NEIMAN MARCUS GROUP INC
Form 10-K
October 25, 2001

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

Form 10-K

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

For the fiscal year ended July 28, 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 no. 1-9659

The Neiman Marcus Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**95-4119509**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1618 Main Street **Dallas, Texas**	**75201**
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: **(214) 741-6911**

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

Title of each class	Name of each exchange on which registered
Class A Common Stock, $.01 par value	New York Stock Exchange
Class B Common Stock, $.01 par value	New York Stock Exchange

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

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

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

As Of October 9, 2001, the aggregate market value of the registrant s voting stock held by non-affiliates of the registrant was approximately $1,186,887,287.

As of October 9, 2001, the registrant had outstanding 27,766,905 shares of its Class A Common Stock and 19,941,835 shares of its Class B Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE.

Part III of this report incorporates information from the registrant s definitive Proxy Statement relating to the registrant s Annual Meeting of Shareholders to be held on January 21, 2002, which will be filed on or before November 25, 2001.

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THE NEIMAN MARCUS GROUP, INC

ANNUAL REPORT ON FORM 10-K

FOR THE FISCAL YEAR ENDED JULY 28, 2001

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PART I

ITEM 1. BUSINESS

General

The Neiman Marcus Group, Inc. together with its operating divisions and subsidiaries (the Company) is a Delaware corporation which commenced operations in August 1987. Prior to October 22, 1999, Harcourt General, Inc. (Harcourt General), a Delaware corporation based in Chestnut Hill, Massachusetts, owned approximately 54% of the outstanding common stock of the Company. On October 22, 1999 Harcourt General distributed to its shareholders approximately 21.4 million of the 26.4 million shares of the Company s common stock held by Harcourt General (the Distribution). For more information about the Distribution and the relationship between the Company and Harcourt General, see Note 7 to the Consolidated Financial Statements in Item 14 below.

Business Overview

The Company is a high-end specialty retailer operating through specialty retail stores, consisting of 33 Neiman Marcus stores, two Bergdorf Goodman stores, and a direct marketing operation. The Neiman Marcus stores are in premier retail locations in major markets nationwide, and the Bergdorf Goodman stores are located in Manhattan at 58th Street and Fifth Avenue. Both Neiman Marcus and Bergdorf Goodman stores offer high-end fashion apparel and accessories primarily from leading designers.

Neiman Marcus Direct, the Company s direct marketing operation, offers a mix of apparel and home furnishings which is complementary to the Neiman Marcus stores merchandise. Neiman Marcus Direct also publishes the Horchow catalogues, the world famous Neiman Marcus Christmas Book, and Chef s Catalog, a leading direct marketer of gourmet cookware and high-end kitchenware. For more information about the Company s business segments, see Note 13 to the Consolidated Financial Statements in Item 14 below.

Description of Operations

Specialty Retail Stores. Neiman Marcus stores offer women s and men s apparel, fashion accessories, shoes, cosmetics, furs, precious and fashion jewelry, decorative home accessories, fine china, crystal and silver, gourmet food products, children s apparel and gift items. A significant percentage of retail sales for Neiman Marcus stores is comprised of sales to a relatively small portion of its customers.

As of October 25, 2001, the Company operates 33 Neiman Marcus stores, located in Arizona (Scottsdale); California (five stores: Beverly Hills, Newport Beach, Palo Alto, San Diego and San Francisco); Colorado (Denver); the District of Columbia; Florida (four stores: Fort Lauderdale, Palm Beach, Tampa and Bal Harbour); Georgia (Atlanta); Hawaii (Honolulu); Illinois (three stores: Chicago, Northbrook and Oak Brook); Missouri (St. Louis); Massachusetts (Boston); Minnesota (Minneapolis); Michigan (Troy); Nevada (Las Vegas); New Jersey (two stores: Short Hills and Paramus); New York (Westchester); Pennsylvania (King of Prussia); Texas (six stores: two in Dallas, one in Plano, one in Fort Worth and two in Houston); and Virginia (McLean). The average size of these 33 stores is approximately 141,000 gross square feet, and they range in size from 53,000 gross square feet to 269,000 gross square feet.

The Company plans to open new Neiman Marcus stores in Coral Gables, Florida in 2002; Orlando, Florida in 2002; San Antonio, Texas in 2004; and Atlanta, Georgia in 2005.

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The Company has opened three stores under the name The Galleries of Neiman Marcus to test the concept of using smaller stores featuring precious and fashion jewelry, gifts and decorative home accessories to extend the Neiman Marcus brand into certain markets that may not be large enough to support full-line stores. The Galleries of Neiman Marcus stores opened in Cleveland, Ohio in November 1998; in Phoenix, Arizona in December 1998; and in Seattle, Washington in October 1999, and range in size from 9,000 to 12,000 square feet. The Company continues to evaluate the concept based on the performance of these stores.

The Company operates two Bergdorf Goodman stores in Manhattan at 58th Street and Fifth Avenue. The main Bergdorf Goodman store consists of 250,000 gross square feet, and features high-end women s apparel and unique fashion accessories from leading designers, traditional and contemporary decorative home accessories, precious and fashion jewelry, gifts, and gourmet foods. The Bergdorf Goodman Men s store consists of 66,000 gross square feet and is dedicated to fine men s apparel and accessories. In fiscal year 2000, the Company completed a remodeling project at the Bergdorf Goodman main store that added 15,000 square feet of selling space in a new plaza level below the first floor.

The Company operates eleven clearance centers which average approximately 23,000 gross square feet. These stores provide an efficient and controlled outlet for the sale of marked down merchandise from Neiman Marcus and Bergdorf Goodman stores, and Neiman Marcus Direct.

Direct Marketing. The Company s direct marketing operation, Neiman Marcus Direct, operates an upscale direct marketing business, which primarily offers women s apparel, accessories and specialty cosmetics under the Neiman Marcus name and, through its Horchow catalogue, offers quality home furnishings, linens and tabletop decorative accessories. Neiman Marcus Direct also annually publishes the world famous Neiman Marcus Christmas Book and offers a broad range of more modestly priced items through its Grand Finale catalogues. In January 1998, the Company acquired Chef s Catalog, a leading direct marketer of gourmet cookware and high-end kitchenware, and has consolidated those operations into Neiman Marcus Direct.

Other. Launched in fiscal year 1999, the Company s brand development initiative is designed to create shareholder value by investing in designer resources that serve affluent customers. In February 1999, the Company acquired a 56% interest in Kate Spade LLC, a manufacturer of high-end designer handbags and accessories, for $33.6 million. In November 1998, the Company acquired a 51% interest in Gurwitch Bristow Products LLC, which manufactures and markets the Laura Mercier cosmetic lines, for $6.7 million.

In October 1999, the Company launched NeimanMarcus.com, an internet e-commerce site, which features more than 5,000 products and over 100 designer e-boutiques.

Competition

The specialty retail industry is highly competitive and fragmented. The Company competes with large specialty retailers, traditional and upscale department stores, national apparel chains, designer boutiques, individual specialty apparel stores and direct marketing firms.

The Company competes for customers principally on the basis of quality, assortment and presentation of merchandise, customer service, marketing and customer loyalty programs and value and, in the case of Neiman Marcus and Bergdorf Goodman stores, on the basis of store ambience. In addition, the Company competes for quality merchandise and assortment principally based on relationships with designer resources and purchasing power. The Company s apparel business is especially dependent upon its relationship with these designer resources. The Company competes with other retailers for real estate opportunities principally on the basis of its ability to attract customers. Neiman Marcus Direct competes principally on the basis of quality, assortment and presentation of merchandise, customer service, price and speed of delivery.

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Employees

As of October 17, 2001, the Company had approximately 15,400 employees. Neiman Marcus stores had approximately 12,800 employees, Bergdorf Goodman stores had approximately 1,100 employees and Neiman Marcus Direct had approximately 1,500 employees. The Company s staffing requirements fluctuate during the year as a result of the seasonality of the retail industry. None of the employees of Neiman Marcus stores or Neiman Marcus Direct are subject to collective bargaining agreements. Approximately 16% of the Bergdorf Goodman employees are subject to collective bargaining agreements. The Company believes that its relations with its employees are generally good.

Quarterly Data and Seasonality

For information on quarterly data, seasonality and liquidity, see Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below.

Regulation

The Company s operations are affected by numerous federal and state laws that impose disclosure and other requirements upon the origination, servicing and enforcement of credit accounts and limitations on the maximum amount of finance charges that may be charged by a credit provider. In addition to the Company s private label credit cards, credit to the Company s customers is provided primarily through third parties such as American Express®, Visa®, MasterCard®, Diners Club® and Carte Blance®. Any change in the regulation of credit that would materially limit the availability of credit to the Company s traditional customer base could adversely affect the Company s results of operations or financial condition.

The Company s and its competitors practices are also subject to review in the ordinary course of business by the Federal Trade Commission and the Company s and other retailers credit cards are subject to regulation by the Office of the Comptroller of the Currency. The Company believes that it is currently in material compliance with all applicable state and federal regulations.

Additionally, the Company is subject to certain truth-in-advertising and other various laws, including consumer protection regulations that regulate retailers generally and/or the promotion of the sale of merchandise. The Company undertakes to monitor changes in those laws and believes that it is in material compliance with applicable laws with respect to such practices.

ITEM 2. PROPERTIES

The Company s corporate headquarters are located at the Downtown Neiman Marcus store location in Dallas, Texas. The operating headquarters for Neiman Marcus, Bergdorf Goodman and Neiman Marcus Direct are located in Dallas, New York City and Las Colinas, Texas, respectively. As of October 17, 2001 the aggregate gross square footage used in the Company s operations was approximately as follows:

	Owned	Owned Subject to Ground Lease	Leased	Total
Specialty Retail Stores	348,000	2,358,000	2,538,000	5,244,000
Distribution, Support and Office Facilities	1,169,000	0	830,000	1,999,000

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Leases for substantially all of the Company s stores, including renewal options, range from 30 to 99 years. The lease on the Bergdorf Goodman main store expires in 2050, and the lease on the Bergdorf Goodman Men s store expires in 2010, with two 10-year renewal options. Leases are generally at fixed rentals and a majority of leases provide for additional rentals based on sales in excess of predetermined levels. The Company owns approximately 34 acres of land in Longview, Texas, where its National Service Center, the principal distribution facility for Neiman Marcus stores, is located in a 464,000 square foot facility and also owns approximately 50 acres of land in Las Colinas, Texas, where its 705,000 square foot Neiman Marcus Direct warehouse and distribution facility is located. For further information on the Company s properties, see Operating Leases in Note 11 of the Notes to the Consolidated Financial Statements in Item 14 below. For more information about the Company s plans to open additional stores, see Description of Operations in Item 1 above.

ITEM 3. LEGAL PROCEEDINGS

The Company presently is engaged in various legal actions which are incidental to the ordinary conduct of its business. The Company believes that any liability arising as a result of these actions and proceedings will not have a material adverse effect on the Company s financial position, results of operations or cash flows.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders of the Company during the quarter ended July 28, 2001.

PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

The Company s Class A Common Stock and Class B Common Stock are currently traded on the New York Stock Exchange under the symbols NMG.A and NMG.B respectively. Class B Common Stock was distributed by Harcourt General to its shareholders in October 1999. Beginning with the third quarter of fiscal year 1995, the Company eliminated the quarterly cash dividend on its Common Stock. The Company currently does not intend to resume paying cash dividends on its Common Stock.

The following table indicates for the past two fiscal years the quarterly stock price ranges:

	NMG.A 2001		NMG.A 2000		NMG.B 2001		NMG.B 2000	
Quarter	**High**	**Low**	**High**	**Low**	**High**	**Low**	**High**	**Low**
First	$ 37.63	$ 29.69	$ 25.06	$ 21.31	$ 35.13	$ 26.75	$ 24.75	$ 21.06
Second	$ 39.31	$ 29.88	$ 28.69	$ 23.00	$ 37.13	$ 27.81	$ 27.00	$ 21.13
Third	$ 40.18	$ 29.21	$ 28.50	$ 20.00	$ 37.10	$ 26.80	$ 28.31	$ 19.25
Fourth	$ 40.10	$ 31.00	$ 33.19	$ 24.00	$ 36.50	$ 29.25	$ 32.00	$ 23.13

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ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data is qualified in its entirety by the Consolidated Financial Statements of the Company (and the related Notes thereto) contained elsewhere in this Form 10-K and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations. The operating results and financial position data for each of the fiscal years ended July 28, 2001, July 29, 2000, July 31, 1999, August 1, 1998, and August 2, 1997 have been derived from the Company s audited Consolidated Financial Statements.

	Years Ended				
(in millions, except for per share data)	July 28, 2001	July 29, 2000 (1)	July 31, 1999 (1)	August 1, 1998	August 2, 1997
OPERATING RESULTS:					
Revenues	$ 3,015.5	$ 2,926.4	$ 2,580.4	$ 2,337.7	$ 2,180.6
Net earnings	$ 107.5	$ 134.0	$ 94.9	$ 106.0	$ 92.1
Net earnings applicable to common shareholders	$ 107.5	$ 134.0	$ 94.9	$ 106.0	$ 63.6
Earnings per share applicable to common shareholders:					
Basic	$ 2.28	$ 2.77	$ 1.93	$ 2.13	$ 1.35
Diluted	$ 2.26	$ 2.75	$ 1.93	$ 2.12	$ 1.34
FINANCIAL POSITION:					
Total assets	$ 1,785.9	$ 1,762.1	$ 1,518.9	$ 1,459.0	$ 1,309.5
Long-term liabilities	$ 338.9	$ 435.1	$ 381.3	$ 392.8	$ 401.6

(1) As discussed in Note 1 to the Consolidated Financial Statements in Item 14 below, the Company has made certain reclassifications to its prior financial statements to conform to its current presentation of shipping and handling revenues and expenses in accordance with EITF Issues No. 00-10.

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

With respect to forward-looking statements made in this Management s Discussion and Analysis of Financial Condition and Results of Operations see Business Cautionary Notice Regarding Forward-Looking Statements.

OVERVIEW

The Neiman Marcus Group, Inc., together with its operating divisions and subsidiaries (the Company), is a high-end specialty retailer. The Company s operations include the Specialty Retail Stores segment, which consists of Neiman Marcus and Bergdorf Goodman stores, and the Direct Marketing segment, which conducts operations through Neiman Marcus Direct.

Approximately 83% of the Company s revenues are generated by its Specialty Retail Stores, with the balance generated primarily by Neiman Marcus Direct. Revenue growth over the last three fiscal years at Specialty Retail Stores can be attributed principally to increases in overall comparable store revenues and new store openings. The Company opened new stores in Palm Beach, Florida in November 2000 and in Tampa, Florida in September 2001 and opened a replacement store in Plano, Texas in August 2001. The Company currently plans to open four new Neiman Marcus stores over the next three fiscal years. In fiscal year 2001, average store revenues per gross square foot reached a record high of $502, representing an increase of 11.1% compared to fiscal year 1999. The Company has consistently focused on renovating and modernizing its stores to improve productivity. The Company s strategy is to improve average transaction amounts and comparable revenue growth with carefully edited assortments and marketing and customer loyalty programs that are designed to increase its customers awareness of merchandise offerings in the store.

Launched in fiscal year 1999, the Company s brand development initiative is designed to create shareholder value by investing in designer resources that serve affluent customers. In February 1999, the Company acquired a 56% interest in Kate Spade LLC, a manufacturer of high-end designer handbags and accessories, for $33.6 million. In November 1998, the Company acquired a 51% interest in Gurwitch Bristow Products LLC, which manufactures and markets the Laura Mercier cosmetic lines, for $6.7 million.

Set forth in the following table is certain summary information with respect to the Company s operations for the most recent three fiscal years.

OPERATING RESULTS

	Years Ended

(1) Prior year revenue amounts have been reclassified to comply with the Emerging Issues Task Force Issue No. 00-10, Accounting for Shipping and Handling Fees and Costs. As reclassified from selling, general and administrative expenses, shipping and handling revenues are included in revenues and the related costs are included in cost of goods sold. Such reclassifications had no impact on previously reported operating earnings, net earnings, shareholders equity or cash flows.

(2) Other includes the operations of Kate Spade LLC and Gurwitch Bristow Products LLC, on-line operations of NeimanMarcus.com and corporate expenses. In fiscal year 2001, other operating earnings include a $9.8 million impairment charge of the Company s investment in a third-party internet retailer.

FISCAL YEAR 2001 COMPARED TO FISCAL YEAR 2000

Revenues. Revenues in fiscal year 2001 increased $89.2 million to $3.02 billion from $2.93 billion in fiscal year 2000. The 3.0% increase was primarily attributable to increased comparable revenues and revenue generated by one new store added during the fiscal year. The Company believes that its sales growth continues to be influenced by the execution of its merchandising, marketing and store operation strategies of carefully edited product assortments and marketing and customer loyalty programs to increase customers awareness of merchandise offerings in its stores. Comparable revenues for fiscal year 2001 increased 1.2% for Specialty Retail Stores and 5.9% for Direct Marketing.

The Company began to experience a decline in its comparable revenues beginning in the second quarter of fiscal year 2001. Comparable revenues increased by 10.4% in the first quarter, increased by 1.7% in the second quarter, decreased by 1.4% in the third quarter and decreased by 1.5% in the fourth quarter. The Company believes the comparable revenue decreases were due primarily to economic conditions and a general softening in the retail industry.

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Cost of goods sold including buying and occupancy costs. Cost of goods sold including buying and occupancy costs, as a percentage of revenues, was 67.0% for fiscal year 2001 compared to 65.6% for fiscal year 2000. The increase in cost of goods sold including buying and occupancy costs as a percentage of revenues was primarily due to higher inventory markdowns taken in the fourth quarter of fiscal year 2001 as a result of a general decline in retail sales.

Selling, general and administrative expenses. As a percentage of revenues, selling, general and administrative expenses increased to 26.2% for fiscal year 2001 from 26.0% for fiscal year 2000. The increase in selling, general and administrative expenses as a percentage of revenues was primarily the result of higher marketing costs associated with the selling of markdown inventories, transition costs of approximately $3 million related to the corporate headquarters relocation from Chestnut Hill, Massachusetts to Dallas, Texas and the deleveraging of the fixed cost component of selling, general and administrative expenses on lower sales in the third and fourth quarters of fiscal 2001. These increases were partially offset by lower incentive compensation in fiscal year 2001 and lower costs incurred in connection with the Company s on-line operations conducted by NeimanMarcus.com. NeimanMarcus.com was launched in October 1999.

Impairment of investment in third-party internet retailer. During the fourth quarter of fiscal 2001, the Company recorded an impairment charge of $9.8 million, which represents the Company s adjustment to state the carrying value of its cost method investment in WeddingChannel.com, Inc. at its estimated fair value. WeddingChannel.com, Inc. is a bridal registry service that supports the Company s strategic initiative to expand its gift business. At July 28, 2001, the carrying value of the Company s investment in WeddingChannel.com, Inc. was approximately $3 million.

Operating earnings. Operating earnings were $193.6 million for fiscal year 2001 compared to $248.4 million for fiscal year 2000. Operating earnings for Specialty Retail Stores were $201.0 million in fiscal year 2001 compared to $248.5 million in fiscal year 2000. This decrease in operating earnings for Specialty Retail Stores was primarily due to higher inventory markdowns at both Neiman Marcus and Bergdorf Goodman in fiscal year 2001. Operating earnings for Direct Marketing were $24.0 million in fiscal year 2001 compared to $24.4 million in fiscal year 2000.

Interest expense. Interest expense was $15.2 million for fiscal year 2001 compared to $25.4 million for fiscal year 2000. The decrease of $10.2 million is principally due to lower average borrowings and reduced interest rates. In the prior year, the Company had higher average borrowings which resulted primarily from borrowings incurred to repay the Company s securitization upon maturities during the second half of fiscal year 2000.

Income taxes. The Company s effective income tax rate was 38% in both fiscal year 2001 and fiscal year 2000.

FISCAL YEAR 2000 COMPARED TO FISCAL YEAR 1999

Revenues. Revenues in fiscal year 2000 increased $345.9 million to $2.93 billion from $2.58 billion in fiscal year 1999. The 13.4% increase was primarily attributable to higher overall comparable revenues. Total comparable revenues increased 11.8%. Comparable revenues increased 10.4% at Neiman Marcus stores, 14.6% at Bergdorf Goodman stores, and 13.1% at Neiman Marcus Direct.

Cost of goods sold including buying and occupancy costs. Cost of goods sold including buying and occupancy costs increased 9.7% to $1.92 billion in fiscal year 2000 from $1.75 billion in fiscal year 1999, primarily due to increased revenues. As a percentage of revenues, cost of goods sold was 65.6% in fiscal year 2000 compared to 67.8% in fiscal year 1999. The proportionate decrease in fiscal year 2000 resulted primarily from higher gross margins at both Neiman Marcus stores and Bergdorf Goodman stores in comparison to the prior year, principally as a result of lower markdowns and, to a lesser extent, higher gross margins at Neiman Marcus Direct.

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Selling, general and administrative expenses. Selling, general and administrative expenses increased 17.1% in fiscal year 2000 to $759.7 million from $649.0 million in fiscal year 1999. As a percentage of revenues, selling, general and administrative expenses increased to 26.0% in fiscal year 2000 from 25.2% in fiscal year 1999. The proportionate increase in fiscal year 2000 was primarily due to approximately $24.0 million of costs incurred to launch the Company s e-commerce initiative.

Operating earnings. Operating earnings increased by 36.0% to $248.4 million from $182.6 million in the prior year. This increase was attributable to higher revenues and higher gross margins.

Interest expense. Interest expense increased 1.6% in fiscal year 2000 to $25.4 million from $25.0 million in the prior year. The increase resulted from higher average borrowings which resulted primarily from borrowings incurred to repay the Company s securitization upon maturities during the second half of fiscal year 2000.

Income taxes. The Company s effective income tax rate was 38% in fiscal year 2000 compared to 39% in fiscal year 1999.

RECENT DEVELOPMENTS

Comparable revenues decreased by 0.8% in August 2001 and by 19.5% in September 2001. The Company believes comparable revenues in September 2001 were negatively impacted by a pronounced decrease in consumer spending that occurred subsequent to the September 11, 2001 terrorist attacks in the United States of America. In the first two weeks of the September 2001 period, comparable revenues averaged a mid single-digit percent decline as the Company cycled against a double-digit percent increase a year ago. In the three weeks that included and followed September 11, 2001, comparable revenues declined by an average of approximately 25 percent, with some improvement at the end of the period. Sales were soft across all regions, particularly at Manhattan-based Bergdorf Goodman. There can be no assurances that the decreases in sales subsequent to September 11, 2001 will not continue for the remainder of fiscal year 2002 and beyond. Further, the Company s ability to mitigate the impacts of declines in sales in the short-term is negatively impacted by several factors, including but not limited to, the time interval between the ordering and delivery of the Company s seasonal merchandise and the advance production requirements associated with the Company s catalogues. These factors could result in, among other things, a higher level of inventory markdowns being required in the remainder of fiscal 2002 to liquidate fall-season merchandise, both goods currently on-hand as well as goods yet to be delivered, and spring-season merchandise previously ordered pursuant to noncancelable purchase commitments. The Company believes that declines in sales levels will have a negative impact on the Company s earnings and cash flows from operations for fiscal year 2002. The Company is currently reviewing its expense structure, anticipated capital expenditure requirements and inventory purchase commitments in light of current and anticipated sales levels for the remainder of fiscal year 2002. However, the Company is currently unable to quantify the impact of the decreases in sales to date, the impact of future decreases in sales, if any, for the remainder of fiscal 2002 or the impact of other actions the Company may take in response to declines in sales on its earnings, cash flows or liquidity for the remainder of fiscal year 2002.

QUARTERLY DATA AND SEASONALITY

The specialty retail industry is seasonal in nature and a disproportionately higher level of the Company s revenues and earnings are generated in the fall and holiday selling seasons. The Company s working capital requirements and inventories increase substantially in the first quarter in anticipation of the holiday selling season.

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LIQUIDITY AND CAPITAL RESOURCES

The Company s cash requirements consist principally of funding inventory growth, capital expenditures for new store growth and renovations, upgrading its management information systems and debt service. As of July 28, 2001, the Company had cash and equivalents of $97.3 million. The Company s working capital requirements fluctuate during the year, increasing substantially during the fall season as a result of higher planned seasonal inventory levels.

Net cash provided by operating activities was $131.9 million for fiscal year 2001 and $255.1 million for fiscal year 2000. The net cash provided by operating activities in fiscal year 2001 decreased from the prior year primarily due to the decrease in operating earnings and higher cash requirements related to the procurement of merchandise inventories in fiscal 2001. In fiscal year 2000, net cash provided by operating activities increased from fiscal year 1999 principally from an increase in net earnings and a higher than normal ratio of accounts payable to inventory at the end of fiscal year 2000. Merchandise inventories increased by $73.5 million from July 29, 2000 to July 28, 2001. This increase resulted primarily from new store growth, earlier receipt of new fall merchandise in fiscal year 2001 compared to fiscal year 2000 and planned inventory growth in certain merchandise categories such as cosmetics and jewelry.

Net cash used for investing activities was $129.1 million for fiscal year 2001 and $95.3 million for fiscal year 2000. The net cash used for investing activities increased from fiscal year 2000 to fiscal year 2001 principally as a result of increased capital expenditures. The net cash used for investing activities decreased from fiscal year 1999 to fiscal year 2000 principally as a result of decreased capital expenditures for fiscal year 2000 and net cash paid to acquire Kate Spade LLC and Gurwitch Bristow Products LLC in fiscal year 1999.

The Company s capital expenditures in fiscal year 2001 included costs related to the construction of new stores and the renovation of existing stores. Capital expenditures were $120.0 million in fiscal year 2001, $89.0 million in fiscal year 2000 and $91.0 million in fiscal year 1999. During fiscal years 2001, 2000 and 1999, the Company invested approximately $53.8 million in the aggregate to remodel its existing stores. In fiscal year 2001, major projects included store remodels in San Francisco, California; Las Vegas, Nevada; Fashion Island, California and Houston, Texas and the construction of a new store in Tampa Bay, Florida and a replacement store in Plano, Texas. The Company s original capital expenditures budget for fiscal year 2002 was approximately $140 million to $150 million. The Company is currently reviewing its capital expenditure requirements for the remainder of fiscal year 2002 in light of the sales declines that the Company has experienced subsequent to the events of September 11, 2001.

Net cash used for financing activities was $80.9 million in fiscal year 2001 and $13.5 million in fiscal year 2000. The net cash used for financing activities increased from fiscal year 2000 to fiscal year 2001 primarily as a result of the $80 million repayment of borrowings on the Company s revolving credit agreement in fiscal year 2001.

At July 28, 2001, the Company has an unsecured revolving credit facility with 21 banks, pursuant to which the Company may borrow up to $450 million. The rate of interest payable varies according to one of four pricing options selected by the Company. The facility, which expires in October 2002, may be terminated by the Company at any time on three business days notice. The revolving credit facility contains covenants which require the Company to maintain certain leverage and fixed charge ratios. There were no borrowings outstanding under this facility at July 28, 2001. During September 2001, the Company borrowed $100 million under this facility to fund its seasonal working capital requirements.

Pursuant to a revolving credit card securitization program that expires in April 2008, the Company sold substantially all of the Company s credit card receivables through a subsidiary to the NMG Credit Card Master Trust in exchange for certificates representing undivided interests in such receivables. The Class A Certificates, which have an aggregate principal value of $225 million, were sold to investors.

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In May 1998, the Company issued $250 million of unsecured senior notes and debentures to the public, the proceeds from which were used to repay borrowings outstanding on the Company s revolving credit facility. The debt is comprised of $125 million, 6.65% senior notes, due 2008 and $125 million, 7.125% senior debentures, due 2028. Interest on the securities is payable semiannually.

In April 2000, the Company s Board of Directors authorized the repurchase of an additional two million shares under the Company s stock repurchase program. At July 28, 2001, up to 1,924,600 shares may be repurchased by the Company pursuant to the prior authorization of the Board of Directors.

Management believes that operating cash flows, currently available vendor financing and amounts available pursuant to its $450 million revolving credit agreement and its outstanding accounts receivable securitization facility should be sufficient to fund the Company s operations, debt service and currently anticipated capital expenditure requirements through the end of fiscal year 2002.

IMPACT OF INFLATION

The Company believes changes in revenues and net earnings that have resulted from inflation and changing prices have not been material during the periods presented. The Company adjusts selling prices to maintain certain profit levels and will continue to do so as economic conditions permit. There is no assurance, however, that inflation will not materially affect the Company in the future.

RECENT ACCOUNTING PRONOUNCEMENTS

On June 30, 2001, the Financial Accounting Standards Board finalized and issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method and eliminates the pooling-of-interests method. SFAS No. 142, upon adoption, eliminates goodwill amortization and the amortization of certain other intangible assets. However, goodwill and other certain intangibles will be subject to at least an annual assessment for impairment by applying a fair-value based test. The provisions of SFAS No. 141 apply immediately to all acquisitions completed after June 30, 2001. Unless early adopted by the Company, the provisions of SFAS No. 142 require that goodwill and intangible assets with indefinite lives continue to be amortized until August 3, 2002. Effective August 4, 2002, such amortization will cease as the Company will be required to adopt the new rules on such date.

The Company has not yet determined the ultimate impact of the provisions of SFAS No. 142 on its consolidated financial statements or the period in which the standard will be adopted. Amortization of goodwill for fiscal year 2001 was $0.9 million.

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FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements, including statements regarding the Company s objectives and expectations regarding its merchandising and marketing strategies, store renovation and expansion plans, inventory performance, capital expenditures, liquidity, development of its management information systems and productivity and profitability that are based upon management s beliefs as well as on assumptions made by and data currently available to management. These forward-looking statements are not guarantees of future performance and a variety of factors could cause the Company s actual results to differ materially from the anticipated or expected results expressed in these forward-looking statements. Factors that could affect future performance include, but are not limited to: current political and economic conditions subsequent to the September 11, 2001 terrorist attacks on the United States of America; changes in economic conditions, political conditions or consumer confidence resulting in a reduction of discretionary spending on goods that are, or are perceived to be, luxuries ; changes in demographic or retail environments; changes in consumer preferences or fashion trends; competitive responses to the Company s marketing, merchandising and promotional efforts; seasonality of the retail business; adverse weather conditions, particularly during peak selling seasons; delays in anticipated store openings; significant increases in paper, printing and postage costs; litigation that may have an adverse effect on the financial results or reputation of the Company; changes in the Company s relationships with designers, vendors and other sources of merchandise; changes in key personnel who have been hired or retained by the Company; changes in the Company s private label credit card arrangement which might adversely impact its ability to provide consumer credit; and changes in government or regulatory requirements increasing the Company s cost of operations. The Company undertakes no obligation to update or revise (publicly or otherwise) any forward-looking statements to reflect subsequent events, new information or future circumstances.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The market risk inherent in the Company s financial instruments represents the potential loss arising from adverse changes in interest rates and exchange rates. The Company does not enter into financial instruments for trading purposes.

At July 28, 2001 and July 29, 2000, the fair values of the Company s fixed-rate senior notes and debentures were $220.6 million and $215.2 million, respectively, based upon quoted market prices. Such fair values were less than the aggregate carrying values of the notes and debentures by $29.1 million at July 28, 2001 and $34.5 million at July 29, 2000. Market risk is estimated as the potential change in fair value resulting from a hypothetical 10% adverse change in interest rates and amounted to approximately $13.7 million at July 28, 2001.

The Company uses derivative financial instruments to manage foreign currency risk related to the procurement of foreign merchandise inventories. The Company enters into foreign currency contracts denominated in the Euro and British pound. The Company had foreign currency contracts in the form of forward exchange contracts in the amount of approximately $46.2 million as of July 28, 2001 and approximately $52.4 million as of July 29, 2000. The market risk inherent in these instruments was not material to the Company s financial condition, results of operations, or cash flows in either fiscal year 2001 or fiscal year 2000.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following Consolidated Financial Statements of the Company and supplementary data are included as pages F-1 through F-24 at the end of this Annual Report on Form 10-K:

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

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Directors of the Registrant

The information set forth under the headings Proposal No. One: Election of Directors and Section 16(a) Beneficial Ownership Reporting Compliance in the Company s definitive Proxy Statement for the 2002 Annual Meeting of Shareholders is incorporated herein by reference.

Executive Officers of the Registrant

Set forth below are the names, ages at October 25, 2001, and principal occupations for the last five years of each executive officer of the Company. All such persons have been elected to serve until the next annual election of officers or until their earlier resignation or removal.

Burton M. Tansky 63

President and Chief Executive Officer since February 21, 2001. Mr. Tansky served as President and Chief Operating Officer of the Company from December 1998 until February 2001; served as Executive Vice President of the Company from February 1998 until December 1998; and served as Chairman and Chief Executive Officer of Neiman Marcus Stores from May 1994 until February 2000.

James E. Skinner 48

Joined the Company as Senior Vice President and Chief Financial Officer on June 28, 2001. Prior to joining the Company, Mr. Skinner served as Senior Vice President and Chief Financial Officer of Caprock Communications Corp. from August 2000 until December 2000; and served as Executive Vice President, Chief Financial Officer and Treasurer for CompUSA, Inc. from 1994 until 2000.