HIBBETT SPORTS INC
Form 10-Q
December 08, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended November 1, 2008

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: 000-20969

HIBBETT SPORTS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	20-8159608
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

451 Industrial Lane, Birmingham, Alabama 35211
(Address of principal executive offices, including zip code)

205-942-4292
(Registrant's telephone number, including area code)

NONE
(Former name, former address and former fiscal year, if changed since last report)

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

Yes X No

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

Large accelerated filer	X	Accelerated filer	
Non-accelerated filer		Smaller reporting company	

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

Yes No X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Shares of common stock, par value $.01 per share, outstanding as of December 2, 2008, were 28,528,736 shares.

HIBBETT SPORTS, INC.

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A WARNING ABOUT FORWARD-LOOKING STATEMENTS

This document contains “forward-looking statements” as that term is used in the Private Securities Litigation Reform Act of 1995. Forward-looking statements address future events, developments and results. They include statements preceded by, followed by or including words such as “believe,” “anticipate,” “expect,” “intend,” “plan,” “target” or “estimate.” example, our forward-looking statements include statements regarding:

- our anticipated sales, including comparable store net sales changes, net sales growth and earnings;
- our growth, including our plans to add, expand or relocate stores and square footage growth, our market’s ability to support such growth and the suitability of our distribution facilities;
- the possible effect of pending legal actions and other contingencies;
- our cash needs, including our ability to fund our future capital expenditures and working capital requirements;
- our ability and plans to renew or increase our revolving credit facilities;
- our seasonal sales patterns and assumptions concerning customer buying behavior;
- our ability to renew or replace store leases satisfactorily;
- our estimates and assumptions as they relate to preferable tax and financial accounting methods, accruals, inventory valuations, dividends, carrying amount and liquidity of financial instruments and fair value of options and other stock-based compensation as well as our estimates of economic and useful lives of depreciable assets and leases;
- our expectations concerning future stock-based award types;
- our expectations concerning employee option exercise behavior;
- the possible effect of inflation, market decline and other economic changes on our costs and profitability, including the impact of changes in fuel costs and a downturn in the retail industry or changes in levels of store traffic;
- the possible effects of the continued volatility and further deterioration of the capital markets, the commercial and consumer credit environment and the continuation of lowered levels of consumer spending resulting from the worldwide economic downturn, lowered levels of consumer confidence and higher levels of unemployment;
- our analyses of trends as related to earnings performance;
- our target market presence and its expected impact on our sales growth;
- our expectations concerning vendor level purchases and related discounts;
- our estimates and assumptions related to income tax liabilities and uncertain tax positions; and
- the possible effect of recent accounting pronouncements.

For a discussion of the risks, uncertainties and assumptions that could affect our future events, developments or results, you should carefully consider the risk factors described from time to time in our other documents and reports, including the factors described under “Risk Factors,” “Business” and “Properties” in our Form 10-K dated April 2, 2008, our second quarter Form 10-Q dated August 2, 2008 and this Form 10-Q.

Our forward-looking statements could be wrong in light of these and other risks, uncertainties and assumptions. The future events, developments or results described in this report could turn out to be materially different. We have no obligation to publicly update or revise our forward-looking statements after the date of this report and you should not expect us to do so.

Investors should also be aware that while we do, from time to time, communicate with securities analysts and others, we do not, by policy, selectively disclose to them any material non-public information with any statement or report issued by any analyst regardless of the content of the statement or report. We do not, by policy, confirm forecasts or projections issued by others. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not our responsibility.

You should assume that the information appearing in this report is accurate only as of the date it was issued. Our business, financial condition, results of operations and prospects may have changed since that date.

INVESTOR ACCESS TO COMPANY FILINGS

We make available free of charge on our website, www.hibbett.com under the heading “Investor Information,” copies of our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as well as all Forms 4 and 5 filed by our executive officers and directors, as soon as the filings are made publicly available by the Securities and Exchange Commission on its EDGAR database at www.sec.gov. In addition to accessing copies of our reports online, you may request a copy of our Annual Report on Form 10-K for the fiscal year ended February 2, 2008, at no charge, by writing to: Investor Relations, Hibbett Sports, Inc., 451 Industrial Lane, Birmingham, Alabama 35211.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements.

HIBBETT SPORTS, INC. AND SUBSIDIARIES
Unaudited Condensed Consolidated Balance Sheets
(in thousands, except share and per share information)

ASSETS	November 1, 2008	February 2, 2008
Current Assets:		
Cash and cash equivalents	$ 6,525	$ 10,742
Short-term investments	279	191
Trade receivables, net	2,380	1,899
Accounts receivable, other	3,341	3,676
Inventories	162,315	141,406
Prepaid expenses and other	6,575	5,348
Deferred income taxes, net	3,897	2,725
Total current assets	185,312	165,987
Property and Equipment:		
Land and building	245	245
Equipment	43,788	40,338
Furniture and fixtures	22,562	20,991
Leasehold improvements	60,319	57,599
Construction in progress	1,500	2,564
	128,414	121,737
Less accumulated depreciation and amortization	83,650	75,232
Net property and equipment	44,764	46,505
Deferred income taxes	3,683	3,780
Other assets, net	341	462
Total Assets	$ 234,100	$ 216,734
LIABILITIES AND STOCKHOLDERS' INVESTMENT		
Current Liabilities:		
Accounts payable	$ 59,199	$ 64,125
Accrued income taxes	-	688
Accrued payroll expenses	4,362	4,432
Deferred rent	4,516	4,379
Short-term debt	14,943	-
Other accrued expenses	3,107	2,980
Total current liabilities	86,127	76,604
Deferred rent	17,123	18,012
Deferred income taxes	2,854	2,968
Other liabilities, net	272	95
Total liabilities	106,376	97,679
Stockholders' Investment:		
Preferred stock, $.01 par value, 1,000,000 shares authorized,		

no shares issued		-		-
Common stock, $.01 par value, 80,000,000 shares authorized, 36,290,549 and 36,162,201 shares issued at November 1, 2008 and February 2, 2008, respectively		363		362
Paid-in capital		90,935		87,142
Retained earnings		203,370		181,555
Treasury stock, at cost; 7,761,813 and 6,723,113 shares repurchased at November 1, 2008 and February 2, 2008, respectively		(166,944)		(150,004)
Total stockholders' investment		127,724		119,055
Total Liabilities and Stockholders' Investment	$	234,100	$	216,734

See notes to unaudited condensed consolidated financial statements.

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HIBBETT SPORTS, INC. AND SUBSIDIARIES
Unaudited Condensed Consolidated Statements of Operations
(in thousands, except share and per share information)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2008	November 3, 2007	November 1, 2008	November 3, 2007
Net sales	$ 140,148	$ 129,628	$ 416,262	$ 377,873
Cost of goods sold, including distribution center and store occupancy costs	93,456	87,154	279,493	252,871
Gross profit	46,692	42,474	136,769	125,002
Store operating, selling and administrative expenses	31,073	26,898	91,041	79,512
Depreciation and amortization	3,587	3,023	10,452	9,038
Operating income	12,032	12,553	35,276	36,452
Interest income	5	91	31	551
Interest expense	(158)	(3)	(554)	(53)
Interest (expense) income, net	(153)	88	(523)	498
Income before provision for income taxes	11,879	12,641	34,753	36,950
Provision for income taxes	4,227	4,826	12,938	14,227
Net income	$ 7,652	$ 7,815	$ 21,815	$ 22,723
Basic earnings per share	$ 0.27	$ 0.25	$ 0.76	$ 0.73
Diluted earnings per share	$ 0.26	$ 0.25	$ 0.75	$ 0.71
Weighted average shares outstanding:				
Basic	28,494,587	31,074,731	28,551,470	31,312,106
Diluted	28,930,306	31,553,636	28,983,303	31,822,506

See notes to unaudited condensed consolidated financial statements.

HIBBETT SPORTS, INC. AND SUBSIDIARIES
Unaudited Condensed Consolidated Statements of Cash Flows
(in thousands, except share information)

	Thirty-Nine Weeks Ended	
	November 1, 2008	November 3, 2007
Cash Flows From Operating Activities:		
Net income	$ 21,815	$ 22,723
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,452	9,038
Deferred income tax (benefit) expense, net	(1,190)	1,854
Excess tax benefit from stock option exercises	(356)	(517)
Loss on disposal of assets, net	320	170
Stock-based compensation	2,707	3,159
Changes in operating assets and liabilities:		
Trade receivables, net	(481)	(191)
Accounts receivable, other	335	242
Inventories	(20,909)	(23,129)
Prepaid expenses and other current assets	(1,229)	(1,217)
Accrued income taxes	(509)	(5,644)
Other assets, non-current	121	(12)
Accounts payable	(4,926)	10,577
Deferred rent, non-current	(889)	824
Accrued expenses and other	372	(2,289)
Net cash provided by operating activities	5,633	15,588
Cash Flows From Investing Activities:		
Purchase of short-term investments, net	(87)	(292)
Capital expenditures	(9,085)	(10,165)
Proceeds from sale of property and equipment	56	9
Net cash used in investing activities	(9,116)	(10,448)
Cash Flows From Financing Activities:		
Cash used for stock repurchases	(16,940)	(26,429)
Proceeds from borrowings on revolving credit facilities, net	14,943	-
Excess tax benefit from stock option exercises	356	517
Proceeds from options exercised and purchase of shares under the employee stock purchase plan	907	1,156
Net cash used in financing activities	(734)	(24,756)
Net Decrease in Cash and Cash Equivalents	(4,217)	(19,616)
Cash and Cash Equivalents, Beginning of Period	10,742	30,367
Cash and Cash Equivalents, End of Period	$ 6,525	$ 10,751

See notes to unaudited condensed consolidated financial statements.

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HIBBETT SPORTS, INC. AND SUBSIDIARIES
Unaudited Condensed Consolidated Statements of Stockholders' Investment
(in thousands, except share information)

	Common Stock				Treasury Stock		
	Number of Shares	Amount	Paid-In Capital	Retained Earnings	Number of Shares	Amount	Total Stockholders' Investment
Balance-February 3, 2007	36,047,732	$ 360	$ 81,916	$ 151,697	4,306,413	$ (97,332)	$ 136,641
Net income				30,329			30,329
Cumulative effect of adopting FIN No. 48				(554)			(554)
Cumulative effect of change in accounting principle, net				83			83
Issuance of shares from the employee stock purchase plan and the exercise of stock options, including tax benefit of $275	114,469	2	1,549				1,551
Purchase of shares under the stock repurchase program					2,416,700	(52,672)	(52,672)
Stock-based compensation			3,677				3,677
Balance-February 2, 2008	36,162,201	362	87,142	181,555	6,723,113	(150,004)	119,055
Net income				21,815			21,815
Issuance of shares from the employee stock purchase plan and the exercise of stock options, including tax	128,348	1	1,262				1,263

benefit of $356							
Tax shortfall on release of restricted stock			(176)				(176)
Purchase of shares under the stock repurchase program					1,038,700	(16,940)	(16,940)
Stock-based compensation			2,707				2,707
Balance-November 1, 2008	36,290,549	$ 363	$ 90,935	$ 203,370	7,761,813	$ (166,944)	$ 127,724

See notes to unaudited condensed consolidated financial statements.

HIBBETT SPORTS, INC. AND SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements

1. Basis of Presentation and Accounting Policies

The accompanying unaudited condensed consolidated financial statements of Hibbett Sports, Inc. and its wholly-owned subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and are presented in accordance with the requirements of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended February 2, 2008. In our opinion, the unaudited condensed consolidated financial statements included herein contain all adjustments considered necessary for a fair presentation of our financial position as of November 1, 2008 and February 2, 2008 and the results of our operations and cash flows for the periods presented.

Seasonality and Inflation

We have historically experienced and expect to continue to experience seasonal fluctuations in our net sales and operating income. Our net sales and operating income are typically higher in the fourth quarter due to the holiday selling season. However, the seasonal fluctuations are mitigated by the strong product demand in the spring and back-to-school sales periods. Our quarterly results of operations may also fluctuate significantly as a result of a variety of factors, including the timing of new store openings, the amount and timing of net sales contributed by new stores, the level of pre-opening expenses associated with new stores, the relative proportion of new stores to mature stores, merchandise mix and demand for apparel and accessories driven by local interest in sporting events.

Although our operations are influenced by general economic conditions, we do not believe that, historically, inflation has had a material impact on our results of operations as we are generally able to pass along inflationary increases in costs to our customers.

Business

We operate sporting goods retail stores in small and mid-sized markets predominately in the Southeast, Southwest, Mid-Atlantic and the lower Midwest regions of the United States. Our fiscal year ends on the Saturday closest to January 31 of each year. Our merchandise assortment features a core selection of brand name merchandise emphasizing team sports equipment, athletic and fashion apparel and footwear. We complement this core assortment with a selection of localized apparel and accessories designed to appeal to a wide range of customers within each market.

Principles of Consolidation

The unaudited condensed consolidated financial statements of our Company include its accounts and the accounts of all wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Occasionally, certain reclassifications are made to conform previously reported data to the current presentation. Such reclassifications had no impact on total assets, net income or stockholders’ investment.

Reportable Segments

Given the economic characteristics of our store formats, the similar nature of products offered for sale, the type of customers, the methods of distribution and how our Company is managed, our operations constitute only one reportable segment.

Revenues from external customers by product category are impractical for us to report.

Use of Estimates in the Preparation of Unaudited Condensed Consolidated Financial Statements

The preparation of unaudited condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles requires our management to make estimates and assumptions that affect:

- the reported amounts of certain assets and liabilities;
- the disclosure of certain contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements; and
- the reported amounts of certain revenues and expenses during the reporting period.

Actual results could differ from those estimates.

Vendor Arrangements

We enter into arrangements with some of our vendors that entitle us to a partial refund of the cost of merchandise purchased during the year or reimbursement of certain costs we incur to advertise or otherwise promote their product. The volume based rebates, supported by vendor agreements, are estimated throughout the year and reduce the cost of inventory and cost of goods sold during the year. This estimate is regularly monitored and adjusted for current or anticipated changes in purchase levels and for sales activity.

We also receive consideration from vendors through a variety of other programs, including markdown reimbursements, vendor compliance charges and defective merchandise credits. If the payment is a reimbursement for costs incurred, it is offset against those related costs; otherwise, it is treated as a reduction to the cost of merchandise. Markdown reimbursements related to merchandise that has been sold are negotiated by our merchandising teams and are credited directly to cost of goods sold in the period received. If vendor funds are received prior to merchandise being sold, they are recorded as a reduction of merchandise cost.

Cash and Cash Equivalents

We consider all short-term, highly liquid investments with original maturities of 90 days or less, including commercial paper and money market funds, to be cash equivalents. We place our cash equivalents in high credit quality financial institutions. We are exposed to credit risk in the event of default by these institutions to the extent the amount recorded on the balance sheet exceeds the FDIC insurance limits per institution. Amounts due from third party credit card processors for the settlement of debit and credit card transactions are included as cash equivalents as they are generally collected within three business days. Cash equivalents related to credit and debit card transactions at November 1, 2008 and February 2, 2008 were $1.9 million and $2.4 million, respectively.

Short-Term Investments

All investments with original maturities of greater than 90 days are accounted for in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." We determine the appropriate classification at the time of purchase. We held approximately $0.3 million and $0.2 million of investments in securities at November 1, 2008 and February 2, 2008, respectively. Our investments in securities primarily consisted of municipal bonds classified as available-for-sale. Investments in these securities are recorded at cost, which approximates fair value. As a result, there are no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from our securities. All income generated from these securities is recorded as interest income. We continually evaluate our short-term investments for other than temporary impairment.

Trade and Other Accounts Receivable

Trade accounts receivable consists primarily of amounts due to us from sales to educational institutions and youth associations. We do not require collateral and we maintain an allowance for potential uncollectible accounts based on an analysis of the aging of accounts receivable at the date of the financial statements, historical losses and existing economic conditions, when relevant. The allowance for doubtful accounts at November 1, 2008 and February 2, 2008 was $60,000 and $46,000, respectively.

Other accounts receivable consists primarily of tenant allowances due from landlords and cooperative advertising due from vendors, all of which are deemed to be collectible.

Inventory Valuation

Lower of Cost or Market: Inventories are valued using the lower of weighted-average cost or market method. Market is determined based on estimated net realizable value. We regularly review inventories to determine if the carrying value exceeds realizable value, and we record an accrual to reduce the carrying value to net realizable value as necessary. We account for obsolescence as part of our lower of cost or market accrual based on historical trends and specific identification. As of November 1, 2008 and February 2, 2008, the accrual was $1.9 million and $1.5 million, respectively. A determination of net realizable value requires significant judgment and estimates.

Shrinkage: We accrue for inventory shrinkage based on the actual historical results of our most recent physical inventories. These estimates are compared to actual results as physical inventory counts are performed and reconciled to the general ledger. Store counts are typically performed on a cyclical basis and the distribution center's counts have historically been performed mid-year and in late December or early January every year. In Fiscal 2009, the distribution center's counts are being performed quarterly. As of November 1, 2008 and February 2, 2008, the accrual was $0.9 million for both periods.

Inventory Purchase Concentration: Our business is dependent to a significant degree upon close relationships with our vendors. Our largest vendor, Nike, represented approximately 46.4% and 46.3% of our purchases for the thirteen weeks ended November 1, 2008 and November 3, 2007, respectively. Our second largest vendor represented approximately 11.4% and 8.9% of our purchases while our third largest vendor represented approximately 10.1% and 10.4% of our purchases for the thirteen weeks ended November 1, 2008 and November 3, 2007, respectively.

For the thirty-nine weeks ended November 1, 2008 and November 3, 2007, Nike, our largest vendor, represented approximately 50.3% and 48.4% of our purchases, respectively. Our second largest vendor represented approximately 8.3% and 9.4% of our purchases while our third largest vendor represented approximately 8.3% and 6.8% of our purchases for the thirty-nine weeks ended November 1, 2008 and November 3, 2007, respectively.

Property and Equipment

Property and equipment are recorded at cost. Depreciation on assets is principally provided using the straight-line method over their estimated service lives (3 to 5 years for equipment, 7 years for furniture and fixtures and 39 years for buildings) or, in the case of leasehold improvements, the shorter of the initial term of the underlying leases or the estimated economic lives of the improvements (typically 3 to 10 years). We continually reassess the remaining useful life of leasehold improvements in light of store closing plans.

Construction in progress is comprised primarily of property and equipment related to unopened stores and costs associated with technology upgrades at period end. At November 1, 2008, construction in progress was comprised mostly of a conveyor project in our distribution center and expenses related to unopened stores.

Maintenance and repairs are charged to expense as incurred. The cost and accumulated depreciation of assets sold, retired or otherwise disposed of are removed from property and equipment and the related gain or loss is credited or charged to income.

Self-Insurance Accrual

We are self-insured for a significant portion of our health insurance. Liabilities associated with the risks that are retained by us are estimated, in part, by considering our historical claims. The estimated accruals for these liabilities could be affected if future occurrences and claims differ from our assumptions. To minimize our potential exposure, we carry stop-loss insurance which reimburses us for losses over $0.1 million per covered person per year or $2.0 million per year in the aggregate. As of November 1, 2008 and February 2, 2008, the accrual for these liabilities was $0.6 million and $0.5 million, respectively, and was included in accrued expenses in the unaudited condensed consolidated balance sheets.

We are also self-insured for our workers’ compensation and general liability insurance up to an established deductible with a cumulative stop loss. As of November 1, 2008 and February 2, 2008, the accrual for these liabilities (which is not discounted) was $0.3 million for both periods and was included in accrued expenses in the unaudited condensed consolidated balance sheets.

Deferred Rent

Deferred rent primarily consists of step rent and allowances from landlords related to our leased properties. Step rent represents the difference between actual operating lease payments due and straight-line rent expense, which is recorded by the Company over the term of the lease, including the build-out period. This amount is recorded as deferred rent in the early years of the lease, when cash payments are generally lower than straight-line rent expense, and reduced in the later years of the lease when payments begin to exceed the straight-line expense. Landlord allowances are generally comprised of amounts received and/or promised to us by landlords and may be received in the form of cash or free rent. We record a receivable from the landlord and a deferred rent liability when the allowances are earned. This deferred rent is amortized into income (through lower rent expense) over the term (including the pre-opening build-out period) of the applicable lease, and the receivable is reduced as amounts are received from the landlord.

On our unaudited condensed consolidated statements of cash flows, the current and long-term portions of landlord allowances are included as changes in cash flows from operations. The current portion is included as a change in accrued expenses and the long-term portion is included as a change in deferred rent, non-current. The liability for the current portion of unamortized landlord allowances was $4.0 million and $3.9 million at November 1, 2008 and February 2, 2008, respectively. The liability for the long-term portion of unamortized landlord allowances was $13.7 million and $14.6 million at November 1, 2008 and February 2, 2008, respectively. The non-cash portion of landlord allowances received is immaterial.

Revenue Recognition

We recognize revenue, including gift card and layaway sales, in accordance with the Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 101, “Revenue Recognition in Financial Statements,” as amended by SAB No. 104, “Revenue Recognition.”

Retail merchandise sales occur on-site in our retail stores. Customers have the option of paying the full purchase price of the merchandise upon sale or paying a down payment and placing the merchandise on layaway. The customer may make further payments in installments, but the entire purchase price for merchandise placed on layaway must be received by the Company within 30 days. The down payment and any installments are recorded by us as short-term deferred revenue until the customer pays the entire purchase price for the merchandise. We recognize revenue at the time the customer takes possession of the merchandise. Retail sales are recorded net of returns and discounts and exclude sales taxes.

The cost of coupon sales incentives is recognized at the time the related revenue is recognized by the Company. Proceeds received from the issuance of gift cards are initially recorded as deferred revenue. Revenue is subsequently recognized at the time the customer redeems the gift cards and takes possession of the merchandise. Unredeemed gift cards are recorded as a current liability.

It is not our policy to take unclaimed layaway deposits and unredeemed gift cards into income. As of November 1, 2008 and November 3, 2007, there was no breakage revenue recorded in income. The deferred revenue liability for layaway deposits and unredeemed gift cards was $1.9 million and $2.1 million at November 1, 2008 and February 2, 2008, respectively. Any unrecognized breakage revenue is immaterial. We escheat unredeemed gift cards to the extent required by law.

Cost of Goods Sold

We include inbound freight charges, merchandise purchases, store occupancy costs and a portion of our distribution costs related to our retail business in cost of goods sold. Outbound freight charges associated with moving merchandise to and between stores are included in store operating, selling and administrative expenses.

Store Opening and Closing Costs

New store opening costs, including pre-opening costs, are charged to expense as incurred. Store opening costs primarily include payroll expenses, training costs and straight-line rent expenses. All pre-opening costs are included in store operating, selling and administrative expenses as a part of operating expenses.

We consider individual store closings to be a normal part of operations and regularly review store performance against expectations. Costs associated with store closings are recognized at the time of closing or when a liability has been incurred.

Impairment of Long-Lived Assets

We continually evaluate whether events and circumstances have occurred that indicate the remaining balance of long-lived assets may be impaired and not recoverable. Our policy is to recognize any impairment loss on long-lived assets as a charge to current income when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Impairment is assessed considering the estimated undiscounted cash flows over the asset’s remaining life. If estimated cash flows are insufficient to recover the investment, an impairment loss is recognized based on a comparison of the cost of the asset to fair value less any costs of disposition. Evaluation of asset impairment requires significant judgment and estimates.

Advertising

We expense advertising costs when incurred. We participate in various advertising and marketing cooperative programs with our vendors, who, under these programs, reimburse us for certain costs incurred. A receivable for cooperative advertising to be reimbursed is recorded as a decrease to expense as advertisements are run.

The following table presents the components of our advertising expense (in thousands):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2008	November 3, 2007	November 1, 2008	November 3, 2007

Gross advertising costs	$ 1,118	$ 1,220	$ 5,052	$ 5,113
Advertising reimbursements	(456)	(571)	(2,936)	(3,249)
Net advertising costs	$ 662	$ 649	$ 2,116	$ 1,864

Fair Value of Financial Instruments

Effective February 3, 2008, we adopted SFAS No. 157, "Fair Value Measurements," which defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The adoption of SFAS No. 157 did not have a material impact on our consolidated financial statements.

SFAS No. 157 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level I – Quoted prices in active markets for identical assets or liabilities.
- Level II – Observable inputs other than quoted prices included in Level I, such as quoted prices for markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

- Level III – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The table below segregates all financial assets and liabilities that are measured at fair value on a recurring basis (at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value as of November 1, 2008 (in thousands).

	Level I	Level II	Level III	Total
Short-term investments	$ 279	$ -	$ -	$ 279

Financial Accounting Standard Board (FASB) Staff Position (FSP) Financial Accounting Standard (FAS) No. 157-2, "Effective Date of FASB Statement No. 157," delayed the effective date for all nonfinancial assets and liabilities until January 1, 2009, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (see Note 2 below).

In October 2008, the FASB issued FSP FAS No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," which clarifies the application of SFAS No. 157 in determining the fair value of assets and liabilities for which there is no active market or the principal market for such asset or liability is not active. This FSP was effective upon issuance and did not have a material impact on our consolidated financial statements.

2. Recent Accounting Pronouncements

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." This statement identifies the sources for U.S. generally accepted accounting principles (GAAP) and lists the categories in descending order. An entity should follow the highest category of GAAP applicable for each of its accounting transactions. SFAS No. 162 is effective 60 days following SEC approval of the Public Company Accounting Oversight Board (PCAOB) amendments to remove the hierarchy of generally accepted accounting principles from auditing standards. The SEC approved the PCAOB amendments on September 16, 2008, making SFAS No. 162 effective on November 15, 2008. The adoption of SFAS No. 162 did not have a material impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities." This statement requires companies to provide enhanced disclosures about (a) how and why they use derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and (c) how derivative instruments and related hedged items affect a company's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We do not expect the adoption of SFAS No. 161 to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations." SFAS No. 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed and any noncontrolling interest in purchased entities, measured at their fair values at the date of acquisition based upon the definition of fair value outlined in SFAS No. 157. For us, SFAS No. 141(R) is effective for acquisitions beginning on and after February 1, 2010. We do not expect the adoption of SFAS No. 141(R) to have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement 115." This statement permits companies to elect to measure certain assets and liabilities at fair value. At each reporting date subsequent to adoption, unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings. On February 3, 2008, we adopted SFAS No. 159 and elected not to use fair value measurement on any assets or liabilities under this statement.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy, as defined. SFAS No. 157 may require companies to provide additional disclosures based on that hierarchy. This statement was to be effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued FSP No. 157-2 which delayed for one year the applicability of SFAS No. 157's fair-value measurements to certain nonfinancial assets and liabilities. We adopted SFAS No. 157 as of February 3, 2008, except as it applies to those nonfinancial assets and liabilities affected by the one-year delay. The partial adoption of SFAS No. 157 did not have a material impact on our consolidated financial statements. We do not expect the adoption of the remaining provisions of SFAS No. 157 to have a material impact on our consolidated financial statements.

3. Debt

At November 1, 2008, we had two unsecured revolving credit facilities, which are renewable in December 2008 and August 2009. The facilities allow for borrowings up to $50.0 million and $30.0 million, respectively, at a fixed rate, a rate based on prime or LIBOR plus 0.375%, at our election. Under the provisions of both facilities, we do not pay commitment fees and are not subject to covenant requirements. As of November 1, 2008, we had $14.9 million of debt outstanding under these facilities all of which is short-term in nature. At February 2, 2008, we only had one credit facility that allowed borrowings up to $30.0 million. As of February 2, 2008, we had no debt outstanding under this facility.

Subsequent to November 1, 2008, we renewed our existing $50.0 million facility at a rate equal to prime plus 2%. The renewal was effective November 20, 2008 and will expire on November 20, 2009. The facility is unsecured and does not require a commitment or agency fee nor are there any covenant restrictions.

4. Stock-Based Compensation Plans

At November 1, 2008, we had four stock-based compensation plans:

(a) The 2005 Equity Incentive Plan (Incentive Plan) provides that the Board of Directors (Board) may grant equity awards to certain employees of the Company at its discretion. The Incentive Plan was adopted effective July 1, 2005 and authorizes grants of equity awards of up to 1,233,159 authorized but unissued shares of common stock. At November 1, 2008, there were 761,047 shares available for grant under the Incentive Plan.

(b) The 2005 Employee Stock Purchase Plan (ESPP) allows for qualified employees to participate in the purchase of up to 204,794 shares of our common stock at a price equal to 85% of the lower of the closing price at the beginning or end of each quarterly stock purchase period. The ESPP was adopted effective July 1, 2005. At November 1, 2008, there were 140,730 shares available for purchase under the ESPP.

(c) The 2005 Director Deferred Compensation Plan (Deferred Plan) allows non-employee directors an election to defer all or a portion of their fees into stock units or stock options. The Deferred Plan was adopted effective July 1, 2005 and authorizes grants of stock up to 112,500 authorized but unissued shares of common stock. At November 1, 2008, there were 84,583 shares available for grant under the Deferred Plan.

(d) The 2006 Non-Employee Director Equity Plan (DEP) provides for grants of equity awards to non-employee directors. The DEP was adopted effective June 1, 2006 and authorizes grants of equity awards of up to 679,891 authorized but unissued shares of common stock. At November 1, 2008, there were 609,891 shares available for grant under the DEP.

Our plans allow for a variety of equity awards including stock options, restricted stock awards, stock appreciation rights and performance awards. As of November 1, 2008, the Company had only granted awards in the form of stock options, restricted stock units (RSUs) and performance-based awards (PSAs). RSUs and options to purchase our common stock have been granted to officers, directors and key employees. Beginning with the adoption of the Incentive Plan, a greater proportion of the awards granted to employees, including executive employees, have been RSUs as opposed to stock options when compared to grants made in prior years. The annual grant made for Fiscal 2009 and Fiscal 2008 to employees consisted solely of RSUs. We also have awarded PSAs to our named executive officers and expect the Board will continue to grant PSAs to key employees in the future. The terms and vesting schedules for stock-based awards vary by type of grant and generally vest upon time-based conditions. Upon exercise, stock-based compensation awards are settled with authorized but unissued Company stock. On May 30, 2008, the Compensation Committee of the Board awarded a grant of 19,900 non-qualified stock options to our Chief Executive Officer that vest equally over four years and have an eight year life.

The compensation costs that have been charged against income for these plans were as follows for the thirteen and thirty-nine weeks ended November 1, 2008 and November 3, 2007 (in thousands):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2008	November 3, 2007	November 1, 2008	November 3, 2007
Stock-based compensation expense by type:				
Stock options	$ 315	$ 389	$ 1,658	$ 1,682
Restricted stock awards	255	294	967	1,377
Employee stock purchase	28	22	72	75
Director deferred compensation	-	7	10	25
Total stock-based compensation expense	598	712	2,707	3,159
Tax benefit recognized	138	166	704	819
Stock-based compensation expense, net of tax	$ 460	$ 546	$ 2,003	$ 2,340

Share-based and deferred stock compensation expenses have been included in store operating, selling and administrative expenses. There is no capitalized stock-based compensation cost.

The tax benefit recognized in our consolidated financial statements, as disclosed above, is based on the amount of compensation expense recorded for book purposes. The actual tax benefit realized in our tax return is based on the intrinsic value, or the excess of the market value over the exercise or purchase price, of stock options exercised and restricted stock awards vested during the period. The actual tax benefit realized for the deductions considered on our tax returns through November 1, 2008 and November 3, 2007 was from option exercises and totaled $0.6 million for both periods.

Stock Options

Stock options are granted with an exercise price equal to the closing market price of our common stock on the date of grant. During the period between July 2005 and December 2006, stock options were granted with an exercise price equal to the closing market price of our common stock on the last trading day preceding the date of grant. Vesting and expiration provisions vary between equity plans. Grants awarded to employees under the 1996 Plan, as amended, vest over a five-year period in equal installments beginning on the first anniversary of the grant date and expire on the tenth anniversary of the date of grant. Grants awarded to employees under the Incentive Plan vest over a four-year period in equal installments beginning on the first anniversary of the grant date and expire on the eighth anniversary of the date of grant with the exception of a grant made on August 18, 2005, whose provisions provided for the five-year vesting schedule and ten-year term described in the 1996 Plan. Grants awarded to outside directors under both the DEP and Deferred Plan, vest immediately upon grant and expire on the tenth anniversary of the date of grant.

Following is the weighted average fair value of each option granted during the thirty-nine weeks ended November 1, 2008. The fair value was estimated on the date of grant using the Black-Scholes pricing model with the following weighted average assumptions for each period:

	Thirty-Nine Weeks Ended November 1, 2008					
Grant date	3/14/08	3/18/08	3/31/08	5/30/08	6/30/08	9/30/08
Weighted average fair value at date of grant	$5.92	$6.36	$6.67	$10.03	$9.18	$9.24
Expected option life (years)	4.20	4.20	4.20	5.07	4.20	4.76
Expected volatility	50.61%	50.89%	51.68%	50.18%	50.38%	51.54
Risk-free interest rate	2.12%	2.19%	2.27%	3.39%	3.14%	2.60%
Dividend yield	None	None	None	None	None	None

We calculate the expected term for our stock options based on historical employee exercise behavior. Historically, an increase in our stock price has led to a pattern of earlier exercise by employees. We also expected the reduction of the contractual term from 10 years to 8 years to facilitate a pattern of earlier exercise by employees and to contribute to a gradual decline in the average expected term in future periods. For the last two years, the Compensation Committee has primarily awarded RSUs rather than options to our employees. With the absence of substantial new grants, the expected term may increase slightly because it will be affected to a greater extent by director options which have a longer contractual life.

The volatility used to value stock options is based on historical volatility. We calculate historical volatility using an average calculation methodology based on daily price intervals as measured over the expected term of the option. We have consistently applied this methodology since our adoption of the original disclosure provisions of SFAS No. 123, “Accounting for Share-Based Compensation.”

Beginning with awards granted in the second quarter of Fiscal 2008, we base the risk-free interest rate on the annual continuously compounded risk-free rate with a term equal to the option's expected term. Previously, we used the market yield on U.S. Treasury securities. While the difference between the two rates is minimal and has only a slight effect on the fair value calculation, we believe using the annual continuously compounded risk-free rate is more compliant with SFAS No. 123R, "Share-Based Payments." The dividend yield is assumed to be zero since we have no current plan to declare dividends.

Activity for our option plans during the thirty-nine weeks ended November 1, 2008 was as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value ($000's)
Options outstanding at February 2, 2008	1,283,758	$ 15.89		$ 7,559
Granted	69,963	16.65		
Exercised	(81,320)	7.91		
Forfeited, cancelled or expired	(3,725)	24.98		
Options outstanding at November 1, 2008	1,268,676	$ 16.41	5.29	$ 5,728
Exercisable at November 1, 2008	1,015,299	$ 14.68	5.11	$ 5,566

The weighted average grant fair value of options granted during the thirteen weeks ended November 1, 2008 and November 3, 2007 was $9.24 and $9.56, respectively. The compensation expense included in store operating, selling and administrative expenses and recognized during the thirteen weeks ended November 1, 2008 and November 3, 2007 was $0.3 million and $0.4 million, respectively, before the recognized income tax benefit of $42,000 and $50,000, respectively.

The weighted average grant fair value of options granted during the thirty-nine weeks ended November 1, 2008 and November 3, 2007 was $7.42 and $10.50, respectively. The compensation expense included in store operating, selling and administrative expenses and recognized during the thirty-nine weeks ended November 1, 2008 and November 3, 2007 was $1.7 million for both periods, before the recognized income tax benefit of $0.3 million for both periods.

The total intrinsic value of stock options exercised during the thirteen weeks ended November 1, 2008 and November 3, 2007 was $0.9 million and $0.1 million, respectively. The intrinsic value of stock options is defined as the difference between the current market value and the grant price. The total cash received from these stock option exercises during the thirteen weeks ended November 1, 2008 and November 3, 2007 was $0.5 million and $0.1 million, respectively.

The total intrinsic value of stock options exercised during the thirty-nine weeks ended November 1, 2008 and November 3, 2007 was $1.2 million and $1.8 million, respectively. The total cash received from these stock option exercises during the thirty-nine weeks ended November 1, 2008 and November 3, 2007 was $0.6 million and $0.9 million, respectively. Excess tax benefits from stock option exercises are included in cash flows from financing activities as required by SFAS No. 123R. As of November 1, 2008, there was $1.6 million of unrecognized compensation cost related to nonvested stock options. This cost is expected to be recognized over a weighted-average period of 1.36 years.

Restricted Stock Awards

Restricted stock awards are granted with a fair value equal to the closing market price of our common stock on the date of grant with the exception of those granted between August 2005 and December 2006 which were granted with a fair value equal to the closing market price of our common stock on the last trading day preceding the date of grant. Compensation expense is recorded straight-line over the vesting period. Restricted stock awards cliff vest in four to five years from the date of grant for those awards that are not performance-based. Performance-based restricted stock awards cliff vest in one to five years from the date of grant after achievement of stated performance criterion and upon meeting service conditions.

The following table summarizes the restricted stock awards activity under all of our plans during the thirty-nine weeks ended November 1, 2008:

	Number of Awards	Weighted-Average Grant Date Fair Value
Restricted stock awards outstanding at February 2, 2008	143,046	$ 29.28
Granted	230,255	15.11
Vested	(24,900)	32.37
Forfeited, cancelled or expired	(34,199)	17.19
Restricted stock awards outstanding at November 1, 2008	314,202	$ 19.96

There were no restricted stock awards granted during the thirteen weeks ended November 1, 2008 and November 3, 2007. The weighted-average grant date fair value of our RSUs granted was $15.11 and $28.30 for the thirty-nine weeks ended November 1, 2008 and November 3, 2007, respectively. The compensation expense included in store operating, selling and administrative expenses and recognized during the comparable thirteen week periods was $0.3 million for both periods, before the recognized income tax benefit of $0.1 million for both periods. The compensation expense included in store operating, selling and administrative expenses and recognized during the comparable thirty-nine week periods was $1.0 million and $1.4 million, respectively, before the recognized income tax benefit of $0.4 million and $0.5 million, respectively.

There were no restricted stock awards that vested during the current thirteen week period. There was one restricted stock award of 24,900 units that vested during the current thirty-nine week period with an intrinsic value of $0.4 million. No restricted stock awards vested during the comparable period in the prior year. The total intrinsic value of our restricted stock awards outstanding and unvested at November 1, 2008 and November 3, 2007 was $5.6 million and $4.3 million, respectively. As of November 1, 2008, there was approximately $4.1 million of total unrecognized compensation cost related to restricted stock awards. This cost is expected to be recognized over a weighted-average period of 2.94 years.

Employee Stock Purchase Plan

The Company's ESPP allows eligible employees the right to purchase shares of our common stock, subject to certain limitations, at 85% of the lesser of the fair market value at the end of each calendar quarter (purchase date) or the beginning of each calendar quarter. Our employees purchased 4,857 shares of common stock at $17.02 per share through the ESPP during the thirteen weeks ended November 1, 2008. Our employees purchased 18,798 shares of common stock at an average price of $14.37 during the thirty-nine weeks ended November 1, 2008. During the thirteen weeks ended November 3, 2007, our employees purchased 4,304 shares of common stock at $21.08 per share through the ESPP. Our employees purchased 13,221 shares of common stock at an average price of $22.95 during the thirty-nine weeks ended November 3, 2007.

The assumptions used in the option pricing model for the thirteen and thirty-nine weeks ended November 1, 2008 and November 3, 2007 were as follows:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2008	November 3, 2007	November 1, 2008	November 3, 2007
Weighted average fair value at date of grant	$4.82	$5.57	$4.26	$6.07
Expected life (years)	0.25	0.25	0.25	0.25
Expected volatility	50.3%	36.3%	48.0%-50.8%	36.3%-41.8%
Risk-free interest rate	1.88%	4.75%	1.28%-3.06%	4.75%-5.08%
Dividend yield	None	None	None	None

The expense related to the ESPP was determined using the Black-Scholes option pricing model and the provisions of FASB Technical Bulletin (FTB) No. 97-1, "Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option," as amended by SFAS No. 123R. The compensation expense included in store operating, selling and administrative expenses and recognized during the thirteen weeks ended November 1, 2008 and November 3, 2007 was approximately $28,000 and $22,000, respectively. The compensation expense included in store operating, selling and administrative expenses and recognized during the thirty-nine weeks ended November 1, 2008 and November 3, 2007 was approximately $72,000 and $75,000, respectively.

Director Deferred Compensation

Under the Deferred Plan, outside non-employee directors can elect to defer all or a portion of their Board and Board committee fees into cash, stock options or deferred stock units. Those fees deferred into stock options are subject to the same provisions as provided for in the DEP and are expensed and accounted for accordingly. Director fees deferred into our common stock are calculated and expensed each calendar quarter by taking total fees earned during the calendar quarter and dividing by the closing price on the last day of the calendar quarter, rounded to the nearest whole share. The total annual retainer, Board and Board committee fees for non-employee directors that are not deferred into stock options, but which includes amounts deferred into stock units under the Deferred Plan, are expensed as incurred in all periods presented. &#16