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FRIEDMANS INC  
Form 10-Q  
May 15, 2001

United States  
Securities and Exchange Commission  
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarterly Period Ended March 31, 2001

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-22356

FRIEDMAN'S INC.

-----  
(Exact name of registrant as specified in its charter)

Delaware  
-----  
(State or other jurisdiction of incorporation or organization)

58-2058362  
-----  
(I.R.S. Employer Identificaiton No.)

4 West State Street  
Savannah, Georgia 31401  
-----  
(Address of principal executive offices)

31401  
-----  
(Zip Code)

(912) 233-9333  
-----  
(Registrant's telephone number, including area code)

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

Indicate the number of shares outstanding of each of the issuer's classes of

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common stock, as of the latest practical

The number of shares of Registrant's Class A Common Stock \$.01 par value per share, outstanding at May 13, 2001 was 13,320,100.

The number of shares of Registrant's Class B Common Stock \$.01 par value per share, outstanding at May 13, 2001 was 1,196,283.

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Friedman's Inc.

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#### Part I. Financial Information

##### Item 1.

FRIEDMAN'S INC.  
Consolidated Income Statements  
(Unaudited)  
(In thousands, except per share and share amounts)

|                                                                         | Three months ended<br>March 31,<br>2001 | April 1,<br>2000 | Six months e<br>March 31,<br>2001 | A     |
|-------------------------------------------------------------------------|-----------------------------------------|------------------|-----------------------------------|-------|
|                                                                         | -----                                   | -----            | -----                             | ----- |
| Net sales.....                                                          | \$88,106                                | \$80,403         | \$261,541                         | \$2   |
| Operating Costs and Expenses:                                           |                                         |                  |                                   |       |
| Cost of goods sold including occupancy,<br>distribution and buying..... | 47,717                                  | 43,516           | 134,852                           | 1     |

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|                                                   |          |          |           |
|---------------------------------------------------|----------|----------|-----------|
| Selling, general and administrative.....          | 33,265   | 29,369   | 89,415    |
| Depreciation and amortization.....                | 2,966    | 2,324    | 5,882     |
|                                                   | -----    | -----    | -----     |
| Income from operations.....                       | 4,158    | 5,194    | 31,392    |
| Interest and other income from related party..... | (643)    | (584)    | (1,292)   |
| Interest expense.....                             | 1,238    | 1,114    | 2,661     |
|                                                   | -----    | -----    | -----     |
| Income before income taxes.....                   | 3,563    | 4,664    | 30,023    |
| Income tax expense.....                           | 1,317    | 1,701    | 10,648    |
| Minority interest.....                            | (198)    | 0        | (400)     |
|                                                   | -----    | -----    | -----     |
| Net income.....                                   | \$ 2,444 | \$ 2,963 | \$ 19,775 |
|                                                   | =====    | =====    | =====     |
| Earnings per share - basic.....                   | \$ 0.17  | \$ 0.21  | \$ 1.37   |
|                                                   | =====    | =====    | =====     |
| Earnings per share - diluted.....                 | \$ 0.17  | \$ 0.21  | \$ 1.37   |
|                                                   | =====    | =====    | =====     |
| Weighted average shares - basic.....              | 14,494   | 14,438   | 14,483    |
| Weighted average shares - diluted.....            | 14,494   | 14,438   | 14,483    |
| Number of stores open .....                       | 635      | 574      | 635       |

See notes to consolidated financial statements.

FRIEDMAN'S INC.  
Consolidated Balance Sheets  
(In thousands, except per share and share amounts)

|                                                                                                                                                                    | March 31,<br>2001 | April<br>2000 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|---------------|
|                                                                                                                                                                    | -----             | -----         |
|                                                                                                                                                                    | (Unaudited)       |               |
| <b>Assets</b>                                                                                                                                                      |                   |               |
| <b>Current Assets:</b>                                                                                                                                             |                   |               |
| Cash.....                                                                                                                                                          | \$ 420            | \$ 1,0        |
| Accounts receivable, net of allowance for doubtful accounts of<br>\$15,550 at March 31, 2001, \$14,173 at April 1, 2000 and \$13,514<br>at September 30, 2000..... | 145,557           | 121,5         |
| Inventories.....                                                                                                                                                   | 140,488           | 128,4         |
| Deferred income taxes.....                                                                                                                                         | 3,107             | 3,6           |
| Other current assets.....                                                                                                                                          | 8,169             | 3,2           |
|                                                                                                                                                                    | -----             | -----         |
| Total current assets.....                                                                                                                                          | 297,741           | 257,9         |
| Equipment and improvements, net.....                                                                                                                               | 56,463            | 49,7          |
| Tradenname rights, net.....                                                                                                                                        | 5,258             | 5,7           |
| Other assets.....                                                                                                                                                  | 3,579             | 4,3           |
|                                                                                                                                                                    | -----             | -----         |
| Total assets.....                                                                                                                                                  | \$363,041         | \$317,7       |
|                                                                                                                                                                    | =====             | =====         |
| <b>Liabilities and Stockholders' Equity</b>                                                                                                                        |                   |               |
| <b>Current Liabilities:</b>                                                                                                                                        |                   |               |
| Accounts payable.....                                                                                                                                              | \$ 49,900         | \$ 37,4       |
| Accrued liabilities.....                                                                                                                                           | 20,804            | 22,9          |

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|                                                                                                                                                                                                                       |           |         |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|---------|
| Total current liabilities.....                                                                                                                                                                                        | 70,704    | 60,4    |
| Bank debt.....                                                                                                                                                                                                        | 59,304    | 45,8    |
| Deferred income taxes and other.....                                                                                                                                                                                  | 1,769     | 2,0     |
| Minority interest in equity of subsidiaries.....                                                                                                                                                                      | 665       |         |
| Stockholders' Equity:                                                                                                                                                                                                 |           |         |
| Preferred stock, par value \$.01, 10,000,000 shares authorized;<br>and none issued.....                                                                                                                               | -         |         |
| Class A common stock, par value \$.01, 25,000,000 shares<br>authorized, 13,320,100, 13,250,857 and 13,271,207 issued and<br>outstanding at March 31, 2001, April 1, 2000 and<br>September 30, 2000, respectively..... | 133       | 1       |
| Class B common stock, par value \$.01, 7,000,000 shares<br>authorized, 1,196,283 issued and outstanding.....                                                                                                          | 12        |         |
| Additional paid-in-capital.....                                                                                                                                                                                       | 119,014   | 118,6   |
| Retained earnings.....                                                                                                                                                                                                | 112,600   | 91,8    |
| Stock purchase loans.....                                                                                                                                                                                             | (1,160)   | (1,1    |
|                                                                                                                                                                                                                       | -----     | -----   |
| Total stockholders' equity.....                                                                                                                                                                                       | 230,599   | 209,4   |
|                                                                                                                                                                                                                       | -----     | -----   |
| Total liabilities and stockholders' equity.....                                                                                                                                                                       | \$363,041 | \$317,7 |
|                                                                                                                                                                                                                       | =====     | =====   |

Note: The balance sheet at September 30, 2000 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements.

See notes to consolidated financial statements.

FRIEDMAN'S INC.  
Consolidated Statements of Cash Flows  
(Unaudited)  
(In thousands)

|                                                                                            | Six months ended  |                  |
|--------------------------------------------------------------------------------------------|-------------------|------------------|
|                                                                                            | March 31,<br>2001 | April 1,<br>2000 |
|                                                                                            | -----             | -----            |
| Operating Activities:                                                                      |                   |                  |
| Net income.....                                                                            | \$ 19,775         | \$ 17,793        |
| Adjustments to reconcile net income to cash<br>provided by (used in) operating activities: |                   |                  |
| Depreciation and amortization.....                                                         | 5,882             | 4,543            |
| Provision for doubtful accounts.....                                                       | 27,187            | 21,027           |
| Income from related party.....                                                             | (168)             | (166)            |
| Changes in assets and liabilities:                                                         |                   |                  |
| Increase in accounts receivable.....                                                       | (50,577)          | (44,770)         |
| Increase in inventories.....                                                               | (18,881)          | (14,334)         |
| (Increase) decrease in other assets.....                                                   | (2,044)           | 908              |

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|                                                                |         |          |
|----------------------------------------------------------------|---------|----------|
| Increase in accounts payable and accrued liabilities.....      | 15,743  | 7,150    |
|                                                                | -----   | -----    |
| Net cash used by operating activities.....                     | (3,083) | (7,849)  |
| Investing Activities:                                          |         |          |
| Additions to equipment and improvements.....                   | (7,658) | (9,648)  |
| Repayments of employee stock purchases.....                    | 15      | 15       |
|                                                                | -----   | -----    |
| Net cash used in investing activities.....                     | (7,643) | (9,633)  |
| Financing Activities:                                          |         |          |
| Proceeds from bank borrowings.....                             | 10,874  | 17,669   |
| Proceeds from employee stock purchases and options exercised.. | 247     | 139      |
| Payment of cash dividend.....                                  | (434)   | (360)    |
|                                                                | -----   | -----    |
| Net cash provided by investing activities.....                 | 10,687  | 17,448   |
|                                                                | -----   | -----    |
| Decrease in cash.....                                          | (39)    | (34)     |
| Cash, beginning of period.....                                 | 459     | 1,076    |
|                                                                | -----   | -----    |
| Cash, end of period.....                                       | \$ 420  | \$ 1,042 |
|                                                                | =====   | =====    |

See notes to condensed consolidated financial statements.

FRIEDMAN'S INC.

Notes to Consolidated Financial Statements

(Unaudited)

March 31, 2001

Note A - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month and six month periods ended March 31, 2001 are not necessarily indicative of the results that may be expected for the year ending September 30, 2001. For further information, refer to the financial statements and footnotes thereto included in the Friedman's Inc. Annual Report on Form 10-K for the year ended September 30, 2000.

Note B - Earnings per Share

The dilutive effect of stock options on the weighted average number of shares outstanding for the period was zero for the three months and six months ended March 31, 2001 and April 1, 2000.

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

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Certain of the matters discussed in this document and in documents incorporated by reference in this document, including matters discussed under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," may constitute forward looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of Friedman's Inc. ("Friedman's" or the "Company") to be materially different from future results performance or achievements expressed or implied by such forward-looking statements. The words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate," and similar expressions are intended to identify such forward-looking statements. The Company's actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including without limitation those discussed under "Factors Affecting Future Performance" below. All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements.

Three months ended March 31, 2001 compared to three months ended April 1, 2000  
-----

### Results of Operations -----

Net sales increased 9.6% to \$88.1 million for the three months ended March 31, 2001, from \$80.4 million for the three months ended April 1, 2000. The increase in net sales was attributable to the net addition of 61 new stores since April 1, 2000, which was partially offset by a comparable store net merchandise sales decrease of 0.2% for the three months ended March 31, 2001.

Cost of goods sold, including occupancy, distribution and buying, increased 9.7% to \$47.7 million, or 54.2%, of net sales, for the three months ended March 31, 2001, versus \$43.5 million, or 54.1% of net sales, for the three months ended April 1, 2000. The increase in cost of goods sold was attributable to the net addition of 61 new stores since April 1, 2000.

Selling, general and administrative expenses increased 13.3% to \$33.3 million for the three months ended March 31, 2001, from \$29.4 million for the three months ended April 1, 2000. As a percentage of net sales, selling, general and administrative expenses increased to 37.8% of net sales for the three months ended March 31, 2001 from 36.5% for the three months ended April 1, 2000. Excluding the consolidation of internet operations, selling, general and administrative expenses increased 11.4% to \$32.7 million for the three months ended March 31, 2001 and as a percentage of net sales, increased to 37.2% from 36.5% for the three months ended April 1, 2000. The increase as a percentage of net sales was primarily the result of a non-comparable charge of \$0.4 million related to the closing of seven stores, and increased advertising expenses, partially offset by improvements in operating expenses and an increase in net earnings from credit operations. The increase in advertising was the result of increased television advertising and direct mail inserts compared to the comparable period last year. The improvement in operating expenses was primarily due to improved expense management. The improvement in credit operations was primarily the result of increases in credit revenues generated from customer accounts receivable.

Depreciation and amortization expenses increased 27.6% to \$3.0 million for the three months ended March 31, 2001, from \$2.3 million for the three months ended April 1, 2000. Depreciation and amortization expense as a percentage of net sales was 3.4% for the three months ended March 31, 2001 compared to 2.9% in the comparable period in the prior year. Excluding the consolidation of internet operations, depreciation and amortization expenses increased 25.1% to \$2.9 million for the three months ended March 31, 2001 and as a percentage of

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net sales increased to 3.3% compared to 2.9% in the comparable period in the prior year. The increase in depreciation and amortization as a percentage of net sales was due primarily to expenses associated with the accelerated depreciation for seven store closings and the decrease in comparable store sales. In general, depreciation and amortization expenses as a percentage of net sales may continue to increase as a result of additional investments in stores, systems and infrastructure, but management does not believe that such potential increases represent a material continuing trend.

Interest and other income from a related party increased to \$643,000 for the three months ended March 31, 2001 compared to \$584,000 for the three months ended April 1, 2000. Interest expense increased to \$1.2 million for the three months ended March 31, 2001 compared to \$1.1 million for the three months ended April 1, 2000. The

increase in interest expense was due primarily to higher average outstanding borrowings on the Company's line of credit and an increase in the Company's effective interest rate. See "Liquidity and Capital Resources."

Net income decreased by 17.5% to \$2.4 million for the three months ended March 31, 2001 compared to \$3.0 million for the three months ended April 1, 2000. Basic and diluted earnings per share decreased 19.0% to \$0.17 per share for the three months ended March 31, 2001 from \$0.21 per share for the three months ended April 1, 2000. Excluding the charge for store closing costs and the loss from internet operations, basic and diluted earnings per share remained unchanged at \$0.21 per share for the three months ended March 31, 2001. Basic and diluted weighted average common shares outstanding increased 0.4% to 14,494,000 for the three months ended March 31, 2001 from 14,438,000 for the comparable period in the prior year.

Six months ended March 31, 2001 compared to six months ended April 1, 2000

### Results of Operations

Net sales increased 12.8% to \$261.5 million for the six months ended March 31, 2001 from \$231.8 million for the six months ended April 1, 2000. The increase in net sales was attributable to the net addition of 61 new stores since January 1, 2000 and an increase in comparable store net merchandise sales of 3.5% for the six months ended March 31, 2001.

Cost of goods sold, including occupancy, distribution and buying, increased 10.5% to \$134.9 million, or 51.6%, of net sales, for the six months ended March 31, 2001 versus \$122.0 million, or 52.6% of net sales, for the six months ended April 1, 2000. The decrease as a percentage of net sales was primarily the result of a higher merchandise gross margin rate as a percentage of net sales. The higher merchandise gross margin rate was primarily due to less sales of lower gross margin clearance merchandise as compared to the prior year. In general, cost of goods sold as a percentage of net sales may increase as a result of the Company's merchandising and promotional activities, but management does not believe that such potential increases represent a material continuing trend.

Selling, general and administrative expenses increased 18.1% to \$89.4 million for the six months ended March 31, 2001, from \$75.7 million for the six months ended April 1, 2000. As a percentage of net sales, selling, general and administrative expenses increased to 34.2% of net sales for the six months ended March 31, 2001 from 32.7% for the six months ended April 1, 2000. Excluding the consolidation of internet operations, selling, general and administrative expenses increased 16.7% to \$88.4 million for the six months ended March 31,

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2001, and as a percentage of net sales, increased to 33.8% from 32.7% for the six months ended April 1, 2000. The increase as a percentage of net sales was primarily the result of increases in advertising expenses and provision for bad debts, partially offset by decreases in operating expenses. The increase in advertising was the result of increased television advertising and direct mail inserts compared to the comparable period last year. The increase in the provision for bad debt as a percentage of net sales was primarily the result of increased charge offs as compared to the comparable period last year.

Depreciation and amortization expenses increased 29.5% to \$5.9 million for the six months ended March 31, 2001, from \$4.5 million for the six months ended April 1, 2000. Depreciation and amortization expense as a percentage of net sales was 2.2% for the six months ended March 31, 2001 compared to 2.0% in the comparable period in the prior year. Excluding the consolidation of internet operations, depreciation and amortization expenses increased 24.2% to \$5.6 million for the six months ended March 31, 2001 and as a percentage of net sales increased to 2.2% compared to 2.0% in the comparable period in the prior year. In general, depreciation and amortization expenses as a percentage of net sales may continue to increase as a result of additional investments in stores, systems and infrastructure, but management does not believe that such potential increases represent a material continuing trend.

Interest and other income from a related party increased to \$1.3 million for the six months ended March 31, 2001 compared to \$1.2 million for the six months ended April 1, 2000. Interest expense increased to \$2.7 million for the six months ended March 31, 2001 compared to \$2.1 million for the three months ended January 1, 2000. The increase in interest expense was due primarily to higher average outstanding borrowings on the Company's line of credit and an increase in the Company's effective interest rate. See "Liquidity and Capital Resources."

Net income increased by 11.1% to \$19.8 million for the six months ended March 31, 2001 compared to \$17.8 million for the six months ended April 1, 2000. Basic and diluted earnings per share increased 11.4% to

\$1.37 per share for the six months ended March 31, 2001 from \$1.23 per share for the six months ended April 1, 2000. Excluding the charge for store closing costs and the loss from internet operations, basic and diluted earnings per share increased 15.4% to \$1.42 per share for the six months ended March 31, 2001 from \$1.23 per share for the six months ended April 1, 2000. Basic and diluted weighted average common shares outstanding increased 0.3% to 14,483,000 for the six months ended March 31, 2001 from 14,433,000 for the comparable period in the prior year.

### Liquidity and Capital Resources

-----

During the six months ended March 31, 2001, net cash used by the Company's operating activities was \$3.1 million compared to \$7.9 million for the six months ended April 1, 2000. For the six months ended March 31, 2001, cash provided by operations was favorably impacted, as compared to the prior year, by increased net income and decreased net inventory levels, including accounts payable, offset by increases in customer accounts receivable.

Investing activities used cash of \$7.6 million for the six months ended March 31, 2001 compared to \$9.6 million during the six months ended April 1, 2000. The decrease was due primarily to the addition of 16 new stores for the six months ended March 31, 2001 compared to 43 new stores for the comparable period in the prior year.

Financing activities provided \$10.7 million of cash for the six months



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ended March 31, 2001 compared to \$17.4 million for the six months ended April 1, 2000. This cash was mostly provided from bank borrowings for the six months ended March 31, 2001.

Currently, the Company has a \$67.5 million senior secured revolving credit facility maturing on September 15, 2002. Borrowings under the credit facility bear interest at either the federal funds rate plus 0.5%, the prime rate or, at the Company's option, the eurodollar rate plus applicable margin ranging from 1.00% to 1.75%. The applicable margin is determined based on a calculation of the combined leverage ratio of the Company and Crescent Jewelers, an affiliate of the Company. The facility contains certain financial covenants and is secured by certain of the Company's assets. At March 31, 2001, \$59.3 million was outstanding under the facility, with interest accruing on such borrowings in a range from 6.4% to 8.5%. Management believes that the Company's credit facility will be sufficient to fund the Company's working capital requirements through fiscal 2001.

In connection with the credit facility, the Company provides certain credit enhancements and guaranties the obligations of Crescent under its \$112.5 million senior secured revolving credit facility. In consideration for this guaranty, Crescent makes quarterly payments to the Company in an amount equal to 2% per annum of the outstanding obligations of Crescent under its credit facility during the preceding fiscal quarter. In further consideration of this guaranty, Crescent issued the Company a warrant to purchase 7,942,904 shares of Crescent's non-voting Class A Common Stock, or approximately 50% of the capital stock of Crescent on a fully diluted basis, for an exercise price of \$500,000.

On March 2, 2001, the Company's Board of Directors declared an increase in its annual cash dividend from \$0.06 per share on an annual basis to \$0.07 per share on an annual basis and subsequently declared a quarterly dividend of \$0.0175, payable on April 16, 2001, to Stockholders of record as of March 31, 2001.

### FACTORS AFFECTING FUTURE PERFORMANCE

Our growth may place a strain on our resources and may affect adversely the results of our operations.

The number of stores we operate has increased greatly during the past three years. For example, we opened approximately 70 net new stores from December 1999 to December 2000, and have continued to expand our store base during fiscal 2001. The success of our expansion program will depend on the performance of our existing stores, our ability to find suitable store locations and our ability to hire and train qualified store personnel. We anticipate that there will continue to be significant competition among specialty retailers for desirable store sites and qualified personnel. Furthermore, if our operations fail to generate sufficient cash flow, we may require additional capital to finance our planned expansion. Our growth has placed, and will continue to place, significant demands on all aspects of our business, including our management information and distribution systems and personnel. For these reasons, we may not be successful in continuing our growth or successfully managing our growth which could result in a reduction in our historical revenue growth or an increase in cost of goods sold which would directly and adversely affect our earnings.

Our industry is highly competitive, and if we fall behind our competitors, our earnings and stock price may be adversely affected.

The retail jewelry business is mature and highly competitive. Our retail jewelry business competes with national and regional jewelry chains, as well as with local independently owned jewelry stores and chains. We also compete with

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other types of retailers who sell jewelry and gift items, such as department stores, catalog showrooms, discounters, direct mail suppliers, television home shopping networks and jewelry retailers who make sales through Internet sites. Our credit operations compete with credit card companies and other providers of consumer credit. Management believes that Friedman's competes primarily on the basis of selection of merchandise offered, pricing, quality of sales personnel, advertising, ability to offer in-house credit, store location and reputation. Many competitors are substantially larger and have greater financial resources than we do. We may not be able to compete successfully with such competitors. Competition could cause us to lose customers, increase expenditures or reduce pricing which could have a material adverse effect on our earnings. See Item 1. "Business - Competition."

Our results of operations may be significantly affected by a downturn in general economic conditions.

Jewelry is a luxury item, not a necessity product. As a result, adverse trends in the general economy, such as decreases in employment levels, wages and salaries, may affect sales of our jewelry. Historically, people spend less money on luxury items, such as jewelry, during a decline in general economic activity. Also, negative developments in local economic conditions, such as plant closings, industry slowdown and government employment cutbacks, may affect sales of our jewelry. We depend on customer traffic at the power strip centers and malls where our stores are located. A reduction in consumer spending due to general economic conditions could negatively affect our net sales.

A majority of our customers use credit (either from us or another consumer credit source) to purchase jewelry from us. When there are adverse trends in the general economy or increases in interest rates, fewer people use credit. General economic trends also affect our credit operations. Any downturn in general or local economic conditions in the markets in which we operate would affect adversely our ability to collect outstanding credit accounts receivable. See Item 6. "Selected Financial Data" and Item 1. "Business - Credit Operations."

Instances of litigation relating to the sale of credit insurance have increased in the retail industry and our business could be adversely affected by this litigation.

States' Attorneys General and private plaintiffs have filed lawsuits against other retailers relating to improper practices conducted in connection with the sale of credit insurance in several jurisdictions around the country. We offer credit insurance in all of our stores and encourage the purchase of credit insurance products in connection with sales of merchandise on credit. Similar litigation may be brought against us, and we could be liable for substantial damages or may be forced to incur substantial costs as part of an out-of-court settlement. This could have a material adverse effect on our results of operations and stock price. Also, an adverse judgment could affect our reputation and this could have a negative impact on sales of our jewelry and credit insurance products.

Our business is highly seasonal, which may cause significant fluctuations in our results.

Our first fiscal quarter, which ends December 30, has historically been the strongest quarter of the year in terms of net sales and operating income. Any substantial disruption of holiday season shopping or other events which affect our first quarter results could have a material adverse effect on our profitability for the whole year. Our quarterly results of operations also may fluctuate significantly as a result of a variety of factors, including the following:

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- . the timing of new store openings,
- . net sales contributed by new stores,
- . actions of competitors,
- . fluctuations in comparable store sales,
- . timing of certain holidays,
- . changes in our merchandise, and
- . general economic, industry and weather conditions that affect consumer spending.

The loss of our president and chief executive officer or other key personnel could significantly harm our business.

Our management and operations depend on the skills and experience of our senior management team, including our President and Chief Executive Officer, Bradley J. Stinn. We believe that our ability to successfully implement our growth strategies depends on the continued employment of our senior management team. The loss of Mr. Stinn or a significant number of other senior officers could hurt us materially. We do not have and do not contemplate entering into employment agreements with, or obtaining key-man life insurance for, any senior officer.

We may incur additional compensation expense because of our incentive compensation arrangements.

In October 1994, we made \$1.5 million in incentive loans to each of Mr. Stinn and Sterling B. Brinkley, our Chairman of the Board of Directors. The loans mature in 2004. We agreed to forgive principal and interest payments on these incentive loans if our Class A Common Stock reached certain prices. If we forgive principal and interest payments, we will incur compensation expense which reduces earnings. During 1995 and 1996, we incurred compensation expense of \$3 million with respect to the incentive loans. If the price of the Class A Common Stock increases above the remaining price targets, we will incur an additional \$3 million in compensation expense. This compensation expense, if incurred, will negatively impact earnings.

Fluctuations in the availability and prices of our merchandise may affect our results of operations.

We primarily sell jewelry made of gold and diamonds and, to a lesser extent, other precious and semi-precious metals and stones. The prices of these materials have been, and we expect for them to continue to be, subject to significant volatility. Further, the supply and price of diamonds are significantly influenced by a single entity, DeBeers Consolidated Mines Ltd. of South Africa. We do not maintain long-term inventories or otherwise hedge against fluctuations in the cost of gold or diamonds. A significant increase in the price of gold and diamonds could adversely affect our sales and gross margins.

Our supply of diamonds comes primarily from South Africa, Botswana, Zaire, the former Soviet republics and Australia. Changes in the social, political or economic conditions in one or more of these countries could have an adverse effect on our supply of diamonds. Any sustained interruption in the supply of diamonds from these producing countries could adversely affect our product costs, and as a result, our earnings.

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Your stock value may be adversely affected because of the concentrated ownership of our Class B Common Stock.

Mr. Phillip E. Cohen controls all of our Class B Common Stock through his ownership of MS Jewelers, the general partner of the partnership which owns the Class B Common Stock. The holders of Class B Common Stock have the right to elect 75% of our directors and control the outcome of all other issues decided by our stockholders, including major corporate transactions. Mr. Cohen can transfer the Class B Common Stock and its voting rights to a third party, subject to certain limitations. If Mr. Cohen were to convert the Class B Common Stock into Class A Common Stock, he would control approximately 8.3% of the Class A Common Stock.

Your stock value may be adversely affected because only holders of Class B Common Stock may vote on corporate actions requiring stockholder approval.

Holders of Class A Common Stock have the right to elect a minimum of 25% of our directors. As long as there are shares of Class B Common Stock outstanding, holders of Class A Common Stock have no other voting rights, except as required by law. Mr. Cohen controls the outcome of substantially all matters submitted to a vote of the stockholders. Some potential investors may not like this concentration of control and the price of Class A Common Stock may be adversely affected. Mr. Cohen's control of Friedman's may also discourage offers by third parties to buy us or to merge with us. Further, the interests of Mr. Cohen could conflict with the interests of the holders of Class A Common Stock.

Our business may be adversely affected by changes in laws and regulations governing our business.

Federal and state consumer protection laws and regulations limit the manner in which we may offer and extend credit and the various types of insurance that we offer. Any adverse change in the regulation of credit could adversely affect our net sales and cost of goods sold. For example, new laws or regulations could limit the amount of interest or fees we could charge on consumer loan accounts, or restrict our ability to collect on account balances. Compliance with, or any violation of, existing and future laws or regulations could require us to make material expenditures or otherwise adversely effect our business or financial results.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The Company's market risk is limited to fluctuations in interest rates as it pertains to the Company's borrowings under its credit facility. The Company pays interest on borrowings at either the federal funds rate plus 0.5%, the prime rate or, at the Company's option, the eurodollar rate plus applicable margin ranging from 1.00% to 1.75%. If the interest rates on the Company's borrowings average 100 basis points more in fiscal 2001 than they did in fiscal 2000, the Company's interest expense would increase and income before income taxes would decrease by \$499,000. This amount is determined solely by considering the impact of the hypothetical change in the interest rate on the Company's borrowing cost without consideration for other factors such as actions management might take to mitigate its exposure to interest rate changes.

## Part II. Other Information

### Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Stockholders of the Company held on March 1, 2001, the following matters were brought before and voted upon by the

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stockholders:

### Class A Common Stock

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1. A proposal to elect the following persons to the Board of Directors to serve until the 2002 Annual Meeting of Stockholders of the Company:

|                       | For<br>--- | Withhold Authority<br>----- |
|-----------------------|------------|-----------------------------|
| John E. Cay III       | 11,444,975 | 104,523                     |
| Robert W. Cruickshank | 11,332,765 | 216,733                     |
| David B. Parshall     | 11,441,245 | 108,253                     |

### Class B Common Stock

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2. A proposal to elect the following persons to the Board of Directors to serve until the 2002 Annual Meeting of Stockholders of the Company:

|                      | For<br>--- | Withhold Authority<br>----- |
|----------------------|------------|-----------------------------|
| Bradley J. Stinn     | 1,196,283  | 0                           |
| Sterling B. Brinkley | 1,196,283  | 0                           |
| Mark C. Pickup       | 1,196,283  | 0                           |

3. A proposal to ratify the selection of Ernst & Young LLP as independent certified public accountants of the Company for the fiscal year ending September 30, 2001:

| For<br>--- | Against<br>----- | Abstain<br>----- |
|------------|------------------|------------------|
| 1,196,283  | 0                | 0                |

4. A proposal to ratify an amendment to the 1994 Stock Option Plan for Outside Directors:

| For<br>--- | Against<br>----- | Abstain<br>----- |
|------------|------------------|------------------|
| 1,196,283  | 0                | 0                |

5. A proposal to ratify an amendment to the 1999 Long-Term Incentive Plan:

| For<br>--- | Against<br>----- | Abstain<br>----- |
|------------|------------------|------------------|
| 1,196,283  | 0                | 0                |

Item 6. Exhibits and Reports on Form 8-K

The Company did not file a Current Report on Form 8-K during the three month period ended March 31, 2001.

The exhibits to this report on Form 10-Q are listed on the Exhibit Index which immediately follows the signature page hereto.

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### Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on May 15, 2001.

FRIEDMAN'S INC.

By: /s/ Victor M. Suglia

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Victor M. Suglia  
Senior Vice President and Chief  
Financial Officer

### EXHIBIT INDEX

#### Exhibit Number

- 3.1 Registrant's Certificate of Incorporation, as amended (incorporated by reference from Exhibit 4(a) to the Registrant's Registration Statement on Form S-8 (File No. 333-17755) dated March 21, 1997).
- 3.2 Bylaws of the Registrant (incorporated by reference from Exhibit 3.2 to the Registrant's Registration Statement on Form S-1 (File No. 33-67662), and amendments thereto, originally filed on August 19, 1993).
- 4.1 See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and Bylaws of the Registrant defining rights of holders of Class A and Class B Common Stock of the Registrant.
- 4.2 Form of Class A Common Stock certificate of the Registrant (incorporated by reference from Exhibit 4.2 to the Registrant's Registration Statement on Form S-1 (File No. 33-67662), and amendments thereto, originally filed on August 19, 1993).