ACCREDITED HOME LENDERS HOLDING CO
Form 10-Q
November 09, 2005

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 September 30, 2005

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 0-50179

ACCREDITED HOME LENDERS HOLDING CO.

(Exact name of registrant as specified in its charter)

Delaware	**04-3669482**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

15090 Avenue of Science

San Diego, California 92128

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: 858-676-2100

Former name, former address and former fiscal year, if changed since last report: Not applicable.

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 or No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x or No ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ or No x

The number of outstanding shares of the registrant s common stock as of November 4, 2005 was 21,920,446.

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FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements. When used in this report, statements which are not historical in nature, including the words anticipate, estimate, should, expect, believe, intend and similar expressions are intended to identify forward-looking statements. Th include statements containing a projection of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

The forward-looking statements in this report are based upon our management s beliefs, assumptions and expectations of our future operations and economic performance, taking into account the information currently available to them. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties, some of which are not currently known to us, that may cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements. Some of the important factors that could cause our actual results, performance or financial condition to differ materially from expectations are:

- the degree and nature of our competition;
- a general deterioration in economic or political conditions;
- changes in demand for, or value of, mortgage loans due to the attributes of the loans we originate; the characteristics of our borrowers; and fluctuations in the real estate market, interest rates or the market in which we sell or securitize
- our ability to protect and hedge our mortgage loan portfolio against adverse interest rate movements;
- changes in government regulations that affect our ability to originate and service mortgage loans;
- changes in the credit markets, which affect our ability to borrow money to originate mortgage loans;
- our ability to employ and retain qualified employees; and
- the other factors referenced in this report, including, without limitation, under the section entitled ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur. We qualify any and all of our forward-looking statements entirely by these cautionary factors.

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In this Form 10-Q, unless the context requires otherwise, Accredited, Company, we, our, and us means Accredited Home Lenders Holding C and its subsidiaries.

PART I

ITEM 1. Financial Statements

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except par value)

	September 30, 2005 (unaudited)	December 31, 2004
ASSETS		
Cash and cash equivalents	$ 21,525	$ 35,155
Restricted cash	139,285	4,589
Mortgage loans held for sale, net of reserve of $20,734 and $17,065, respectively	2,349,385	1,790,134
Mortgage loans held for investment, net of reserve of $95,728 and $60,138 respectively	6,581,439	4,690,758
Furniture, fixtures and equipment, net	35,798	34,763
Other receivables	98,426	57,658
Deferred income tax asset, net		34,250
Prepaid expenses and other assets	65,791	41,070
Total assets	$ 9,291,649	$ 6,688,377
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Warehouse credit facilities	$ 2,074,994	$ 2,204,860
Asset backed commercial paper	985,348	
Securitization bond financing	5,550,348	3,954,115
Income taxes payable, current	20,879	22,310
Deferred income tax liability, net	2,204	
Accounts payable and accrued liabilities	59,113	46,615
Total liabilities	8,692,886	6,227,900
COMMITMENTS AND CONTINGENCIES (Note 13)		
MINORITY INTEREST IN SUBSIDIARY	97,922	97,922

STOCKHOLDERS EQUITY:		
Preferred stock, $.001 par value; authorized 5,000,000 shares; no shares issued or outstanding		
Common stock, $.001 par value; authorized 40,000,000 shares; issued and outstanding 21,914,686 shares and 21,379,690 shares, respectively (including 771,885 and 585,545, respectively, of restricted stock awarded under the deferred compensation plan)	22	21
Additional paid-in capital	101,598	84,281
Unearned compensation	(17,329)	(12,058)
Accumulated other comprehensive income	16,130	2,042
Retained earnings	400,420	288,269
Total stockholders equity	500,841	362,555
Total liabilities and stockholders equity	$ 9,291,649	$ 6,688,377

The accompanying notes are an integral part of these consolidated financial statements.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
REVENUES:				
Interest income	$ 164,147	$ 97,493	$ 430,194	$ 242,792
Interest expense	(84,571)	(37,114)	(207,022)	(86,137)
Net interest income	79,576	60,379	223,172	156,655
Provision for losses	(19,168)	(14,416)	(56,465)	(39,708)
Net interest income after provision	60,408	45,963	166,707	116,947
Gain on sale of loans	85,644	77,993	237,886	210,342
Loan servicing income	3,243	1,996	8,082	5,205
Other income	2,461	690	5,800	2,606
Total net revenues	151,756	126,642	418,475	335,100
OPERATING EXPENSES:				
Salaries, wages and benefits	48,378	42,772	140,501	117,885
General and administrative expenses	15,441	12,298	41,019	32,929
Occupancy	5,247	4,810	15,694	13,341
Advertising and promotion	5,388	3,580	13,480	9,073
Depreciation and amortization	3,999	2,911	10,929	6,934
Total operating expenses	78,453	66,371	221,623	180,162
Income before income taxes and minority interest	73,303	60,271	196,852	154,938
Income tax provision	29,517	23,234	77,217	61,101
Minority interest dividends on preferred stock of subsidiary	2,495	1,160	7,484	1,160
Net income	$ 41,291	$ 35,877	$ 112,151	$ 92,677
Earnings per common share:				
Basic	$ 1.95	$ 1.75	$ 5.34	$ 4.57
Diluted	$ 1.87	$ 1.66	$ 5.11	$ 4.31
Weighted average shares outstanding:				
Basic	21,217	20,470	21,017	20,287
Diluted	22,059	21,580	21,932	21,516

The accompanying notes are an integral part of these consolidated financial statements

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)(Unaudited)

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 112,151	$ 92,677
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	10,929	6,934
Provision for losses	56,465	39,708
Minority interest dividends paid on preferred stock of subsidiary	7,484	1,160
Deferred income tax provision (benefit)	29,042	(1,162)
Unrealized loss (gain) on risk derivatives	7,032	(16,910)
Adjustment into earnings for gain on derivatives from other comprehensive income	(10,029)	
Amortization of deferred costs	2,344	4,278
Changes in operating assets and liabilities:		
Restricted cash	(134,696)	(5,481)
Mortgage loans held for sale originated, net of fees	(11,870,478)	(8,982,452)
Cost of loans sold, net of fees	7,850,953	5,789,582
Principal payments received on loans held for sale	98,718	52,405
Other receivables	(45,928)	(15,659)
Prepaid expenses and other assets	29,467	(21,573)
Income taxes payable	2,311	2,676
Accounts payable and accrued liabilities	9,549	3,691
Net cash used in operating activities	(3,844,686)	(3,050,126)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal payments received on loans held for investment	1,403,442	581,562
Capital expenditures	(12,132)	(18,952)
Net cash provided by investing activities	1,391,310	562,610
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from warehouse credit facilities	(129,866)	896,220
Net proceeds from issuance of asset backed commercial paper	985,348	
Proceeds from issuance of securitization bond financing, net of fees	3,003,173	2,167,569
Payments on securitization bond financing	(1,417,245)	(616,071)
Payments on capital leases		(12)
Proceeds from sale of common stock through employee stock plans	4,354	3,226
Proceeds from preferred stock offering of consolidated subsidiary		84,094
Payment by consolidated subsidiary of preferred stock dividends	(7,484)	(1,160)
Net cash provided by financing activities	2,438,280	2,533,866

Effect of exchange rate changes on cash	1,466	
Net (decrease) increase in cash and cash equivalents	(13,630)	46,350
Beginning balance, cash and cash equivalents	35,155	27,119
Ending balance, cash and cash equivalents	$ 21,525	$ 73,469
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 212,664	$ 74,772
Income taxes	$ 45,864	$ 78,194
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of mortgage loans held for sale to mortgage loans held for investment	$ 3,233,710	$ 2,570,380
Transfer of mortgage loans held for sale to real estate owned, net of reserve, included in other assets	$ 12,318	$ 4,721
Transfer of mortgage loans held for investment to real estate owned, net of reserve, included in other assets	$ 5,537	$

The accompanying notes are an integral part of these consolidated financial statements.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements include the accounts of Accredited Home Lenders Holding Co. (AHLHC), a Delaware corporation, its wholly owned subsidiaries, Accredited Home Lenders, Inc. (AHL) and Accredited Home Lenders Canada, Inc., and AHL s subsidiary Accredited Mortgage Loan REIT Trust (the REIT) (collectively referred to as Accredited).

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. All intercompany balances and transactions are eliminated in consolidation. The unaudited consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in AHLHC s Annual Report on Form 10-K for the year ended December 31, 2004.

Accredited engages in the business of originating, financing, securitizing, servicing and selling non-prime mortgage loans secured by residential real estate. Accredited focuses on borrowers who may not meet conforming underwriting guidelines because of higher loan-to-value ratios, the nature or absence of income documentation, limited credit histories, high levels of consumer debt, or past credit difficulties. Accredited originates loans primarily based upon the borrower s willingness and ability to repay the loan and the adequacy of the collateral.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates and assumptions included in our consolidated financial statements relate to the provision for loan losses, hedging policies and income taxes.

Cash and Cash Equivalents

For purposes of financial statement presentation, Accredited considers all liquid investments with an original maturity of three months or less to be cash equivalents. All liquid assets with an original maturity of three months or less which are not readily available for use, including cash deposits, are classified as restricted cash.

Mortgage Banking Activities

Accredited originates, finances, securitizes, services and sells mortgage loans secured by residential real estate. Accredited recognizes interest income on loans held for sale and investment from the time that it originates the loan until the time the loans are sold. Interest income is also recognized over the life of the loans that Accredited has securitized in structures that require financing treatment. Gains on sale of loans are

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

recognized upon the sale of loans for a premium to various third-party investors under purchase and sale agreements. Loan sales may be either on a servicing retained or released basis. Loan servicing income represents fees from interim servicing for whole loan buyers, and ancillary servicing revenue for loans that Accredited securitizes net of external servicing costs and amortization of mortgage servicing rights. We do not recognize loan servicing income on our mortgage loans held for investment.

In the ordinary course of business, an investor may request that Accredited refund a portion of the premium paid on the sale of mortgage loans if a loan is prepaid in full within a certain amount of time from the date of sale. Accredited records a reserve for estimated premium recapture on loans sold, which is charged to gain on sale of loans.

Mortgage Loans Held for Sale

Mortgage loans held for sale are carried at the lower of aggregate cost (including hedge basis adjustments) or market. Market is determined by current investor commitments or, in the absence of such commitments, upon current investor commitments for loans of similar credit quality. Market valuation reserves have been provided on certain non-performing loans and other loans held for sale based upon Accredited s estimate of probable losses, generally based on Accredited s loss history for such loans. Valuation adjustments are charged against operations.

Gains or losses resulting from loan sales are recognized at the time of sale, based on the difference between the net sales proceeds and the book value of the loans sold. During the three months ended September 30, 2005 and 2004, Accredited sold $3.0 billion and $2.3 billion, respectively, of loans with mortgage servicing rights released. During the nine months ended September 30, 2005 and 2004, Accredited sold $7.9 billion and $5.8 billion, respectively, of loans with mortgage servicing rights released.

Mortgage Loans Held for Investment and Securitization Bond Financing

Mortgage loans held for investment include loans that Accredited has securitized in structures that require financing treatment as well as mortgage loans held for a scheduled securitization. During each of the three-month periods ended September 30, 2005 and 2004, Accredited completed one securitization of mortgage loans totaling $1.1 billion and $1.0 billion, respectively, that were structured as financings under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125*. During each of the nine-month periods ended September 30, 2005 and 2004, Accredited completed securitizations of mortgage loans totaling $3.0 billion and $2.2, respectively, that were structured as financings for accounting purposes.

These securitizations are structured legally as sales, but for accounting purposes are treated as financings under SFAS No. 140. These securitizations do not meet the qualifying special purpose entity criteria under SFAS No. 140 and related interpretations because after the loans are securitized, the securitization trusts may acquire derivatives relating to beneficial interests retained by Accredited and, Accredited, as servicer, subject to applicable contractual provisions, has discretion, consistent with prudent mortgage servicing practices, to determine whether to sell or work out any loans securitized through the securitization trusts that become troubled. Accordingly, the loans remain on the balance sheet as loans held for investment , retained interests are not created, and securitization bond financing replaces the warehouse debt or asset backed commercial paper originally associated with the loans held for investment. Accredited records interest income on loans held for investment and interest expense on the bonds issued in the securitizations over the life of the securitizations. Deferred debt issuance costs and discounts related to the bonds are amortized on a level yield basis over the estimated life of the bonds.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Accredited periodically evaluates the need for or the adequacy of the allowance for loan losses on its loans held for investment. Provision for loan losses on loans held for investment is made in an amount sufficient to maintain credit loss allowances at a level considered appropriate to cover probable losses in the portfolio. Accredited defines a loan as non-accruing at the time the loan becomes 90 days or more delinquent under its payment terms. Probable losses are determined based on segmenting the portfolio relating to their contractual delinquency status and applying Accredited s historical loss experience. Accredited also uses other analytical tools to determine the reasonableness of the allowance for loan losses. Loss estimates are reviewed periodically and adjustments are reported in earnings. As these estimates are influenced by factors outside of Accredited s control, there is uncertainty inherent in these estimates, making it reasonably possible that they could change. Carrying values are written down to fair value when the loan is foreclosed upon or deemed uncollectible.

Derivative Financial Instruments

As part of Accredited s interest rate management process, Accredited uses derivative financial instruments such as futures contracts, options contracts, interest rate swap and interest rate cap agreements. It is not Accredited s policy to use derivatives to speculate on interest rates. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, derivative financial instruments are reported on the consolidated balance sheets at their fair value.

Fair Value Hedges

Accredited designates certain derivative financial instruments as hedge instruments under SFAS No. 133, and at trade date, these instruments and their hedging relationship are identified, designated and documented. For derivative financial instruments designated as hedge instruments, Accredited evaluates the effectiveness of these hedges against the mortgage loans being hedged to ensure that there remains adequate correlation in the hedge relationship. To hedge the effect of interest rate changes on the fair value of mortgage loans held for sale or securitization, Accredited uses derivatives as fair value hedges under SFAS No. 133. Once the hedge relationship is established, the realized and unrealized changes in fair value of both the hedge instrument and mortgage loans are recognized in the period in which the changes occur. Any change in the fair value of mortgage loans held for sale recognized as a result of hedge accounting is reversed at the time Accredited sells the mortgage loans. This results in a correspondingly higher or lower gain on sale revenue at such time. The net amount recorded in the consolidated statements of operations is referred to as hedge ineffectiveness.

Cash Flow Hedges

During the third quarter of 2004, Accredited implemented the use of cash flow hedging on its securitization debt under SFAS No. 133. Pursuant to SFAS No. 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. During the third quarter 2005, Accredited implemented the use of cash flow hedging on its variable rate debt in Canada under SFAS No. 133. Pursuant to SFAS No. 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our variable rate debt in Canada attributable to interest rates. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported as a component of other comprehensive income in stockholders equity, and recognized into earnings in the period during which the hedged transaction affects earnings pursuant to SFAS No. 133. At the inception of the hedge and on an ongoing basis, Accredited assesses whether the derivatives used in hedging transactions are highly effective in offsetting changes in cash flows of the hedged items. If it is determined that a derivative is not highly effective as a hedge, Accredited would discontinue the application of cash flow hedge accounting prospectively. In the instance cash flow hedge accounting is discontinued, the

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

derivative will continue to be recorded on the balance sheet at its fair value. Any change in the fair value of a derivative no longer qualifying as an effective hedge is recognized in current period earnings. For terminated hedges or hedges that no longer qualify as effective, the effective portion previously recorded remains in other comprehensive income and continues to be amortized or accreted into earnings with the hedged item. The ineffective portion on the derivative instrument is reported in current earnings as a component of interest expense.

For derivative financial instruments not designated as hedge instruments, unrealized changes in fair value are recognized in the period in which the changes occur and realized gains and losses are recognized in the period in which such instruments are settled.

Provision for Losses

Market valuation adjustments have been recorded on certain nonperforming loans, other loans held for sale and real estate owned. These adjustments are based on Accredited s estimate of probable losses, calculated using loss severity and loss frequency rate assumptions and are based on the value that Accredited could reasonably expect to obtain from a sale, that is, other than in a forced or liquidation sale. Provision for losses on loans held for investment is recorded in an amount sufficient to maintain the allowance for loan losses at a level considered appropriate to cover probable losses on such loans. Provision for losses also includes net losses on real estate owned. Accredited accrues liabilities associated with loans sold which may be required to be repurchased due to breaches of representations and warranties or early payment defaults. Accredited periodically evaluates the estimates used in calculating expected losses and adjustments are reported in earnings. As these estimates are influenced by factors outside of Accredited s control and as uncertainty is inherent in these estimates, actual amounts charged-off could differ from amounts recorded.

Interest Income

Interest income is recorded when earned. Interest income represents the interest earned on mortgage loans held for sale and on mortgage loans held for investment. For loans that are 90 days or more delinquent, Accredited reverses income previously recognized but not collected, and ceases to accrue income until all past-due amounts are collected. In addition, Accredited calculates an effective yield based on the carrying amount of our residual interest in off-balance sheet securitizations and Accredited s then-current estimates of future cash flows and recognizes accretion income, which is included as a component of interest income. Interest income also includes revenue related to our mortgage loans held for investment (on-balance sheet securitizations), contractually designated as servicing income but classified as interest income for accounting purposes.

Escrow and Fiduciary Funds

Accredited maintains segregated bank accounts in trust for the benefit of investors for payments on securitized loans and mortgage loans serviced for investors. Accredited also maintains bank accounts for the benefit of borrowers   property tax and hazard insurance premium payments that are escrowed by borrowers. These bank accounts totaled $120.5 million and $101.9 million at September 30, 2005 and December 31, 2004, respectively, and are excluded from Accredited   s assets and liabilities.

Income Taxes

Deferred tax assets and liabilities are determined based on temporary differences between financial reporting and tax basis of assets and liabilities and are measured by applying enacted tax rates and laws to

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

taxable years in which such temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established, if necessary, based on management s determination of the likelihood of realization of deferred tax assets.

Real Estate Owned

Real estate acquired in settlement of loans generally results when property collateralizing a loan is foreclosed upon or otherwise acquired by Accredited in satisfaction of the loan. Real estate acquired through foreclosure is carried at lower of cost or its fair value less costs to dispose. Fair value is based on the net amount that Accredited could reasonably expect to receive for the asset in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Adjustments to the carrying value of real estate owned are made through valuation allowances and charge-offs recognized through a charge to earnings. Legal fees and other direct costs incurred after foreclosure are expensed as incurred. At September 30, 2005 and December 31, 2004, real estate owned amounting to $10.6 million and $6.1 million, net of valuation allowances, respectively, was included in prepaid and other assets.

Stock-Based Compensation

Accredited currently accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees* and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the fair value of Accredited s stock at the date of grant over the grant price.

SFAS No. 123, *Accounting for Stock-Based Compensation,* encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value.

Accredited has adopted the disclosure only provisions of SFAS No. 123. Had compensation cost for Accredited s stock-based compensation plans been determined based on the fair value at the grant date for options consistent with the provisions of SFAS No. 123, Accredited s net income would have been reduced to the pro forma amounts in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**

	(In thousands, except per share amounts)			
Net income, as reported	$ 41,291	$ 35,877	$ 112,151	$ 92,677
Add: Stock-based compensation included in reported net income, net of tax	16	85	190	164
Deduct: Stock-based employee compensation expense determined using fair value method, net of tax	(431)	(491)	(2,071)	(1,473)
Pro forma net income	$ 40,876	$ 35,471	$ 110,270	$ 91,368
Earnings per share:				
Basic as reported	$ 1.95	$ 1.75	$ 5.34	$ 4.57
Basic pro forma	$ 1.93	$ 1.73	$ 5.25	$ 4.50
Diluted as reported	$ 1.87	$ 1.66	$ 5.11	$ 4.31
Diluted pro forma	$ 1.85	$ 1.64	$ 5.03	$ 4.25

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The fair value of each option grant and purchase right is estimated as of the date of the grant using the Black-Scholes option-pricing model. The weighted average risk free rate applied is for a period commensurate with the expected life of the options or purchase rights. Accredited s historical volatility is used for options or purchase rights where there is sufficient history to correspond with the term of the option or purchase right. Where there is insufficient history due to the limited time that Accredited has been a publicly traded company, Accredited s volatility is calculated as an average of its own volatility and the mean of its closest competitors volatility for the respective periods. The underlying assumptions used to estimate the fair values of options and purchase rights granted are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Weighted average risk free rate for options	3.88%	2.97%	3.52%	2.36%
Weighted average expected option life	2.5 yrs	2.7 yrs	2.7 yrs	2.7 yrs
Expected stock price volatility for options	46%	50%	45%	54.5%
Expected dividend yield				
Weighted average fair value of options granted with an exercise price equal to market price on grant date	$ 14.13	$ 10.22	$ 14.08	$ 12.70

In December 2004, the Financial Accounting Standards Board issued a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, which also supersedes APB 25, Accounting for Stock Issued to Employees. The revised standard eliminates the alternative to use Opinion 25 s intrinsic value method of accounting and eliminates the disclosure only provisions of SFAS No. 123. The compliance date for the revised standard was extended by the Securities and Exchange Commission (the SEC) in April 2005. The revised standard applies to all awards granted after December 31, 2005 and requires the recognition of compensation expense in the financial statements for all share-based payment transactions subsequent to that date. The revised standard also requires the prospective recognition of compensation expense in the financial statements for all unvested options after January 1, 2006. Adoption of this standard on January 1, 2006 will have a negative impact on our earnings based on the pro forma data in the table above.

Comprehensive Income

Other comprehensive net income includes unrealized gains and losses that are excluded from the consolidated Statements of Operations and are reported as a separate component in stockholders equity. The unrealized gains and losses include unrealized gains and losses on the effective portion of cash flow hedges and foreign currency translation adjustments.

Accumulated other comprehensive income for the nine months ended September 30, 2005 is determined as follows:

	(In thousands)	
	(Unaudited)	
Balance at December 31, 2004	$	2,042
Net unrealized gains on cash flow hedges, net of taxes of $11,424		18,247
Reclassification adjustment into earnings for realized gain on derivatives, net of taxes of $3,985		(6,044)
Foreign currency translation adjustments		1,885
Balance at September 30, 2005	$	16,130

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Comprehensive income is determined as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
		(In thousands) (Unaudited)		
Net income	$ 41,291	$ 35,877	$ 112,151	$ 92,677
Net unrealized gains or losses on cash flow hedges, net of taxes of $8,027, ($1,240), $11,424 and ($1,240) respectively	13,180	(1,921)	18,247	(1,921)
Reclassification adjustment into earnings for realized gain on derivatives, net of taxes of ($1,535), $0, ($3,985) and $0, respectively	(2,342)		(6,044)	
Foreign currency translation adjustments	1,615		1,885	
Total comprehensive income	$ 53,744	$ 33,956	$ 126,239	$ 90,756

Segment Reporting

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. These segments should engage in business activities and have discrete financial information available, such as revenue, expenses, and assets. While Accredited s management monitors originations and sales gains by wholesale and retail channels, it does not record any of the actual financial results other than direct expenses by these groups. In addition, the retail originations have generally been less than 10% of total originations over the past five years. Accordingly, Accredited operates in one reportable operating segment.

Reclassifications

Certain items in the prior year financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on reported net income. We have reclassified $2.9 billion of cash used for the origination of mortgage loans from investing activities to operating activities in the cash flow statement for the period ended September 30, 2004 to conform to the September 30, 2005 presentation.

Recently Issued Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, which also supersedes APB 25, Accounting for Stock Issued to Employees. The revised standard eliminates the alternative to use Opinion 25 s intrinsic value method of accounting and eliminates the disclosure only provisions of SFAS No. 123. The compliance date for the revised standard was extended by the Securities and Exchange Commission (the SEC) in April 2005. The revised standard applies to all awards granted after December 31, 2005 and requires the recognition of compensation expense in the financial statements for all share-based payment transactions subsequent to that date. The revised standard also requires the prospective recognition of compensation expense in the financial statements for all unvested options after January 1, 2006. Adoption of this standard on January 1, 2006 will have a negative impact on our earnings based on the pro forma data in the table above.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

2. CONCENTRATIONS OF RISK

Significant Customers

During the three months ended September 30, 2005, Accredited sold $1.0 billion, $0.7 billion and $0.6 billion in loans to three separate investors, which represented 34%, 25% and 19%, respectively, of total loans sold. During the three months ended September 30, 2004, Accredited sold $0.8 billion, $0.6 billion and $0.5 billion in loans to three separate investors, which represented 34%, 25% and 22%, respectively, of total loans sold.

During the nine months ended September 30, 2005, Accredited sold $2.0 billion, $1.8 billion and $1.0 billion in loans to three separate investors, which represented 26%, 22% and 13%, respectively, of total loans sold. During the nine months ended September 30, 2004, Accredited sold $1.8 billion and $1.7 billion in loans to two separate investors, which represented 32% and 30%, respectively, of total loans sold.

No other sales to individual investors accounted for more than 10% of total loans sold during the three and nine months ended September 30, 2005 and 2004.

Credit Repurchase Risk

Accredited s sales of mortgage loans are subject to standard mortgage industry representations and warranties, material violations of which may require Accredited to repurchase one or more mortgage loans. Additionally, certain whole loan sale contracts include provisions requiring Accredited to repurchase a loan if a borrower fails to make one or more of the first loan payments due on the loan. During the three months ended September 30, 2005 and 2004 loans repurchased totaled $21.3 million and $8.3 million, respectively, and during the nine months ended September 30, 2005 and 2004 loans repurchased totaled $55.3 million and $21.7 million, respectively, pursuant to these provisions. The increase in repurchase activity results primarily from a modification to our typical sales agreement requiring our buyers to notify us promptly of their intent to exercise their repurchase right coupled with a more diligent review of loan payment performance on the part of our buyers. While we are unable to accurately predict the future level of repurchase activity, we expect repurchases to stabilize at current levels. At September 30, 2005 and December 31, 2004, the reserve for potential future repurchase losses totaled $6.8 million and $5.1 million, respectively.

Geographic Concentration

Properties securing the mortgage loans in Accredited s servicing portfolio (loans held for sale, loans held for investment and off-balance sheet securitizations), including loans subserviced, are geographically dispersed throughout the United States and, to a much lesser extent, in Canada. At September 30, 2005, 23% and 10% of the unpaid principal balance of mortgage loans in Accredited s servicing portfolio were secured by properties located in California and Florida, respectively. At September 30, 2004, 33% of the unpaid principal balance of mortgage loans in Accredited s servicing portfolio were secured by properties located in California. The remaining properties securing mortgage loans serviced did not exceed 10% in any other state at September 30, 2005 and 2004.

Loan originations are geographically dispersed throughout the United States and, to a much lesser extent, in Canada. During the three months ended September 30, 2005, 18% and 11% of loans originated were collateralized by properties located in California and Florida, respectively. During the three months ended September 30, 2004, 28% and 7% of loans originated were collateralized by properties located in California and Florida, respectively. During the nine months ended September 30, 2005, 20% and 11% of loans originated were

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

collateralized by properties located in California and Florida, respectively. During the nine months ended September 30, 2004, 29% and 8% of loans originated were collateralized by properties located in California and Florida, respectively. The remaining originations did not exceed 10% in any other state during the three and nine months ended September 30, 2005 and 2004.

An overall decline in the economy or the residential real estate market, or the occurrence of a natural disaster that is not covered by standard homeowners insurance policies, such as an earthquake, hurricane or wildfire, could decrease the value of mortgaged properties. This, in turn, would increase the risk of delinquency, default or foreclosure on mortgage loans in our portfolio and restrict our ability to originate, sell, or securitize mortgage loans, which would significantly harm our business, financial condition and liquidity. While we have not completed our assessment of potential losses stemming from the recent hurricanes in the southeastern United States, we do not expect the resulting losses to have a material adverse impact on our business, financial condition, liquidity or results of operations.

3. MORTGAGE LOANS

Mortgage loans held for sale Mortgage loans held for sale were as follows:

	September 30, 2005	December 31, 2004
		(In thousands)
	(Unaudited)	
Mortgage loans held for sale principal balance	$ 2,370,788	$ 1,805,620
Basis adjustment for fair value hedge accounting	882	5
Net deferred origination costs (fees)	(1,551)	1,574
Market reserve	(20,734)	(17,065)

Deferred amounts (which include vested matching contributions) are paid to the executive following the executive s retirement, death, disability or termination following a change of control of the Company. Those amounts are paid either in a lump sum or over time as the executive elects. The plan allows for in service accounts whereby funds are channeled to accounts for specific purposes and are allowed by regulation to be withdrawn at certain additional times.

Automobile Allowance. Each Named Executive Officer receives an automobile allowance of $3,300 per calendar quarter to compensate such individuals for use of their personal automobiles on Company business except for Mr. Stein, who is provided a Company automobile.

Employment Agreements

Our Named Executive Officers have employment agreements that provide for payments upon a termination of employment by the executive for good reason or by us without cause. We believe that these agreements effectively create incentives for our executives to build shareholder value without the fear of losing employment for situations other than for cause. These arrangements are intended to attract and retain qualified executives who could have other job alternatives that may appear to them to be less risky absent these arrangements. Each of the employment agreements contains, among other things, the following provisions:

Term. The current employment agreements, are each for an initial period of two (2) years and do not automatically renew for additional periods. The employment agreements may be terminated before the end of their terms by the Company with or without cause or by the Named Executive Officer with or without good reason. Our interim Chief Executive Officer does not have an employment contract; however, the Company expects to have an employment agreement with a new Chief Executive Officer when hired.

Responsibilities. The employment agreements outline the responsibilities of each of the Named Executive Officers to devote, among other things, their full business time and attention to the affairs of the Company.

Compensation. The employment agreements provide for base compensation to each Named Executive Officer, which compensation is reviewed annually by the Compensation Committee. Bonuses are also paid on an annual incentive bonus program which is formula-driven and each officer receives Long-Term Incentive Compensation, as appropriate, paid in the form of equity-based compensation. In addition, each Named Executive Officer is entitled to participate in our Non-Qualified Deferred Compensation Plan.

Effect of Termination. In the event a Named Executive Officer is terminated by us for cause (as defined below) or if the Named Executive Officer leaves during the employment term without good reason (as defined below), then our only obligations to the executive are to pay his or her base salary through the date of termination, and to provide such other benefits as have been vested. However, if the Named Executive Officer is terminated by us without cause, or if he or she terminates his or her employment for good reason, or in the event we fail to renew the Named Executive Officer s contract on expiration on terms not materially less than in the current employment agreement, then in addition to payment of base salary through the termination date, the Named Executive Officer is entitled to receive one hundred percent (100%) of his or her current annual base salary paid out over a continuation period ranging from twelve (12) to twenty-four (24) months following his or her termination. During the continued payment period, he or she also receives continued coverage under our medical, life and disability insurance programs. Finally, for Named Executive Officers, if such termination without cause (by us) or for good reason (by the executive) occurs within two (2) years following a change of control, then the severance payment is two hundred percent (200%) of such officer s target bonus in the year of termination in addition to two hundred percent (200%) of base salary.

Good reason includes, among other things, a material reduction in the Named Executive Officer s compensation or benefits which is materially more adverse to the executive than similar reductions applicable to other executives of a similar level of status within the Company, and the assignment to the Named Executive Officer of duties which results in a material diminution in such position, authority, duties or responsibilities and which could reasonably be believed to be demeaning.

Cause includes, among other things, that the Named Executive Officer (i) has been convicted of, or pleads guilty or nolo contendere to, a felony involving dishonesty, theft, misappropriation, embezzlement, fraud, crimes against property or person, or moral turpitude which negatively impacts us; (ii) intentionally furnishes materially false, misleading, or incomplete information concerning a substantial matter to us or persons to whom the executive reports; (iii) intentionally fails to fulfill any assigned responsibilities for compliance with the Sarbanes-Oxley Act of 2002 or violates the same; (iv) intentionally and wrongfully damages material assets of ours; (v) intentionally and wrongfully discloses material confidential information of ours; (vi) intentionally and wrongfully engages in any competitive activity which would constitute a material breach of the duty of loyalty; (vii) intentionally breaches any stated material employment policy or any material provision of our ethics policy which could reasonably be expected to expose us to liability, (viii) intentionally commits a material breach of the employment agreement, or (ix) intentionally engages in acts or omissions which constitute failure to follow reasonable and lawful directives of ours.

Death and Disability. The employment agreements also provide that in the event of the Named Executive Officer s death, his or her estate shall receive annual base compensation through the end of the month during which the death occurred, plus whatever bonus the Named Executive Officer was entitled to for the year during which the death occurred. Normal payments will also be made for the Named Executive Officer s benefit under our other benefit plans in which he or she was a participant. In the event that termination is a result of permanent disability, such Named Executive Officer may be terminated if he or she does not recover within six (6) months following the onset of the disability, and the executive will receive a pro rata portion of his or her bonus for the year in which the termination occurred, and an additional nine (9) months base compensation following termination, as well as payment of benefits from any of our benefit plans in which the disabled executive was a participant.

Restrictive Covenant. Each executive agrees to maintain all of our trade secrets fully confidential, in perpetuity, and agrees to certain non-solicitation provisions in favor of us.

Internal Revenue Code Section 409A. The employment agreements of the Named Executive Officers contain provisions intended to comply with Internal Revenue Code Section 409A which may have the effect of postponing payments received by the Named Executive Officers following the termination of their employment with us.

Tax Limitations on Deductibility of Compensation

Section 162(m) of the Internal Revenue Code precludes a public company from deducting compensation of more than $1 million each for its Named Executive Officers. Certain performance-based compensation is exempt from this limitation. We believe our incentive plans meet the performance-based compensation exemption from the deductibility limitation of §162(m) and that our current compensation plans are unlikely to generate any material compensation in excess of the §162(m) limits.

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Changes For 2012

We have made several changes in an effort to further align our executive compensation practices to the achievement of our goals. For 2012, the Compensation Committee established a total merit pool equivalent to 1.5% of total base compensation for all employees including those of the Named Executive Officers. Merit Increases, if earned, are granted based on each associate s individual performance review scores, and range between 1.0 3.5%. The increase for any individual associate is based on recommendations of that individual s immediate supervisor and as approved by the Company s president.

Merit pay raises in 2012 for our Named Executive Officers range from 2.0% to 2.5%. The Compensation Committee increased Mr. Hawkin s base pay to $425,000 in December to recognize the additional responsibilities he assumed when named the Company s Chief Operating Officer. The Compensation Committee determined that those increases nevertheless resulted in base compensation for our Named Executive Officers which generally remained substantially below that of the 50% percentile of base pay for similar positions in our Peer Group.

For 2012, the Compensation Committee continues to believe that Comparable Store Sales Growth and Operating Income are the measures of our short term success and will use those metrics for the Short-Term Incentive Plan. The Short-Term Incentive Plan Performance Levels will be based fifty percent (50%) on achieving levels of Operating Income and fifty percent (50%) on achieving Comparable Store Sales.

The Compensation Committee has changed the performance levels for 2012 to be as follows:

Threshold level which is generally the minimum performance level which must be achieved for an incentive compensation to be paid and which is established at the level which the Compensation Committee believes we have an eighty percent (80%) probability of achieving. For 2012, however, the Compensation Committee established the Threshold level based on the Business Plan, and is the level which the Compensation Committee believes we have a fifty percent (50%) probability of achieving the level at which minimal bonuses will be paid under our Short-Term Incentive Plans.

Target level which is the intended performance level for the Company commensurate with fiscal 2011, and which the Compensation Committee believes we have a forty percent (40%) probability of achieving;

Superior level which is intended to reward performance above our expected achievement or Target achievement level and is established at the level which the Compensation Committee believes we have a twenty percent (20%) or less probability of achieving; and

Outstanding level which is intended to reward performance above our Superior achievement level and is established at the level which the Compensation Committee believes we have a ten percent (10%) or less probability of achieving.

The following table shows the Performance Levels based on the 2012 performance goals at each Performance Level for the Short-Term Incentive Plan:

Short-Term Performance Level for 2012	Operating Income Required to Achieve	Comparable Store Sales Growth
Threshold	$31.4M	2.0%
Target	$41.1M	4.0%
Superior	$48.4M	5.5%
Outstanding	$55.7M	7.0%

For 2012, the Compensation Committee has elected to continue to use a relative measure and will continue to use the S&P 500 Apparel Retail Index, as comprised at the beginning of 2012, to compare our performance to others in the industry. Awards under the 2012-2014 Long-Term Incentive Plan for our Named Executive Officers will be based on our relative Total Shareholder Return compared to the S&P 500 Apparel Retail Index for the three (3) year performance period.

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For 2012, the Long-Term Incentive Plan for the Named Executive Officers and general counsel will be based on a three year performance period and paid sixty percent (60%) in Performance Shares and forty percent (40%) in Restricted Shares. The Performance Shares will vest at the end of the third year based upon the performance level achieved for the cumulative three year performance period and the time-based Restricted Shares will vest at the end of the third year. However, a participant who fails to remain employed due to death, disability, normal retirement or termination following a change of control will nevertheless receive a pro-rata portion of both the Performance Shares and Restricted Stock he or she would have received had he or she remained employed for the full performance period. This pro-rata award is based on the amount of elapsed time between the time of grant and the time of termination of employment for each applicable performance cycle. The Performance Shares will be earned, if at all, based on our relative Total Shareholder Return compared to that of the S&P 500 Apparel Retail Index. For the Named Executive Officers, the relative Total Shareholder Return performance goals are shown in the following table:

Long-Term Performance Level	Company Percentile Rank vs. S&P 500 Apparel Retail Index
Threshold	33rd Percentile
Target	53rd Percentile
Superior	75th Percentile

For 2012, the Compensation Committee has set the Aggregate Equity-Based Run Rate Cap at two and one half percent (2.5%) for shares issued under our Long-Term Incentive Plan.

COMPENSATION COMMITTEE REPORT

The Compensation Committee, comprised entirely of independent directors, reviewed and discussed the above Compensation Discussion and Analysis with the Company s management. Based on such review and discussions, the Compensation Committee recommended to our Board of Directors that the Compensation Discussion and Analysis be included in these Proxy materials and incorporated by reference into the Annual Report on Form 10-K for the year ended January 28, 2012.

Alvin R. Carpenter, Chairman

Ralph Alexander

Richard L. Sisisky

Martin E. Stein, Jr.

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EXECUTIVE COMPENSATION

The Summary Compensation Table summarizes the compensation paid or accrued by us to anyone who served as our Chief Executive Officer or Chief Financial Officer and our three other highest paid executive officers during the year ended January 28, 2012.

The amounts reported in this section for stock and option awards may not represent the amounts that the Named Executive Officers will actually realize from the awards. Whether, and to what extent, a Named Executive Officer realizes value will depend on our performance, stock price and continued employment.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)(1)	Option Awards ($)(2)	Non-Equity Incentive Plan Compensation ($)(3)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(4)	All Other Compensation ($)(5)	Total ($)
Jay Stein Chairman and Interim Chief Executive Officer (6)	2011	$215,715	-	-	-	-	-	$ 82,035	$ 297,750
David H. Stovall, Jr.	2011	$526,850	-	$1,528,003	-	-	$ 1,111	$1,102,068	$ 3,158,032
Former President and Chief	2010	$826,000	-	$1,207,252	-	$504,521	-	$ 136,954	$ 2,674,727
Executive Officer	2009	$753,725	-	-	-	$210,000	-	$ 153,140	$ 1,116,865
Gregory W. Kleffner	2011	$358,167	-	$ 431,664	-	-	-	$ 81,076	$ 870,907
Executive Vice President,	2010	$350,000	-	$ 341,038	-	$171,024	-	$ 101,309	$ 963,371
Chief Financial Officer	2009	$152,564	-	$ 285,423	$209,673	-	-	$ 20,002	$ 667,662
D. Hunt Hawkins	2011	$384,738	-	$ 456,266	-	-	-	$ 80,942	$ 921,946
Executive Vice President,	2010	$370,000	-	$ 360,515	-	$180,797	$26,882	$ 123,620	$ 1,061,814
Chief Operating Officer	2009	$337,625	-	$ 123,794	-	-	$34,636	$ 90,156	$ 586,211
Brian R. Morrow Executive Vice President,	2011	$539,000	-	$ 647,496	-	-	-	$ 89,514	$ 1,276,010
Chief Merchandising Officer	2010	$525,000	-	$ 511,553	$175,800	$256,536	-	$ 286,991	$ 1,755,880
Gary L. Pierce	2011	$332,854	-	$ 327,934	-$113,200	-	-	$ 63,813	$ 724,601
Senior Vice President,	2010	$230,208	-	$ 245,569		$119,106	-	$ 107,189	$ 815,272

Director of Stores

(1) The amounts reflect the aggregate grant date fair value computed in accordance with ASC Topic 718 of stock awards made during the fiscal years indicated. Forfeiture estimates have been disregarded in determining the amounts indicated. The grant date fair value of restricted stock awards and units was based on the closing price of our common stock on the applicable grant dates except for market-based performance awards granted at the target level during 2011 whose value was determined using a Monte-Carlo simulation model to estimate the relative and absolute total shareholder return performance of the forty-six (46) companies forming the S&P Apparel Retail Index as of the valuation date of May 16, 2011.

(2) The amounts reflect the aggregate grant date fair value computed in accordance with ASC Topic 718 of option awards made during the fiscal years indicated. Forfeiture estimates have been disregarded in determining the amounts indicated. The grant date fair value of stock options is estimated using the Black-Scholes option pricing model with the expected term for fiscal years 2009 and 2010 being derived via a lattice model. The grant date fair value of stock option awards was determined based on the assumptions in the following chart for grants made during each fiscal year indicated. There were no option awards granted during 2011 to the Named Executive Officers.

	Fiscal Years	
Assumptions	**2010**	**2009**
Weighted average volatility	73.3%	66.1%
Weighted average dividend yield	0.0%	0.0%
Weighted average risk-free interest rate	2.3%	2.8%
Weighted average expected term	5.2 years	6.0 years

(3) The amounts reflect the cash bonus awards to the named individuals under our Short-Term Incentive Plan.

(4) The amounts reflect the above-market earnings on the non-tax-qualified deferred compensation for each Named Executive Officer. The preferential earnings are computed by taking the earnings for deferred compensation plans and subtracting a rate of return using one hundred twenty percent (120%) of the applicable federal long-term rate (AFR).

(5) The amounts reflected are:

Name	Year	Perquisites and Other Personal Benefits ($)(a)	Premiums Paid Relating To Executive Split- Dollar Plan ($)	Company Contributions to 401(k) Plans ($)	Company Contributions to Deferred Compensation Plans ($)	Relocation Expenses ($)	Separation Compensation ($)	Total ($)
Jay Stein	2011	$35,160	$ 43,275	$3,600	-	-	-	$ 82,035
David H. Stovall, Jr. (b)	2011	$27,534	$133,134	$3,158	$28,063	-	$910,179	$1,102,068
Gregory W. Kleffner	2011	$29,083	$ 34,556	$ 299	$17,138	-	-	$ 81,076
D. Hunt Hawkins	2011	$43,646	$ 22,753	$4,982	$ 9,561	-	-	$ 80,942
Brian R. Morrow	2011	$34,880	$ 46,200	$2,026	-	$6,408	-	$ 89,514
Gary L. Pierce	2011	$33,330	$ 30,344	$ 139	-	-	-	$ 63,813

(a) Perquisites and other personal benefits consist of automobile allowances; medical benefits not provided to non-executive employees (includes excess medical, dental & vision payments plus a tax gross up); and medical administration and reinsurance cost plus long-term disability and group life premiums. No single item exceeds the greater of $25,000 or ten percent (10%) of the aggregate value of all perquisites and other personal benefits received by any of the Named Executive Officers, except for medical benefit payments not provided to non-executive employees (which includes excess medical, dental & vision payments plus a tax gross up based on these amounts) in the amount of $29,647 for Mr. Stein and $28,225 for Mr. Hawkins. All perquisites and other personal benefits are valued on the basis of the aggregate incremental cost to the Company.

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(b) Mr. Stovall s date of separation was September 16, 2011. Pursuant to the 2001 Stein Mart, Inc. Omnibus Plan, Mr. Stovall may exercise his vested remaining options, if any, on or before December 17, 2011. Such exercise, if any, shall comply with the terms of the 2001 Stein Mart,Iinc. Omnibus Plan. All other options and performance shares, except for 41, 586 Performance Shares earned relating to the 2010 Incentive Compensation Plans and 12,794 Restricted Shares earned under the 2011 Incentive Compensation Plans that are scheduled to vest on March 17, 2012, which would otherwise vest after September 16, 2011 are forfeited as being non-vested.
The amount of separation compensation shown reflects the amount due by the Company relating to the Separation Agreement and Release for Mr. Stovall that was effective September 16, 2011.
The amount indicated consists of the following:
salary continuation of $849,128 (the annual sum for the post-retirement period September 16, 2011 through September 16, 2012) to be paid in semi-monthly installments until and through September 16, 2012 except that during the period September 17, 2011 through March 16, 2012 (the Deferral Period) no salary continuation shall be paid to Mr. Stovall to comply with Treasury Regulation 1.409A-3(i)(2), and instead the amount that would have been paid during the Deferral Period shall accrue and such amount with interest thereon at 3.25% per annum (calculated as $3,751) shall be paid to Mr. Stovall on April 1, 2012;
estimated benefit continuation costs of $43,200 to be paid by the Company each month during the post-termination period, except that the first six months shall be paid directly by Mr. Stovall with reimbursement to be made by the Company to Mr. Stovall on April 1, 2012 and;
annual telephone allowance of $900 and annual automobile allowance of $13,200 to be paid by the Company each month during the post-termination period, except that the first six months for each of these shall be paid to Mr. Stovall on April 1, 2012.

(6) Mr. Stein was appointed the Company s interim Chief Executive Officer on September 16, 2011. Mr. Stein served as a non-executive officer of the Company since his retirement as the Company s Chief Executive Officer in September 2001 until his appointment as interim Chief Executive Officer on September 16, 2011. As our interim Chief Executive Officer, Mr. Stein received an annualized salary of $540,00 beginning September 16, 2011.

GRANTS OF PLAN-BASED AWARDS FOR FISCAL YEAR ENDED JANUARY 28, 2012

The following table shows the Plan-Based awards granted to each Named Executive Officer during the fiscal year ended January 28, 2012.

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards (1)				Estimated Future Payouts Under Equity Incentive Plan Awards (2)						
Name	Grant Date	Commencement ($)	Threshold ($)	Target ($)	Maximum ($)	Threshold (#)	Target (#)	Maximum (#)	All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Option (#)	Exercise or Base Price of Option Awards ($/Sh)	Gran Date Fair Valu of Stock and Optio Awar ($)
Jay Stein (3)	-	-	-	-	-	-	-	-	-	-	-	-
	03/28/11 05/16/11	$212,282	$424,564	$636,846	$849,128	-	-	-	-	-	-	-
David H.	05/16/11	-	-	-	-	43,220	86,440	129,660	-	-	-	$ 982,8

Stovall, Jr. (4)		-	-	-	-	-	-	-	57,630	-	-	$ 545,1
	03/28/11	$ 71,960	$143,920	$215,880	$287,840	-	-	-	-	-	-	-
Gregory W.	05/16/11	-	-	-	-	12,210	24,420	36,630	-	-	-	$ 277,6
Kleffner	05/16/11	-	-	-	-	-	-	-	16,280	-	-	$ 154,0
	03/28/11	$ 85,000	$170,000	$255,000	$340,000	-	-	-	-	-	-	-
D. Hunt	05/16/11	-	-	-	-	12,905	25,810	38,715	-	-	-	$ 293,4
Hawkins	05/16/11	-	-	-	-	-	-	-	17,210	-	-	$ 162,8
	03/28/11	$108,360	$216,720	$325,080	$433,440	-	-	-	-	-	-	-
Brian R.	05/16/11	-	-	-	-	18,315	36,630	54,945	-	-	-	$ 416,4
Morrow	05/16/11	-	-	-	-	-	-	-	24,420	-	-	$ 231,0
	03/28/11	$ 50,164	$100,328	$150,491	$200,655	-	-	-	-	-	-	-
Gary L.	05/16/11	-	-	-	-	9,275	18,550	27,825	-	-	-	$ 210,9
Pierce	05/16/11	-	-	-	-	-	-	-	12,370	-	-	$ 117,0

(1) The amounts shown reflect the minimum, threshold, target and maximum annual incentive compensation payment levels under our Company s Short-Term Incentive Plan. These amounts are based on the individual s current position. No amounts were earned under the Company s Short-Term incentive Program for 2011 by any named executive officer.

(2) The threshold amounts shown reflect the long-term compensation awards of performance shares which are 50% of the target amounts shown. The maximum amounts shown are 150% of the target amounts. The percentage of target award paid is determined based on Stein Mart s stock performance relative to forty-six (46) companies that made up the S&P Apparel Retail Index at the time of the grant. Based on percentile ranking of the Company s three year total share holder return within the forty-six (46) company group, participants will receive varying percentages of the target award at the end of the three year period.

(3) Mr. Stein was appointed the Company s interim Chief Executive Officer on September 16, 2011.

(4) Mr. Stovall s date of separation was September 16, 2011. Any vested stock options not exercised within ninety days of his separation of employment were forfeited. All performance shares, except for 41,586 shares earned under the 2010 Incentive Compensation Plans, and restricted awards, except for 12,794 earned under the 2011 Incentive Compensation Plans, were forfeited as being non-vested. See note 5 to the Summary Compensation Table.

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OUTSTANDING EQUITY AWARDS AT FISCAL YEAR ENDED JANUARY 28, 2012

The following table shows the outstanding equity awards for each Named Executive Officer as of the fiscal year ended January 28, 2012.

	Option Awards				Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)(1)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Pl Awards: Market o Payout Value of Unearned Shares Units or Other Rights That Hav Not Vested ($)(1)
Jay Stein (2)	-	-	-	-	-	-	-	-
David H. Stovall, Jr. (3)	-	-	-	-	12,794(4)	$ 94,036	41,586(5)	$305,657
Gregory W. Kleffner	-	30,000(6)	$ 8.91	07/31/19	-	-	-	-
	-	-	-	-	16,280(7)	$119,658	48,272(8)	$354,799
D. Hunt Hawkins	31,880(9)	-	$19.61	02/29/12	-	-	-	-
	35,000(9)	-	$16.19	03/21/13	-	-	-	-
	17,200(9)	-	$14.36	06/06/13	-	-	-	-
	18,744(9)	9,656(9)	$13.24	03/02/14	-	-	-	-
	-	-	-	-	31,370(10)	$230,570	51,024(11)	$375,026
Brian R. Morrow	-	30,000(12)	$ 7.56	03/05/17	-	-	-	-
	-	-	-	-	24,420(7)	$179,487	72,407(13)	$532,191
Gary L. Pierce	-	20,000(14)	$ 7.25	05/18/17	-	-	-	-
	-	-	-	-	12,370(7)	$ 90,920	36,670(15)	$269,525

(1) The market value is determined by multiplying the number of shares times the closing price of the Company s stock on The NASDAQ Global Select Market as of the last day of the fiscal year. The closing price of the Company s stock on January 27, 2012 was $7.35. The actual value will depend on the fair market value on the date of vesting.

(2) Mr. Stein was appointed the Company s interim Chief Executive Officer on September 16, 2011.

(3) Mr. Stovall s date of separation was September 16, 2011. Any vested stock options not exercised within ninety days of his separation of employment were forfeited. All performance shares, except for 41,586 shares earned under the 2010 Incentive Compensation Plans, and restricted awards, except for 12,794 earned under the 2011 Incentive Compensation Plans, were forfeited as being non-vested. See note 5 to the Summary Compensation Table.

(4) The shares indicated represent the shares issued under the 2011 Long-Term Incentive Plan that vest on March 17, 2012 per the Separation and Release Agreement for Mr. Stovall.

(5) The shares indicated represent the actual number of shares earned under the 2010 Long-Term Incentive Plan based upon the level of operating income achieved and the level of comparable store sales achieved that vest on March 17, 2012 per the Separation and Release

Agreement for Mr. Stovall.

(6) Options granted on 7/31/2009 vest at 33% on the first anniversary date, another 33% on the second anniversary date and the final 34% on the third anniversary date, and expire on the date shown, which is the tenth anniversary of the grant. Upon termination, except for death, disability, retirement or change of control, unvested options are forfeited.

(7) The shares indicated represent the shares issued under the 2011 Long-Term Incentive Plan that cliff vest on February 1, 2014. Upon termination, except for death, disability, retirement or change of control, unvested restricted stock awards are forfeited.

(8) The shares indicated represent 23,852 performance shares earned under the 2010 Long-Term Incentive Plan based upon the level of operating income achieved and the level of comparable store sales achieved that vest if the Participant remains employed by the Company on February 2, 2013, the last day of the Company s 2012 fiscal year, plus 24,420 performance shares, which represents the number of performance shares that would be issued at the target level of the 2011 Long-Term Incentive Plan based on the Company s total shareholder return compared to that of the S&P 500 Apparel Retail Index over the cumulative three year performance period that consists of fiscal years 2011 2013. The actual performance shares that will be earned, if any, will be based on the actual performance level achieved and would vest if the Participant remains employed by the Company on February 1, 2014. If the Participant fails to remain employed due to death, disability, normal retirement or termination following a change of control, he will nevertheless receive a pro-rata portion of the Performance Shares he would have received had he remained employed for the full performance vesting period. This pro-rata award is based on the amount of elapsed time between the time of grant and the time of termination of employment for each applicable performance cycle.

(9) Options granted vest at 33% on the third anniversary date, another 33% on the fourth anniversary date and the final 34% on the fifth anniversary date, and expire on the dates shown, which represent the seventh anniversary of their grant. Upon termination, except for death, disability, retirement or change of control, unvested options are forfeited.

(10) The shares indicated consist of (1) 6,130 shares that cliff vest on March 1, 2012, the seventh anniversary of the grant, unless a pre-determined performance goal was met during the second year following the year of grant, at which time vesting would have been accelerated to March 1, 2008 plus (2) 8,030 shares that cliff vest on March 21, 2013, the seventh anniversary of the grant, unless a pre-determined performance goal was met during the second year following the year of grant, at which time vesting would have been accelerated to March 21, 2009 plus (3) 17,210 shares issued under the 2011 Long-Term Incentive Plan that cliff vest on February 1, 2014. Upon termination, except for death, disability, retirement or change of control, unvested restricted stock awards are forfeited.

(11) The shares indicated represent 25,214 performance shares earned under the 2010 Long-Term Incentive Plan based upon the level of operating income achieved and the level of comparable store sales achieved that vest if the Participant remains employed by the Company on February 2, 2013, the last day of the Company s 2012 fiscal year, plus 25,810 performance shares, which represents the number of performance shares that would be issued at the target level of the 2011 Long-Term Incentive Plan based on the Company s total shareholder return compared to that of the S&P 500 Apparel Retail Index over the cumulative three year performance period that consists of fiscal years 2011 2013. The actual performance shares that will be earned, if any, will be based on the actual performance level achieved and would vest if the Participant remains employed by the Company on February 1, 2014. If the Participant fails to remain employed due to death, disability, normal retirement or termination following a change of control, he will nevertheless receive a pro-rata portion of the Performance Shares he would have received had he remained employed for the full performance vesting period. This pro-rata award is based on the amount of elapsed time between the time of grant and the time of termination of employment for each applicable performance cycle.

(12) Options granted on 3/5/2010 vest at 33% on the first anniversary date, another 33% on the second anniversary date and the final 34% on the third anniversary date, and expire on the date shown, which is the seventh anniversary of the grant. Upon termination, except for death, disability, retirement or change of control, unvested options are forfeited.

(13) The shares indicated represent 35,777 performance shares earned under the 2010 Long-Term Incentive Plan based upon the level of operating income achieved and the level of comparable store sales achieved that vest if the Participant remains employed by the Company on February 2, 2013, the last day of the Company s 2012 fiscal year, plus 36,630 performance shares, which represents the number of performance shares that would be issued at the target level of the 2011 Long-Term Incentive Plan based on the Company s total shareholder return compared to that of the S&P 500 Apparel Retail Index over the cumulative three year performance period that consists of fiscal years 2011 2013. The actual performance shares that will be earned, if any, will be based on the actual performance level achieved and would vest if the Participant remains employed by the Company on February 1, 2014. If the Participant fails to remain employed due to death, disability, normal retirement or termination following a change of control, he will nevertheless receive a pro-rata portion of the Performance Shares he would have received had he remained employed for the full performance vesting period. This pro-rata award is based on the amount of elapsed time between the time of grant and the time of termination of employment for each applicable performance cycle.

(14) Options granted on 5/18/2010 vest at 33% on the first anniversary date, another 33% on the second anniversary date and the final 34% on the third anniversary date, and expire on the date shown, which is the seventh anniversary of the grant. Upon termination, except for death, disability, retirement or change of control, unvested options are forfeited.

(15) The shares indicated represent 18,120 performance shares earned under the 2010 Long-Term Incentive Plan based upon the level of operating income achieved and the level of comparable store sales achieved that vest if the Participant remains employed by the Company on February 2, 2013, the last day of the Company s 2012 fiscal year, plus 18,550 performance shares, which represents the number of performance shares that would be issued at the target level of the 2011 Long-Term Incentive Plan based on the Company s total shareholder return compared to that of the S&P 500 Apparel Retail Index over the cumulative three year performance period that consists of fiscal years 2011 2013. The actual performance shares that will be earned, if any, will be based on the actual performance level achieved and would vest if the Participant remains employed by the Company on February 1, 2014. If the Participant fails to remain employed due to death, disability, normal retirement or termination following a change of control, he will nevertheless receive a pro-rata portion of the Performance Shares he would have received had he remained employed for the full performance vesting period. This pro-rata award is based on the amount of elapsed time between the time of grant and the time of termination of employment for each applicable performance cycle.

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OPTION EXERCISES AND STOCK VESTED DURING FISCAL YEAR ENDED JANUARY 28, 2012

The following table provides information relating to options exercised and stock awards that vested during the fiscal year ended January 28, 2012 for each of the Named Executive Officers.

	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise	Value Realized on Exercise	Number of Shares Acquired on Vesting	Value Realized on Vesting
Name	(#)	($)(1)	(#)	($)(2)
Jay Stein	-	-	-	-
David H. Stovall, Jr.	-	-	-	-
Gregory W. Kleffner	-	-	11,747	$ 86,340
D. Hunt Hawkins	10,000	$22,100	22,418	$184,772
Brian R. Morrow	-	-	17,621	$129,514
Gary L. Pierce	-	-	8,925	$ 65,599

(1) The value realized is calculated based on the excess of the market price on the date of exercise over the grant price of the options multiplied by the number of options exercised.
(2) The value realized represents the number of shares acquired on vesting multiplied by the closing market price of the Company s Common Stock as listed on The NASDAQ Global Select Market on the date of vesting.

NON-QUALIFIED DEFERRED COMPENSATION FOR FISCAL YEAR ENDED JANUARY 28, 2012

Amounts credited to each Named Executive Officer s account will receive earnings/(loss) depending upon the investment option elected by each named executive. The following table shows the current investment options available under our Non-Qualified Deferred Compensation Plan and their annual rate of return for the calendar year ended December 31, 2011.

Fund	Annual Rate of Return
Model Portfolio Conservative	3.54%
Model Portfolio Moderate/Conservative	1.53%
Model Portfolio Moderate	0.14%
Model Portfolio Moderate/Aggressive	-0.92%
Model Portfolio Aggressive	-2.58%
Nationwide NVIT Money Market V	0.00%
PIMCO VIT Total Return Admin	3.61%
PIMCO VIT Real Return Admin	11.67%
LASSO Long and Short Strategic Opportunities	-1.24%

Fund	Annual Rate of Return
T Rowe Price Equity Income II	-1.04%
Dreyfus Stock Index Initial	1.88%
American Funds IS Growth 2	-4.28%
Goldman Sachs VIT Mid Cap Value	-6.38%
Morgan Stanley UIF Mid Cap Growth I	-7.12%
Royce Capital Small Cap	-3.28%
Vanguard VIF Small Company Growth	1.36%
Oppenheimer VA Global Securities NS	-8.29%
MFS VIT II International Value Svc	-1.78%

The earnings (loss) realized by each of the Named Executive Officers is reflected in the table below:

Name	Executive Contributions in Last Fiscal Year ($)(1)	Registrant Contributions in Last Fiscal Year ($)(2)	Aggregate Earnings/ (Loss) in Last Fiscal Year ($)(3)	Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last FYE ($)(4)
Jay Stein	-	-	-	-	-
David H. Stovall, Jr. (5)	$ 56,127	$28,063	$2,703	-	$ 92,044
Gregory W. Kleffner	$201,947	$17,138	$(1,356)	-	$219,897
D. Hunt Hawkins	$ 37,202	$ 9,561	$5,742	-	$304,836
Brian R. Morrow	-	-	-	-	-
Gary L. Pierce	-	-	-	-	-

(1) The amount reflected for each of the Named Executive Officers is reported as compensation to such Named Executive Officer in the Summary Compensation Table (Salary and Non-Equity Incentive Plan Compensation columns).

(2) The amount reflected for each of the Named Executive Officers is reported as compensation to such Named Executive Officer in the Summary Compensation Table (All Other Compensation column).

(3) The amount reflected for each of the Named Executive Officers includes above-market earnings reported in the Summary Compensation Table of the following amounts for 2011: $1,111 for Mr. Stovall.

(4) The following aggregate balances existed at the end of fiscal year 2010 for each of the Named Executive Officers: $5,151 for Mr. Stovall; $2,168 for Mr. Kleffner and $252,331 for Mr. Hawkins. These balances include the following amounts previously reported in Summary Compensation Tables in prior years for each of the Named Executive Officers: $5,163 for Mr. Stovall; $2,187 for Mr. Kleffner and $456,820 for Mr. Hawkins.

(5) Mr. Stovall s date of separation was September 16, 2011.

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POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE IN CONTROL

The following table shows the potential payments upon termination, disability, death or a change in control of the Company for Jay Stein, the Company s Chairman and interim Chief Executive Officer.

Compensation and Benefits	Termination With Cause	Termination Without Cause	Termination With Good Reason	Termination Without Good Reason(1)	Termination For Disability	Death	Terminatio After Change In Contro
Earned But Unpaid Base Salary (the fiscal year ended 1/28/12)	-	-	-	-	-	-	-
100% of Current Total Annual Base Salary	-	-	-	-	-	-	-
Medical, Dental, Vision, Life and Disability Insurance During Post Termination Payment Period	-	-	-	-	-	-	-
Annual Base Salary Through End of Month of Termination	-	-	-	-	$ 45,000	$ 45,000	-
Earned Bonus (Pro rata)	-	-	-	-	-	-	-
Benefits Entitled to Under the Disability Plan of the Company	-	-	-	-	$ 20,000 Per month	-	-
Make Payments and Provide Benefits Called for Under each Employee Benefit Plan	-	-	-	-	-	-	-
Net Value of Unvested Options	-	-	-	-	-	-	-
Current Value of Unvested Restricted Shares	-	-	-	-	-	-	-
All Benefits Payable Under Company s Plans Relating to Deferred Comp, Retirement or Other Benefits (2)	-	-	-	-	-	-	-
Split-Dollar Life Insurance	-	-	-	-	-	$3,000,000	-
Total (3)	-	-	-	-	$ 45,000	$3,045,000	-

(1) Retirement is treated the same as termination by the Named Executive Officer without good reason.
(2) The benefits payable under the Company s 401(k) plan have been omitted since this plan is non-discriminatory.
(3) In addition to the total reflected for disability, $20,000 per month during the disability period would also be received.

The following table shows the potential payments upon termination, disability, death or a change in control of the Company for Gregory W. Kleffner, our Company s Executive Vice President and Chief Financial Officer.

Compensation and Benefits	Termination With Cause	Termination Without Cause	Termination With Good Reason	Termination Without Good Reason(1)	Termination For Disability	Death	Termination After Change In Control
Earned But Unpaid Base Salary (the fiscal year ended 1/28/12)	-	-	-	-	-	-	-
100% of Current Total Annual Base Salary	-	$359,800	$359,800	-	-	-	-
Medical, Dental, Vision, Life and Disability Insurance During Post Termination Payment Period	-	$201,494	$201,494	-	$ 47,422	-	$ 47,422
Annual Base Salary Through End of Month of Termination	-	-	-	-	$ 29,983	$ 29,983	-
Earned Bonus (Pro rata)	-	-	-	-	-	-	-
Additional Nine Months of Compensation at the Current Base Salary	-	-	-	-	$ 269,850	-	-
Benefits Entitled to Under the Disability Plan of the Company	-	-	-	-	$ 20,000 Per month	-	-
Make Payments and Provide Benefits Called for Under each Employee Benefit Plan	-	-	-	-	-	-	-
Net Value of Unvested Options	-	-	-	-	-	-	-
Current Value of Unvested Restricted Shares	-	-	-	-	$ 474,457	$ 474,457	$ 474,457
Lump Sum Payment of 200% of Current Annual Base Salary	-	-	-	-	-	-	$ 719,600
Lump Sum Payment of 200% of Target Bonus	-	-	-	-	-	-	$ 287,740
All Benefits Payable Under Company s Plans Relating to Deferred Comp,	$201,644	$219,897	$219,897	$201,644	$ 219,897	$ 201,644	$ 219,897

Retirement or Other Benefits (2)							
Split-Dollar Life Insurance	-	-	-	-	-	$2,654,120	-
Total (3)	$201,644	$781,191	$781,191	$201,644	$1,041,609	$3,360,204	$1,749,116

(1) Retirement is treated the same as termination by the Named Executive Officer without good reason.
(2) The benefits payable under our 401(k) plan have been omitted since this plan is non-discriminatory.
(3) In addition to the total reflected for disability, $20,000 per month during the disability period would also be received.

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The following table shows the potential payments upon termination, disability, death or a change in control of the Company for D. Hunt Hawkins, the Company s Executive Vice President and Chief Operating Officer.

Compensation and Benefits	Termination With Cause	Termination Without Cause	Termination With Good Reason	Termination Without Good Reason(1)	Termination For Disability	Death	Termination After Change In Control
Earned But Unpaid Base Salary (the fiscal year ended 1/28/12)	-	-	-	-	-	-	-
100% of Current Total Annual Base Salary	-	$ 425,000	$ 425,000	-	-	-	-
Medical, Dental, Vision, Life and Disability Insurance During Post Termination Payment Period	-	$ 313,560	$ 313,560	-	$ 47,422	-	$ 47,422
Annual Base Salary Through End of Month of Termination	-	-	-	-	$ 35,417	$ 35,417	-
Earned Bonus (Pro rata)	-	-	-	-	-	-	-
Additional Nine Months of Compensation at the Current Base Salary	-	-	-	-	$ 318,750	-	-
Benefits Entitled to Under the Disability Plan of the Company	-	-	-	-	$ 20,000 Per month	-	-
Make Payments and Provide Benefits Called for Under each Employee Benefit Plan	-	-	-	-	-	-	-
Net Value of Unvested Options	-	-	-	-	-	-	-
Current Value of Unvested Restricted Shares	-	-	-	-	$ 605,598	$ 605,598	$ 605,598
Lump Sum Payment of 200% of Current Annual Base Salary	-	-	-	-	-	-	$ 850,000
Lump Sum Payment of 200% of	-	-	-	-	-	-	$ 340,000

Target Bonus							
All Benefits Payable Under Company s Plans Relating to Deferred Comp, Retirement or Other Benefits (2)	$304,836	$ 304,836	$ 304,836	$304,836	$ 304,836	$ 304,836	$ 304,836
Split-Dollar Life Insurance	-	-	-	-	-	$2,809,484	-
Total (3)	$304,836	$1,043,396	$1,043,396	$304,836	$1,312,023	$3,755,335	$2,147,856

(1) Retirement is treated the same as termination by the Named Executive Officer without good reason.
(2) The benefits payable under our 401(k) plan have been omitted since this plan is non-discriminatory.
(3) In addition to the total reflected for disability, $20,000 per month during the disability period would also be received.

The following table shows the potential payments upon termination, disability, death or a change in control of the Company for Brian R. Morrow, our Executive Vice President and Chief Merchandising Officer.

Compensation and Benefits	**Termination With Cause**	**Termination Without Cause**	**Termination With Good Reason**	**Termination Without Good Reason(1)**	**Termination For Disability**	**Death**	**Termination After Change In Control**
Earned But Unpaid Base Salary (the fiscal year ended 1/28/12)	-	-	-	-	-	-	-
100% of Current Total Annual Base Salary	-	$541,800	$541,800	-	-	-	-
Medical, Dental, Vision, Life and Disability Insurance During Post Termination Payment Period	-	$254,796	$254,796	-	$ 28,853	-	$ 28,853
Annual Base Salary Through End of Month of Termination	-	-	-	-	$ 45,150	$ 45,150	-
Earned Bonus (Pro rata)	-	-	-	-	-	-	-
Additional Nine Months of Compensation at the Current Base Salary	-	-	-	-	$ 406,350	-	-
Benefits Entitled to Under the Disability Plan of the Company	-	-	-	-	$ 20,000 Per month	-	-
Make Payments and Provide Benefits Called for Under each Employee Benefit Plan	-	-	-	-	-	-	-
Net Value of Unvested Options	-	-	-	-	-	-	-
Current Value of Unvested Restricted Shares	-	-	-	-	$ 711,679	$ 711,679	$ 711,679
Lump Sum Payment of 200% of	-	-	-	-	-	-	$1,083,600

Current Annual Base Salary							
Lump Sum Payment of 200% of Target Bonus	-	-	-	-	-	-	$ 433,440
All Benefits Payable Under Company s Plans Relating to Deferred Comp, Retirement or Other Benefits (2)	-	-	-	-	-	-	-
Split-Dollar Life Insurance	-	-	-	-	-	$3,991,680	-
Total (3)	-	$796,596	$796,596	-	$1,192,032	$4,748,509	$2,257,572

(1) Retirement is treated the same as termination by the Named Executive Officer without good reason.
(2) The benefits payable under our 401(k) plan have been omitted since this plan is non-discriminatory.
(3) In addition to the total reflected for disability, $20,000 per month during the disability period would also be received.

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The following table shows the potential payments upon termination, disability, death or a change in control of the Company for Gary L. Pierce, our Senior Vice President and Director of Stores.

Compensation and Benefits	Termination With Cause	Termination Without Cause	Termination With Good Reason	Termination Without Good Reason(1)	Termination For Disability	Death	Termination After Change In Control
Earned But Unpaid Base Salary (the fiscal year ended 1/28/12)	-	-	-	-	-	-	-
100% of Current Total Annual Base Salary	-	$334,425	$334,425	-	-	-	-
Medical, Dental, Vision, Life and Disability Insurance During Post Termination Payment Period	-	$182,832	$182,832	-	$ 47,422	-	$ 47,422
Annual Base Salary Through End of Month of Termination	-	-	-	-	$ 27,868	$ 27,868	-
Earned Bonus (Pro rata)	-	-	-	-	-	-	-
Additional Nine Months of Compensation at the Current Base Salary	-	-	-	-	$250,819	-	-
Benefits Entitled to Under the Disability Plan of the Company	-	-	-	-	$ 20,000 Per month	-	-
Make Payments and Provide Benefits Called for Under each Employee Benefit Plan	-	-	-	-	-	-	-
Net Value of Unvested Options	-	-	-	-	$ 2,000	$ 2,000	$ 2,000
Current Value of Unvested Restricted Shares	-	-	-	-	$ 360,445	$ 360,445	$ 360,445
Lump Sum Payment of 200% of Current Annual Base Salary	-	-	-	-	-	-	$ 668,850
Lump Sum Payment of 200% of Target Bonus	-	-	-	-	-	-	$ 200,655
All Benefits Payable Under Company s Plans Relating to Deferred Comp, Retirement or	-	-	-	-	-	-	-

Other Benefits (2)							
Split-Dollar Life Insurance	-	-	-	-	-	$2,267,655	-
Total (3)	-	$517,257	$517,257	-	$ 688,554	$2,657,968	$1,279,372

(1) Retirement is treated the same as termination by the Named Executive Officer without good reason.
(2) The benefits payable under our 401(k) plan have been omitted since this plan is non-discriminatory.
(3) In addition to the total reflected for disability, $20,000 per month during the disability period would also be received.

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PROPOSAL NO. 2

ADVISORY RESOLUTION ON EXECUTIVE COMPENSATION

We are asking shareholders to approve an advisory resolution approving our executive compensation as reported in this proxy statement. As described below, in the Compensation Discussion and Analysis section of this proxy statement, the Compensation Committee has structured our executive compensation program to achieve the following key objectives:

Objective	How Our Executive Compensation Program Achieves This Objective
Pay For Performance	Our annual Short-Term Incentive Plan provides performance-based cash incentive awards focused on closely aligning rewards with results.
Align the Interests of Our Executives and Shareholders	Our Long-Term Incentive Plan promotes a long-term focus on results to align employee and shareholder interests.
Attract and Retain Top Talent	Our executive compensation program is designed to be similar to the programs that are offered by other companies in our Peer Group. We attempt to set our total compensation levels at the median level of comparable companies because of the desire to attract and retain top-level executives in the market in which we operate and compete for talent.

We urge shareholders to read the Compensation Discussion and Analysis beginning on page 13 of this proxy statement, which describes in more detail how our executive compensation policies and procedures operate and are designed to achieve our compensation objectives, as well as the Summary Compensation Table and other related compensation tables and narrative, which provide detailed information on the compensation of our Named Executive Officers. The Compensation Committee and the Board of Directors believe that the policies and procedures articulated in the Compensation Discussion and Analysis are effective in achieving our goals and that the compensation of our Named Executive Officers reported in this proxy statement has contributed to our recent and long-term success.

In accordance with recently adopted Section 14A of the Securities Exchange Act of 1934, as amended (the **Exchange Act**), we are asking shareholders to approve the following advisory resolution:

RESOLVED, that the shareholders of Stein Mart, Inc. approve, on an advisory basis, the 2011 compensation of our Named Executive Officers disclosed in the Compensation Discussion and Analysis, the Summary Compensation Table and the related compensation tables, notes and narrative in the Proxy Statement for our 2012 Annual Meeting of Shareholders.

This advisory resolution, commonly referred to as a say-on-pay resolution, is non-binding on the Board of Directors. Although non-binding, the Board and the Compensation Committee will review and consider the voting results when making future decisions regarding our executive compensation program.

OUR BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE APPROVAL OF THE ADVISORY RESOLUTION APPROVING EXECUTIVE COMPENSATION.

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AUDIT COMMITTEE REPORT

The Audit Committee met with management and the independent registered certified public accounting firm fourteen (14) times during 2011 to review and discuss the Company s annual and quarterly financial statements prior to their issuance, and other matters. Four (4) of these meetings also included separate executive sessions with the independent registered certified public accounting firm, with the Company s Chief Financial Officer and with the Company s Senior Vice President of Internal Audit, Safety and Security. During 2011, management advised the Audit Committee that each set of financial statements reviewed had been prepared in accordance with accounting principles generally accepted in the USA. The Audit Committee also discussed with the independent registered certified public accounting firm the matters required by PCAOB AU Section 380, as amended (Communications with Audit Committees). The Audit Committee also received the written disclosures from the independent registered certified public accounting firm mandated by applicable requirements of the Public Company Accounting Oversight Board regarding the independent registered certified public accounting firm s communication with the Audit Committee concerning independence, and discussed with the independent registered certified public accounting firm their firm s independence. The Audit Committee also monitored the Company s compliance with the internal controls provisions of Section 404 of the Sarbanes-Oxley Act of 2002.

Based upon the Audit Committee s discussions with management and the independent registered certified public accounting firm and its review of their representations, the Audit Committee recommended that the Board of Directors include the audited consolidated financial statements in the Company s annual report on Form 10-K for the year ended January 28, 2012, filed with the Securities and Exchange Commission.

Irwin Cohen, Chairman

Susan Falk

Linda M. Farthing

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PROPOSAL NO. 3

RATIFICATION OF APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS

THE COMPANY S INDEPENDENT REGISTERED CERTIFIED PUBLIC ACCOUNTING FIRM

The Audit Committee has selected the firm PricewaterhouseCoopers LLP to serve as our independent registered certified public accounting firm for the current fiscal year ending February 2, 2013. That firm has served as our audit firm since 1983. Our Board of Directors has directed that the appointment of the independent registered certified public accounting firm be submitted for ratification by the shareholders at the annual meeting. Representatives of PricewaterhouseCoopers LLP will be present at the annual meeting of shareholders and will be given the opportunity to make a statement, if they so desire, and to respond to appropriate questions.

Shareholder ratification of the selection of PricewaterhouseCoopers LLP as our independent registered certified public accounting firm is not required by our articles of incorporation or bylaws. However, the Board of Directors is submitting the appointment of PricewaterhouseCoopers LLP as a matter of good corporate practice. If the shareholders do not ratify the selection, the Audit Committee will reconsider whether or not to retain PricewaterhouseCoopers LLP. In such event, the Audit Committee may retain PricewaterhouseCoopers LLP notwithstanding the fact that the shareholders did not ratify the selection, or select another nationally recognized accounting firm without re-submitting the matter to a shareholder vote. Even if the selection is ratified, the Audit Committee retains the right in its discretion to select a different nationally recognized accounting firm at any time during the year if it determines that such a change would be in the best interests of our shareholders and the Company.

The following table provides information relating to the fees billed or expected to be billed for the audit including the audit of internal controls and fees billed/paid in each of the last two (2) fiscal years for other services provided by PricewaterhouseCoopers LLP.

	2011	2010
audit fees (1)	$1,060,400	$656,150
audit-related fees (2)	201,645	81,567
tax fees (3)	176,775	184,250
all other fees (4)	63,326	-
total fees	$1,502,146	$921,967

(1) Includes fees for professional services relating to the annual audit of our financial statements, review of our quarterly financial statements and services related to the certification of our internal controls, as required by Section 404 of the Sarbanes-Oxley Act of 2002.
(2) Includes fees for professional services for consultation on accounting standards or transactions and consultations concerning pre-implementation assessments relating to new merchandise information and point-of-sale system.
(3) Includes fees for professional services relating to tax compliance (preparation of returns) and fees relating to an IRS examination. No services were provided by PricewaterhouseCoopers LLP relating to aggressive tax transactions, contingent fee services or any tax services to certain persons who serve in financial reporting oversight roles.
(4) Professional services related to other activity assessments.

All decisions regarding selection of independent registered certified public accounting firms and approval of accounting services and fees are made by our Audit Committee in accordance with the provisions of the Sarbanes-Oxley Act of 2002 and the rules and regulations of the Securities Exchange Commission (SEC). The Audit Committee must pre-approve (i) all audit services, and (ii) all non-audit services provided by the independent registered certified public accounting firm that are permitted by Section 201 of the Sarbanes Act, except if:

1.

in the case of permissible non-audit services, such services qualify as de minimus under Section 202 of the Sarbanes Act and we did not recognize that such services were non-audit services at the time of the engagement;

2. the Audit Committee, or one (1) or more of its designated members, approves the permissible non-audit services before completion of the audit; and

3. when one (1) or more designated members approve such services, such approval is presented to the Audit Committee at its next scheduled meeting.

All audit, audit-related and tax services provided by PricewaterhouseCoopers LLP were pre-approved in accordance with the Audit Committee s guidelines.

The Audit Committee discussed the non-audit services with PricewaterhouseCoopers LLP and determined that their provision would not impair that firm s independence.

THE BOARD OF DIRECTORS OF THE COMPANY RECOMMENDS THAT THE SHAREHOLDERS VOTE FOR THE PROPOSAL TO RATIFY THE APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS THE COMPANY S INDEPENDENT REGISTERED CERTIFIED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING FEBRUARY 2, 2013.

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RELATED PARTY TRANSACTIONS

The Audit Committee of the Board of Directors is responsible for evaluating the appropriateness of all related-party transactions.

The Audit Committee has adopted written policies and procedures for the Committee to review and approve or ratify related-party transactions involving the Company, any of its executive officers, directors or five percent (5%) or more shareholders or any of their family members. These transactions include:

(a) transactions that must be disclosed in proxy statements under SEC rules; and

(b) transactions that could potentially cause a non-employee director to cease to qualify as independent under NASDAQ listing requirements.

Transactions that are deemed immaterial under SEC disclosure requirements are generally deemed pre-approved under these written policies and procedures, including transactions with a company with which a Stein Mart director s sole relationship is as a non-employee director and the total amount involved does not exceed one percent (1%) of the other company s total annual revenues.

Criteria for Audit Committee approval or ratification of related-party transactions include:

(a) whether the transactions are on terms no less favorable to the Company than terms generally available from an unrelated third party;

(b) the extent of the related-party s interest in the transaction;

(c) whether the transaction would interfere with the performance of the officer s or director s duties to the Company;

(d) in the case of a transaction involving a non-employee director, whether the transaction would disqualify the director from being deemed independent under NASDAQ listing requirements; and

(e) such other factors that the Audit Committee deems appropriate under the circumstances.

The Audit Committee has approved the related-party transactions described below, each involving non-employee directors of the Company, after determining that the transactions do not adversely affect the performance by these directors of their duties to the Company.

Mr. Mitchell W. Legler. Mr. Legler is the majority shareholder of Kirschner & Legler, P.A., general counsel to the Company since April 2001. From August 1995 to April 2001, Mr. Legler was the sole shareholder of the law firm of Mitchell W. Legler, P.A., which served as general counsel to us. Legal fees received by Kirschner & Legler, P.A. for fiscal year 2011 were $178,800. The Audit Committee believes that amounts paid for these services are competitive with amounts that would be paid to a third party for similar services. In addition, Mr. Legler as general counsel to the Company participated in our 2011 Incentive Plans and was granted 10,270 Performance Share Awards at a target level and 6,850 Restricted Stock Awards under our Long-Term Incentive Plan. In April 2011, we entered into an agreement with Kirschner & Legler, P.A. pursuant to which we have retained Mr. Legler and his firm to serve as our general counsel for a term of two (2) years. This agreement provides that we will pay Kirschner & Legler, P.A. $180,000 per year and that such firm will be eligible to receive bonus and equity awards through our compensation program. This agreement further provides that Mr. Legler will be able to participate in our medical and dental insurance plans to the same extent as a person employed as a Senior Vice President. The agreement provides for a severance payment of $180,000 if the agreement is terminated without cause (as defined in the agreement) or if the agreement is not renewed at the expiration of the term. If the agreement is terminated following a change of control, we have agreed to pay 200% of the sum of (i) the amount due for a termination without cause and (ii) the target bonus in the year of termination.

Mr. Martin E. Stein, Jr. Mr. Stein, a member of the Compensation Committee of the Board of Directors, is Chairman and Chief Executive Officer of Regency Centers Corporation, a New York Stock Exchange listed real estate investment trust, through which we lease three (3) store locations owned by Regency Centers Corporation for approximately $800,000 in base rent annually. The Audit Committee believes that amounts paid for leased space and other lease-related services are competitive with amounts that would be paid to a third party to lease similar space.

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SHAREHOLDER PROPOSALS FOR THE 2013 ANNUAL MEETING OF SHAREHOLDERS

Regulations of the Securities and Exchange Commission require proxy statements to disclose the date by which shareholder proposals must be received by us in order to be included in our proxy materials for the next annual meeting. In accordance with these regulations, shareholders are hereby notified that if they wish a proposal to be included in our proxy statement and form of proxy relating to the 2013 annual meeting, a written copy of their proposal must be received at the principal executive offices of the Company no later than December 31, 2012. To ensure prompt receipt by us, proposals should be sent certified mail return receipt requested. Proposals must comply with the proxy rules relating to shareholder proposals in order to be included in our proxy materials. Notice to us of a shareholder proposal submitted otherwise than pursuant to Rule 14a-8 will be considered untimely if received by us after December 31, 2012 and the proposal will not be brought before the meeting.

ANNUAL REPORT

A copy of our Annual Report for the year ended January 28, 2012 accompanies this proxy statement. Additional copies may be obtained by writing to Ms. Linda Tasseff, our Director, Investor Relations and Special Projects, at 1200 Riverplace Boulevard, Jacksonville, Florida 32207.

SHAREHOLDERS ARE URGED TO SPECIFY THEIR CHOICES AND VOTE BY INTERNET, TELEPHONE OR MAIL. INTERNET OR TELEPHONE VOTE AUTHORIZES THE NAMED PROXIES TO VOTE YOUR SHARES IN THE SAME MANNER AS IF YOU MARKED, SIGNED AND RETURNED YOUR PROXY CARD. IF YOU VOTE YOUR PROXY BY INTERNET OR BY TELEPHONE, YOU DO NOT NEED TO MAIL BACK YOUR PROXY CARD.

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STEIN MART, INC.

1200 RIVERPLACE BLVD

JACKSONVILLE, FL 32207

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

Electronic Delivery of Future PROXY MATERIALS

If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

KEEP THIS PORTION FOR YOUR RECORDS

DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

For	Withhold	For All	To withhold authority to vote for any individual nominee(s), mark For All Except and write the number(s) of the

	All	All	Except	nominee(s) on the line below.
The Board of Directors recommends you vote	..	..	..	

FOR the following:

1. Election of Directors

Nominees

01 Ralph Alexander 02 Alvin R. Carpenter 03 Irwin Cohen 04 Susan Falk 05 Linda M. Farthing

06 Mitchell W. Legler 07 Robert L. Mettler 08 Richard L. Sisisky 09 Jay Stein 10 Martin E. Stein, Jr.

11 John H. Williams, Jr.

The Board of Directors recommends you vote FOR proposals 2 and 3.	**For**	**Against**	**Abstain**
2 To approve an advisory resolution approving executive compensation for fiscal year 2011.	..	..	..
3 To ratify the appointment of PricewaterhouseCoopers LLP as the Company s independent registered certified public accounting firm for the fiscal year ending February 2, 2013.	..	..	..

NOTE: To transact such other business as may properly come before the meeting or any adjournment thereof.

For address change/comments, mark here. ..

(see reverse for instructions)

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name, by authorized officer.

Signature [PLEASE SIGN WITHIN BOX]	**Date**	**Signature (Joint Owners)**	**Date**

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Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting: The Notice & Proxy Statement, 2011 Annual Report on Form 10-K is/are available at www.proxyvote.com.

STEIN MART, INC.

THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS IN

CONNECTION WITH THE ANNUAL MEETING OF SHAREHOLDERS TO

BE HELD JUNE 19, 2012

The undersigned hereby appoints Jay Stein and John H. Williams, Jr., and each of them, with full power of substitution and revocation, as true and lawful agents and proxies of the undersigned to attend and vote all shares of Common Stock of Stein Mart, Inc., a Florida corporation, that the undersigned would be entitled to vote if then personally present at the Annual Meeting of Shareholders of Stein Mart, Inc., a Florida corporation, to be held on June 19, 2012 at 2:00 P.M., local time, at The Museum of Science and History, 1025 Museum Circle, Jacksonville, Florida, 32207 and at any adjournments thereof, hereby revoking any proxy heretofore given.

Address change/comments:

(If you noted any Address Changes and/or Comments above, please mark corresponding box on the reverse side.)

Continued and to be signed on reverse side