SHOE PAVILION INC
Form 10-Q
November 13, 2001

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 September 29, 2001

OR

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

For the transition period from __________ to __________

Commission File Number 0-23669

SHOE PAVILION, INC.
(Exact name of Registrant as Specified in its Charter)

Delaware	94-3289691
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

3200-F Regatta Boulevard, Richmond, California 94804
(Address of principal executive offices) (Zip Code)

(510) 970-9775
(Registrant's telephone number, including area code)

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

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

As of October 31, 2001 the Registrant had 6,800,000 shares of Common Stock outstanding.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995 which provides a "safe harbor" for these types of statements. These forward-looking statements are subject to risks and uncertainties that could cause the Company's actual results to differ materially from management's current expectations. These factors include, without limitation, change in the trend of same store sales, competitive pressures in the footwear industry, changes in the level of consumer spending on or preferences in footwear merchandise, economic and other factors affecting the retail market conditions, including the events of September 11, 2001 and uncertainties related to the ongoing conflict, the Company's ability to purchase attractive name brand merchandise at desirable discounts and the availability of desirable store locations as well as management's ability to negotiate acceptable lease terms, and maintain supplier and business relationships including the license agreement with Gordmans Inc. and open new stores in a timely manner. Other risk factors are detailed in the Company's filings with the Securities and Exchange Commission. The Company assumes no obligation to update forward-looking statements.

SHOE PAVILION, INC.
INDEX TO FORM 10-Q

PART I
FINANCIAL INFORMATION

PART I
FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

The following financial statements and related financial information are filed as part of this report:

Shoe Pavilion, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)

(In thousands, except share data)		September 29, 2001
ASSETS		
Current assets		
Cash	$	594
Accounts receivable		313
Inventories		33,222
Prepaid expenses and other		1,072
Total current assets		35,201
Property and equipment, net		4,655
Other assets		970
Total assets	$	40,826
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$	8,456
Accrued expenses		1,840
Current portion of capital lease obligations		50
Total current liabilities		10,346
Long-term debt		7,350
Deferred rent		1,767
Total liabilities		19,463
Stockholders' equity		
Preferred stock- $.001 par value; 1,000,000 shares authorized; no shares issued or outstanding		-
Common stock- $.001 par value; 15,000,000 shares authorized; 6,800,000 issued and outstanding		7
Additional paid-in capital		13,967
Retained earnings		7,389
Total stockholders' equity		21,363
Total liabilities and stockholders' equity	$	40,826

See notes to condensed consolidated financial statements.

Shoe Pavilion, Inc.
Condensed Consolidated Statements of Income
(Unaudited)

(In thousands, except per share amounts and number of stores)

	Thirteen weeks ended		
	September 29, 2001	September 30, 2000	S
Net sales	$ 21,304	$ 23,148	$
Cost of sales and related occupancy expenses	14,886	15,527	
Gross profit	6,418	7,621	
Selling, general and administrative expenses	5,953	6,602	
Income from operations	465	1,019	
Interest expense	123	349	
Other expense (income)	(40)	28	
Income before taxes	382	642	
Income tax provision	153	253	
Net income	$ 229	$ 389	$
Earnings per share:			
Basic	$ 0.03	$ 0.06	$
Diluted	$ 0.03	$ 0.06	$
Weighted average shares outstanding:			
Basic	6,800	6,800	
Diluted	6,800	6,845	
Stores operated at end of period			

See notes to condensed consolidated financial statements.

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Shoe Pavilion, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

(In thousands)

	Thirty-nine weeks ended	
	September 29, 2001	Septembe
Operating activities:		
Net income	$ 1,146	$
Adjustments to reconcile net income to net cash provided (used) by operating activities		
Depreciation and amortization	1,151	
Loss on disposal of fixed assets	1	
Effect of changes in:		
Inventories	4,965	(1
Accounts receivables	427	
Prepaid expenses and other	(152)	
Accounts payable	(294)	

Accrued expenses	(187)	
Deferred rent	(117)	
Net cash provided (used) by operating activities	6,940	(
Investing activity-		
Purchase of property and equipment	(523)	
Financing activities:		
Proceeds from (payments on) line of credit, net	(6,625)	
Principal payments on capital leases	(12)	
Net cash provided (used) by financing activities	(6,637)	
Net decrease in cash	(220)	
Cash, beginning of period	814	
Cash, end of period	$ 594	$

See notes to condensed consolidated financial statements.

Shoe Pavilion, Inc.

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

General - The accompanying unaudited condensed consolidated financial statements have been prepared from the records of Shoe Pavilion, Inc. (the "Company") without audit, and in the opinion of management, include all adjustments necessary to present fairly the financial position of the Company and the results of its operations and its cash flows for the periods presented. The balance sheet as of December 30, 2000 presented herein has been derived from the audited financial statements of the Company as of December 30, 2000.

Accounting policies followed by the Company are described in Note 2 to the audited consolidated financial statements for the year ended December 30, 2000. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted for purposes of the condensed consolidated interim financial statements. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements, including the notes thereto, for the year ended December 30, 2000 on Form 10-K.

The results of operations for the thirteen weeks and thirty-nine weeks ended September 29, 2001 presented herein are not necessarily indicative of the results to be expected for the full year.

Comprehensive Income and net income are the same.

2. Recently Issued Accounting Standards

On December 31, 2000 the Company adopted Statement of Financial Accounting

Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS 137 and SFAS 138. SFAS 133 requires all derivative financial instruments to be recognized on the balance sheet at fair value. The effect of adopting SFAS 133 was immaterial.

The Company has minimal purchases outside of the United States that involve foreign currencies and, therefore, has only minimal exposure to foreign currency exchange risks. The Company does not typically hedge against foreign currency risks and believes that foreign currency exchange risk is insignificant.

At September 29, 2001 the Company had a foreign exchange contract outstanding to hedge certain purchases in Euro Dollars. The purpose of the Company's foreign currency hedging activities is to protect the Company from the risk that the eventual dollar net cash outflow resulting from inventory purchases will be affected by changes in exchange rates. As of September 29, 2001 the notional amount and fair value of the Company's foreign exchange contract in U.S. dollars were $500,000 and $28,203, respectively.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations and SFAS No.142, Goodwill and Other Intangible Assets. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for under the purchase method and addresses the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. SFAS No. 142 addresses the initial recognition and measurement of intangible assets acquired outside of a business combination and the accounting for goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 provides that intangible assets with finite useful lives be amortized and that goodwill and intangible assets with indefinite lives will not be amortized, but will rather be tested at least annually for impairment. The Company will adopt SFAS No. 142 for its fiscal year beginning December 30, 2001 and is currently evaluating the provisions of the new standards and assessing their potential impact, if any, on the Company's financial position and results of operations.

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

Overview

Shoe Pavilion is the largest independent off-price footwear retailer on the West Coast that offers a broad selection of women's and men's designer label and name brand merchandise. As of September 29, 2001, the Company operated 80 retail stores in California, Washington and Oregon and 38 licensed shoe departments in Colorado, Illinois, Iowa, Kansas, Missouri, Nebraska, North Dakota, Oklahoma and South Dakota.

The Company operates and manages the 38 shoe departments pursuant to a licensing agreement entered into in July 1999 with Gordmans, Inc., a Midwestern department store chain. The initial term of the agreement shall expire, unless terminated sooner as provided by the agreement, on June 29, 2002. Upon the expiration of the initial term, the agreement shall automatically renew for an additional term of three years, expiring on July 2, 2005, unless either the Company or Gordmans gives the other party written notice on or before January 1, 2002, that they do not intend to renew the agreement.

Results of Operations

Net sales for the thirteen weeks ended September 29, 2001 decreased 8.0% to $21.3 million, from net sales of $23.1 million for the same period last year. Net sales for the thirty-nine weeks ended September 29, 2001 decreased 4.7% to $64.3 million, from net sales of $67.4 million for the same period last year. The decrease in net sales for these periods is principally attributable to the decline in comparable store net sales of 9.3% or $1.9 million and 6.7% or $3.9 million for the thirteen weeks and thirty-nine weeks ended September 29, 2001, respectively. These decreases were partially offset by the increase in new store net sales.

Gross profit for the thirteen weeks ended September 29, 2001 decreased 15.8% to $6.4 million from gross profit of $7.6 million for the same period last year. Gross profit as a percentage of net sales decreased to 30.1% for the thirteen weeks ended September 29, 2001 from 32.9% for the same period last year. For the thirty-nine weeks ended September 29, 2001 gross profit decreased 10.5% to $19.9 million, from gross profit of $22.3 million for the comparable period last year. Gross profit as a percentage of net sales decreased to 31.0% for the thirty-nine weeks ended September 29, 2001 from 33.0% for the comparable period last year. The decrease in gross profit as a percentage of net sales for the thirteen weeks and thirty-nine weeks ended September 29, 2001 is principally attributable to an increase in occupancy costs coupled with the decrease in net sales.

Selling, general and administrative expenses for the thirteen weeks ended September 29, 2001 decreased by $649,000 or 9.8% compared to the same period last year, and decreased as a percentage of net sales to 27.9% from 28.5% for the same period last year. For the thirty-nine weeks ended September 29, 2001, selling, general and administrative expenses decreased by $1.1 million or 5.8% compared to the same period last year, and decreased as a percentage of net sales to 27.1% from 27.5% for the same period last year. The decrease in selling, general and administrative expenses for the thirteen weeks ended September 29, 2001 is principally due to the reduction in advertising expense. The decrease in selling, general and administrative expenses for the thirty-nine weeks ended September 29, 2001 is principally due to the reduction in advertising and freight expense. These decreases during the thirty-nine weeks ended September 29, 2001 were partially offset by an increase in sales payroll.

Interest expense decreased 64.8% to $123,000 for the thirteen weeks ended September 29, 2001 from $349,000 for the comparable period in 2000. This decrease was attributable to reduced average borrowings and a lower average interest rate on the Company's revolving line of credit. For the thirty-nine weeks ended September 29, 2001 interest expense decreased 19.0% to $625,000 from $772,000 for the comparable period

in 2000. The decrease was principally attributable to a lower average interest rate on borrowings on the Company's revolving line of credit.

The effective income tax rate increased slightly to 40.0% for the thirty-nine weeks ended September 29, 2001 from 39.5% for the same period last year. The increase resulted from higher state income taxes.

Liquidity and Capital Resources

The Company has historically funded its cash requirements primarily through cash flows from operations and borrowings under its credit facility. Net cash provided by operating activities during the thirty-nine weeks ended September 29, 2001 totaled $6.9 million and was primarily generated from a reduction in inventory. Merchandise inventory decreased $5.0 million to $33.2 million at September 29, 2001 from $38.2 million at December 30, 2000. This decrease in inventory is the result of the Company's efforts to improve liquidity. Net cash used by financing activities for the thirty-nine weeks ended September 29, 2001 totaled $6.6 million consisting principally of net payments on the Company's line of credit. Working capital decreased to $24.9 million at September 29, 2001 from $29.9 million at December 30, 2000.

Capital expenditures for the thirty-nine weeks ended September 29, 2001 were $523,000. These expenditures were principally related to the build-out of four new stores and two leased departments and the purchase of fixtures for the remodeling of existing stores. During the remainder of the Company's fiscal year 2001, the Company anticipates that cash will be used primarily to acquire merchandise inventory, and to a lesser degree, for capital expenditures.

The Company has a credit facility agreement with a commercial bank, which includes a revolving line of credit for $20.0 million. On June 1, 2001 the commercial bank extended the maturity date of the revolver to June 1, 2003. As of September 29, 2001, the unused and available portion of the credit facility was approximately $8.3 million.

The Company believes that operating cash flow and borrowings under its credit facility will satisfy its cash requirements for at least the next 12 months.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no material changes from the information reported in the Company's Form 10-K for the year ended December 30, 2000.

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PART II
OTHER INFORMATION

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

None.

Item 6. Exhibits and Reports on Form 8-k.

(a) Exhibits required to be filed by Item 601 of Regulation S-K:

10.18 First Amendment to Credit Agreement between Shoe Pavilion Corporation and Wells Fargo Bank, National Association dated June 1, 2001

10.19 Second Amendment to Credit Agreement between Shoe Pavilion Corporation and Wells Fargo Bank, National Association dated September 1, 2001

(b) Reports on Form 8-K filed during the quarter ended September 29, 2001:

None.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on the 9th day of November 2001.

SHOE PAVILION, INC., as Registrant

By /s/ Dmitry Beinus

Dmitry Beinus
Chairman and Chief Executive Officer

By /s/ John D. Hellmann

John D. Hellmann
Vice President and Chief Financial Officer

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INDEX TO EXHIBITS

Exhibit Number	Description
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