget spending by approximately \$12 - \$15 million during the second half of Fiscal 2008 through the reduction of certain store development and non-critical infrastructure projects.

Our consolidated net sales for the Fiscal 2008 Third Quarter were \$669.4 million, as compared to net sales for the Fiscal 2007 Third Quarter of \$695.3 million, a decrease of 3.7%. Diluted net loss per share for the Fiscal 2008 Third Quarter was \$(0.03), as compared to diluted net income per share for the Fiscal 2007 Third Quarter of \$0.15. For the first three quarters of Fiscal 2008, our consolidated net sales were \$2,225.0 million, as compared to net sales for the first three quarters of Fiscal 2007 of \$2,193.6 million, an increase of 1.4%. Diluted net income per share for the first three quarters of Fiscal 2008 was \$0.32, as compared to diluted net income per share of \$0.63 for the first three quarters of Fiscal 2007, a decrease of 49.2%.



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The year-over-year reductions in net income and net income per share are primarily attributable to reduced traffic levels, the decline in Retail Stores merchandise margins, lower response rates and average order values from our apparel-related catalogs, and negative expense leverage on lower-than-planned sales. Each of our Retail Stores brands and our Direct-to-Consumer segment experienced declines in operating results in the Fiscal 2008 Third Quarter as compared to the prior-year period. The Fiscal 2008 Third Quarter includes a net pre-tax benefit of approximately \$4.7 million related to our purchase and subsequent securitization of the LANE BRYANT credit card portfolio on November 1, 2007 and our re-issuance of new credit cards (see **“LIQUIDITY AND CAPITAL RESOURCES; Off-Balance-Sheet Financing”** below). Fiscal 2007 year-to-date results included pre-opening operating expenses of approximately \$7.8 million pre-tax, (\$5.0 million after tax, or \$0.04 per diluted share) relating to our opening of 80 LANE BRYANT OUTLET stores in July 2006.

We continue to execute on a number of new product and marketing initiatives that were initiated during the Fiscal 2008 Third Quarter to improve traffic and sales trends. We are encouraged by the initial response to our new “Right Fit by Lane Bryant™” campaign, which supports our launch of new core denim and career pant assortments using new fit technology. Our FASHION BUG stores began stocking Gitano® brand fashionable casual merchandise offerings during the Fiscal 2008 Third Quarter under our exclusive licensing agreement, and will carry the new merchandise into the December holiday season and beyond.

At the end of the Fiscal 2008 Third Quarter, we acquired and securitized the LANE BRYANT proprietary credit card portfolio, which had previously been serviced under an agreement with a third party. We re-launched the LANE BRYANT proprietary credit card program with the issuance of approximately 2.4 million new credit cards in connection with a new loyalty card program designed to stimulate traffic and sales at our LANE BRYANT brand.

While we are committed to executing our long-term growth strategy as a multi-brand, multi-channel retailer, we are currently facing a number of challenges that continue to negatively impact our short-term results. In view of uncertain economic conditions and indications that the December holiday season is expected to be highly promotional for retail sales, we remain cautious for the remainder of Fiscal 2008. In response, we are implementing the additional near-term actions described in the following three paragraphs, which are designed to enable us to manage through the difficult retail environment.

In addition to the relocation and consolidation of our CATHERINES operations (discussed in **“RECENT DEVELOPMENTS”** above) and the expansion of our LANE BRYANT credit card program (discussed above), we are taking additional steps to enhance merchandise and marketing at our Retail Stores brands and making additional improvements to our catalog business.

In response to reduced demand by our customers for basic fashions, we plan to improve our merchandise content at LANE BRYANT by including a higher fashion component. Changes to the LANE BRYANT product mix are in process for the December holiday season, with more significant changes being made for the Spring season. We are also being more aggressive in our marketing efforts, which include increases in direct-mail advertising for each of our brands throughout the December holiday season and cable television advertising for our LANE BRYANT brand during the Thanksgiving holiday.

In our catalog business, we launched the Lane Bryant Woman catalog, which offers clothing, footwear, and intimate apparel in an expanded range of plus sizes at a value price point. We have also launched our [www.lanebryantcatalog.com](http://www.lanebryantcatalog.com) website to complement the catalog launch. We are also continuing to initiate new creative marketing programs and product offerings for other catalog titles, as well as streamlining apparel catalog operations. We plan to discontinue the Regalia® catalog, one of our smaller catalog titles, and to begin marketing efforts to migrate the Regalia customer base to our other catalog titles.



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The following table shows our results of operations expressed as a percentage of net sales and on a comparative basis:

|   | <b>Thirteen Weeks Ended<sup>(1)</sup></b> |                         | <b>Percentage Change From Prior Period</b> | <b>Thirty-nine Weeks Ended<sup>(1)</sup></b> |                         | <b>Percentage Change From Prior Period</b> |
|---|---|-------------------------|--|--|-------------------------|--|
|   | <b>November 3, 2007</b>                   | <b>October 28, 2006</b> |  | <b>November 3, 2007</b>                      | <b>October 28, 2006</b> |  |
| Net sales   | 100.0%                                    | 100.0%                  | (3.7)%                                     | 100.0%                                       | 100.0%                  | 1.4%                                       |
| Cost of goods sold, buying, catalog, and occupancy expenses | 72.7                                      | 69.2                    | 1.2  | 71.2   | 69.1                    | 4.5  |
| Selling, general, and administrative expenses               | 28.1                                      | 26.4                    | 2.5  | 25.8   | 24.7                    | 6.2  |
| Income/(loss) from operations                               | (0.8)                                     | 4.5                     | (116.5)                                    | 3.0  | 6.2                     | (51.3)                                     |
| Other income  | 0.4                                       | 0.3                     | 29.5                                       | 0.3  | 0.3                     | 20.0                                       |
| Interest expense  | 0.3                                       | 0.5                     | (37.7)                                     | 0.4  | 0.5                     | (27.8)                                     |
| Income tax provision/(benefit)                              | (0.2)                                     | 1.5                     | (110.6)                                    | 1.1  | 2.1                     | (47.3)                                     |
| Net income/(loss)   | (0.5)                                     | 2.8                     | (118.4)                                    | 1.8  | 3.8                     | (51.2)                                     |

*(1) Results may not add due to rounding.*

The following table shows details of our consolidated total net sales:

|  | <b>Thirteen Weeks Ended</b> | <b>Thirty-nine Weeks Ended</b> |
|--|-----------------------------|--------------------------------|
|  | <b>November 3,</b>          | <b>October 28,</b>             |