

SHOE CARNIVAL INC  
Form 10-Q  
September 11, 2008

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

**Form 10-Q**

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended **August 2, 2008**

or  
 **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-21360

**Shoe Carnival, Inc.**  
*(Exact name of registrant as specified in its charter)*

**Indiana**  
*(State or other jurisdiction of  
incorporation or organization)*

**35-1736614**  
*(IRS Employer Identification Number)*

**7500 East Columbia Street**  
**Evansville, IN**  
*(Address of principal executive offices)*

**47715**  
*(Zip code)*

**(812) 867-6471**  
*(Registrant's telephone number, including area code)*

**NOT APPLICABLE**  
*(Former name, former address and former fiscal year, if changed since last report)*

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

Yes                       No

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

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

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

Yes                       No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Number of Shares of Common Stock, \$.01 par value, outstanding at September 4, 2008 were 12,638,282.

**SHOE CARNIVAL, INC.  
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**SHOE CARNIVAL, INC.  
PART I - FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**SHOE CARNIVAL, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
Unaudited**

(In thousands, except per share data)	August 2, 2008	February 2, 2008	August 4, 2007
<b>Assets</b>			

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Current Assets:

Cash and cash equivalents	\$ 16,659	\$ 9,177	\$ 15,466
Accounts receivable	1,961	411	1,216
Merchandise inventories	208,409	200,781	210,043
Deferred income tax benefit	2,481	2,340	2,304
Other	8,383	7,221	10,542
Total Current Assets	237,893	219,930	239,571
Property and equipment-net	71,014	71,686	74,736
Total Assets	\$ 308,907	\$ 291,616	\$ 314,307

**Liabilities and Shareholders' Equity**

Current Liabilities:

Accounts payable	\$ 74,953	\$ 67,786	\$ 84,859
Accrued and other liabilities	14,546	10,689	13,493
Total Current Liabilities	89,499	78,475	98,352
Deferred lease incentives	4,735	5,396	5,442
Accrued rent	5,626	5,925	6,163
Deferred income taxes	917	399	534
Deferred compensation	3,395	3,559	3,543
Other	1,410	1,250	795
Total Liabilities	105,582	95,004	114,829

Shareholders' Equity:

Common stock, \$.01 par value, 50,000 shares authorized, 13,664, 13,670 and 13,673 shares issued at August 2, 2008, February 2, 2008 and August 4, 2007, respectively	137	137	137
Additional paid-in capital	72,821	75,523	75,169
Retained earnings	154,308	148,547	143,234
Treasury stock, at cost, 1,045, 1,205 and 665 shares at August 2, 2008, February 2, 2008 and August 4, 2007, respectively	(23,941)	(27,595)	(19,062)
Total Shareholders' Equity	203,325	196,612	199,478
Total Liabilities and Shareholders' Equity	\$ 308,907	\$ 291,616	\$ 314,307

See notes to condensed consolidated financial statements.

**SHOE CARNIVAL, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
Unaudited**

<b>(In Thousands, except per share data)</b>	<b>Thirteen Weeks Ended August 2, 2008</b>	<b>Thirteen Weeks Ended August 4, 2007</b>	<b>Twenty-six Weeks Ended August 2, 2008</b>	<b>Twenty-six Weeks Ended August 4, 2007</b>
Net sales	\$ 158,480	\$ 154,805	\$ 320,599	\$ 320,458
Cost of sales (including buying, distribution and occupancy costs)	116,334	114,558	231,373	230,420

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Gross profit		42,146	40,247	89,226	90,038
Selling, general and administrative expenses		40,661	40,118	79,984	79,443
Operating income		1,485	129	9,242	10,595
Interest income		(39)	(176)	(76)	(510)
Interest expense		36	32	69	64
Income before income taxes		1,488	273	9,249	11,041
Income tax expense		511	106	3,488	3,547
Net income	\$	977	\$ 167	\$ 5,761	\$ 7,494
Net income per share:					
Basic	\$	.08	\$ .01	\$ .47	\$ .56
Diluted	\$	.08	\$ .01	\$ .46	\$ .55
Average shares outstanding:					
Basic		12,367	13,091	12,360	13,295
Diluted		12,463	13,400	12,455	13,634

See notes to condensed consolidated financial statements.

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**SHOE CARNIVAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**Unaudited**

(In thousands)	Common Stock		Amount	Additional	Retained	Treasury
	Issued	Treasury		Paid-In	Earnings	Stock
Balance at February 2, 2008	13,670	(1,205)	\$ 137	\$ 75,523	\$ 148,547	\$ (27,595)
Stock option exercises		27		(312)		604
Stock-based compensation income tax benefit				(6)		
Employee stock purchase plan purchases		10		(123)		230
Restricted stock awards	(6)	123		(2,820)		2,820
Stock-based compensation expense				559		
Net income					5,761	
Balance at August 2, 2008	13,664	(1,045)	\$ 137	\$ 72,821	\$ 154,308	\$ (23,941)

See notes to condensed consolidated financial statements.

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**SHOE CARNIVAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Unaudited**

Twenty-six

Twenty-six

(In thousands)	Weeks Ended August 2, 2008	Weeks Ended August 4, 2007
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 5,761	\$ 7,494
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,286	7,834
Stock-based compensation	559	830
Loss on retirement and impairment of assets	109	389
Deferred income taxes	377	(216)
Lease incentives	174	0
Other	(1,135)	(334)
Changes in operating assets and liabilities:		
Accounts receivable	(1,550)	(268)
Merchandise inventories	(7,628)	(13,381)
Accounts payable and accrued liabilities	9,992	16,739
Other	(1,164)	(8,710)
Net cash provided by operating activities	13,781	10,377
<b>Cash Flows From Investing Activities</b>		
Purchases of property and equipment	(6,700)	(11,372)
Proceeds from sale of property and equipment	2	379
Other	0	6
Net cash used in investing activities	(6,698)	(10,987)
<b>Cash Flows From Financing Activities</b>		
Borrowings under line of credit	6,625	0
Payments on line of credit	(6,625)	0
Proceeds from issuance of stock	399	513
Excess tax benefits from stock-based compensation	0	290
Common stock repurchased	0	(19,566)
Net cash provided by (used in) financing activities	399	(18,763)
Net increase (decrease) in cash and cash equivalents	7,482	(19,373)
Cash and cash equivalents at beginning of period	9,177	34,839
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 16,659</b>	<b>\$ 15,466</b>
Supplemental disclosures of cash flow information:		
Cash paid during period for interest	\$ 66	\$ 64
Cash paid during period for income taxes	\$ 2,927	\$ 7,796
Capital expenditures incurred but not yet paid	\$ 3,092	\$ 2,773

See notes to condensed consolidated financial statements.

**SHOE CARNIVAL, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Unaudited**

**Note 1 - Basis of Presentation**

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In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly our financial position and the results of our operations and our cash flows for the periods presented. Certain information and disclosures normally included in the notes to consolidated financial statements have been condensed or omitted according to the rules and regulations of the Securities and Exchange Commission (the "SEC"), although we believe that the disclosures are adequate to make the information presented not misleading. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended February 2, 2008.

### Note 2 - Net Income Per Share

Net income per share of common stock is based on the weighted average number of shares and common share equivalents outstanding during the period. The following table presents a reconciliation of our basic and diluted (weighted average common shares outstanding as required by Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share"):

<b>(In thousands)</b>	<b>Thirteen Weeks Ended August 2, 2008</b>	<b>Thirteen Weeks Ended August 4, 2007</b>	<b>Twenty-six Weeks Ended August 2, 2008</b>	<b>Twenty-six Weeks Ended August 4, 2007</b>
Basic shares	12,367	13,091	12,360	13,295
Dilutive effect of stock-based awards	96	309	95	339
Diluted shares	12,463	13,400	12,455	13,634

Options to purchase 227,100 shares of common stock for the second quarter of fiscal 2008 and options to purchase 220,300 shares of common stock for the first six months of fiscal 2008 were not included in the computation of diluted shares because the options' exercise prices were greater than the average market price for the period. For the quarter and six months ended August 4, 2007, there were no anti-dilutive options.

### Note 3 □ Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB deferred the implementation of SFAS No. 157 for certain non-financial assets and liabilities for fiscal years beginning after November 15, 2008. We adopted the provisions of SFAS No. 157 for financial assets and liabilities on February 3, 2008 and elected to defer adoption for non-financial assets and liabilities. The adoption of SFAS No. 157 for financial assets did not have a material impact on our consolidated financial statements. We do not believe the adoption of SFAS No. 157 for certain non-financial assets and liabilities will have a material impact on our consolidated financial statements.

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In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 allows companies the choice to measure many financial instruments and certain other items at fair value. This gives companies the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. We adopted the provisions of SFAS No. 159 on February 3, 2008. As we did not elect the fair value measurement option for any of our financial assets and liabilities, the adoption did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" ("SFAS No. 141R"). SFAS No. 141R requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the acquired business at the acquisition date, measured at their full fair values as of that date. SFAS

No. 141R is effective for business combinations occurring after December 31, 2008, with early application prohibited. We do not believe the adoption of SFAS No. 141R will have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" an amendment of ARB No. 51 ("SFAS No. 160"). SFAS No. 160 establishes accounting and reporting standards that require (i) noncontrolling interests to be reported as a component of equity, (ii) changes in a parent's ownership interest while the parent retains its controlling interest to be accounted for as equity transactions, and (iii) any retained noncontrolling equity investment upon the deconsolidation of a subsidiary to be initially measured at fair value. SFAS No. 160 is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008, with early adoption prohibited. We do not believe the adoption of SFAS No. 160 will have a material impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" an amendment of FASB Statement No. 133 ("SFAS No. 161"). SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about how and why an entity uses derivative instruments, how the instruments are accounted for under FASB Statement No. 133 ("SFAS No. 133") and its related interpretations, and how the instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. We early adopted the disclosure requirements of SFAS No. 161 on February 3, 2008. The adoption did not have a material impact on our consolidated financial statements.

In April 2008, the FASB issued Staff Position No. FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, "Goodwill and Other Intangible Assets". FSP FAS 142-3 allows an entity to use its own historical experience in renewing or extending similar arrangements, adjusted for specified entity-specific factors, in developing assumptions about renewal or extension used to determine the useful life of a recognized intangible asset. Additional disclosures are required to enable financial statement users to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement. The guidance for determining the useful life of a recognized intangible asset is to be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements are to be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. FSP FAS 142-3 is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008, with early adoption prohibited. We do not believe the adoption of FSP FAS 142-3 will have a material impact on our consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"). SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board auditing amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." We will adopt SFAS No. 162 once it is effective and we are currently evaluating the effect that the adoption will have on our consolidated financial statements.

**Note 4 - Stock-Based Compensation**

Stock Options

The following table summarizes the stock option transactions pursuant to the stock-based compensation plans for the six months ended August 2, 2008:

	<b>Weighted- Average</b>	<b>Weighted- Average</b>	<b>Weighted- Average Remaining Contractual</b>	<b>Aggregate</b>
<b>Number of</b>	<b>Number of</b>	<b>Number of</b>	<b>Number of</b>	<b>Number of</b>

	Shares	Exercise Price	Term (Years)	Intrinsic Value (in thousands)
Outstanding at February 2, 2008	637,709	\$ 12.40		
Grants	15,000	14.79		
Forfeited or expired	(2,667)	15.33		
Exercised	(26,374)	11.06		
Outstanding August 2, 2008	623,668	\$ 12.51	3.73	\$ 1,983
Options outstanding at August 2, 2008, net of estimated forfeitures	617,772	\$ 12.51	3.67	\$ 1,968
Exercisable at August 2, 2008	577,834	\$ 12.50	3.27	\$ 1,864

The weighted-average fair value of options granted was \$6.46 during the first half of fiscal 2008. No stock options were granted during the first half of fiscal 2007. The fair value of options granted during the first half of fiscal 2008 was estimated at grant date using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	2008
Risk free interest rate	3.1%
Expected dividend yield	0.0%
Expected volatility	45.39%
Expected term	5 Years

The risk free interest rate was based on the U.S. Treasury yield curve in effect at the time of the grant. We had not paid and did not anticipate paying cash dividends; therefore, the expected dividend yield was assumed to be zero. Expected volatility was based on the historical volatility of our stock. The expected term of the options was based on our historical option exercise data taking into consideration the exercise and forfeiture patterns of the class of option holders during the option's life.

The following table summarizes information regarding options exercised during the thirteen and twenty-six week periods ended August 2, 2008 and August 4, 2007:

	Thirteen Weeks Ended August 2, 2008	Thirteen Weeks Ended August 4, 2007	Twenty-six Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 4, 2007
Total intrinsic value <sup>(1)</sup>	\$ 0	\$ 44,000	\$ 26,600	\$ 548,000
Total cash received	\$ 0	\$ 41,000	\$ 291,800	\$ 409,000
Associated excess income tax benefits recorded	\$ 0	\$ 10,000	\$ 6,000	\$ 190,000

(1) Defined as the difference between the market value at exercise and the grant price of stock options exercised.

The following table summarizes information regarding outstanding and exercisable options at August 2, 2008:



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Range of Exercise Price	Options Outstanding	Options Outstanding Weighted Average	Weighted Average Exercise Price	Options Exercisable	Options Exercisable Weighted Average Exercise Price
	Number of Options Outstanding	Remaining Life		Number of Options Exercisable	Weighted Average Exercise Price
\$ 4.38 - 5.75	61,162	2.34	\$ 4.46	61,162	\$ 4.46
\$ 8.56 - 12.63	209,585	2.84	\$ 10.77	178,751	\$ 10.65
\$ 12.67 - 16.30	195,301	5.16	\$ 13.16	180,301	\$ 13.03
\$ 17.12	157,620	3.67	\$ 17.12	157,620	\$ 17.12

The following table summarizes information regarding stock-based compensation expense for non-vested options recognized during the thirteen and twenty-six week periods ended August 2, 2008 and August 4, 2007:

	Thirteen Weeks Ended August 2, 2008	Thirteen Weeks Ended August 4, 2007	Twenty-six Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 4, 2007 <sup>(1)</sup>
Stock-based compensation expense before the recognized income tax benefit	\$ 21,700	\$ 17,000	\$ 37,400	\$ 39,000
Income tax benefit	\$ 7,500	\$ 6,000	\$ 14,100	\$ 15,000

(1) Income tax benefit was calculated using an adjusted effective tax rate. The adjusted rate removes the tax effect of a reduction in state income taxes from state incentives related to the investment in our new distribution center.

As of August 2, 2008, there was approximately \$184,000 of unrecognized compensation expense, net of estimated forfeitures, remaining related to non-vested stock options. This expense is expected to be recognized over a period of 2.6 years.

Restricted Stock Awards

The following table summarizes the restricted share transactions for the twenty-six week period ended August 2, 2008:

	Number of Shares	Weighted-Average Grant Date Fair Value
Non-vested at February 2, 2008	130,154	\$ 27.61
Granted	123,100	12.50
Forfeited	(5,535)	20.23
Non-vested at August 2, 2008	247,719	\$ 20.27

No previously non-vested stock awards vested during the first six months of fiscal 2008. The total fair value at grant date of previously non-vested stock awards that vested during the first six months of fiscal 2007 was \$831,000. The weighted-average grant date fair values of stock awards granted during the twenty-six week periods ended August 2, 2008 and August 4, 2007 were \$12.50 and \$29.42, respectively.

The following table summarizes information regarding stock-based compensation expense for restricted stock awards recognized during the thirteen and twenty-six week periods ended August 2, 2008 and August 4, 2007:

	<b>Thirteen Weeks Ended August 2, 2008</b>	<b>Thirteen Weeks Ended August 4, 2007</b>	<b>Twenty-six Weeks Ended August 2, 2008</b>	<b>Twenty-six Weeks Ended August 4, 2007<sup>(1)</sup></b>
Stock-based compensation expense before the recognized income tax benefit	\$ 296,100	\$ 332,000	\$ 503,000	\$ 773,000
Income tax benefit	\$ 101,700	\$ 129,000	\$ 189,700	\$ 291,000

(1) Income tax benefit was calculated using an adjusted effective tax rate. The adjusted rate removes the tax effect of a reduction in state income taxes from state incentives related to the investment in our new distribution center.

As of August 2, 2008, there was approximately \$3.1 million of unrecognized compensation expense remaining related to non-vested stock awards. The expense is expected to be recognized over a weighted average period of 2.7 years, incorporating the current assumptions of the estimated requisite service period required to achieve the designated performance conditions for performance-based stock awards.

#### Employee Stock Purchase Plan

The following table summarizes information regarding stock-based compensation expense recognized for the employee stock purchase plan during the thirteen and twenty-six week periods ended August 2, 2008 and August 4, 2007:

	<b>Thirteen Weeks Ended August 2, 2008</b>	<b>Thirteen Weeks Ended August 4, 2007</b>	<b>Twenty-six Weeks Ended August 2, 2008</b>	<b>Twenty-six Weeks Ended August 4, 2007<sup>(1)</sup></b>
Stock-based compensation expense before the recognized income tax benefit <sup>(2)</sup>	\$ 9,500	\$ 7,000	\$ 19,000	\$ 18,000
Income tax benefit	\$ 3,300	\$ 3,000	\$ 7,200	\$ 7,000

(1) Income tax benefit was calculated using an adjusted effective tax rate. The adjusted rate removes the tax effect of a reduction in state income taxes from state incentives related to the investment in our new distribution center.

(2) Amounts are representative of the 15% discount employees are provided for purchases under the employee stock purchase plan.

#### **Note 5 - Litigation Matters**

On or about April 22, 2008, an arbitration claim was filed by SDI Industries, Inc. ("SDI") against us with the American Arbitration Association Western Case Management Center in Los Angeles, California, captioned *SDI Industries, Inc. (Claimant and Counter-Respondent) v. Shoe Carnival, Inc. (Respondent and Counterclaimant)*, in which SDI seeks payment of \$1.04 million of unpaid retainage, as defined in our contract with SDI ("Contract"), plus additional interest and fees. The retainage was withheld from progress billings for work performed on our new distribution center and is recorded in accrued and other liabilities and fixed assets in our consolidated financial statements. On or about May 21, 2008, we filed a Counterclaim and Response in this matter, denying SDI's claim, and seeking monetary damages of more than \$3.0 million. We contend that SDI breached the Contract due to their failure to deliver our distribution center's material handling system pursuant to the specifications of the Contract. The hearing before the arbitration panel is currently scheduled for April 2009.

Although the investment we made in the new distribution center will satisfy our distribution needs throughout fiscal 2008, we have not achieved the productivity that we expect will be required in three to five years, based on

our long-term store growth plan. We are currently seeking proposals from other vendors to complete the work that we believe SDI failed to deliver and tentatively expect to have those modifications completed prior to the end of fiscal 2009.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Factors That May Effect Future Results**

This Quarterly Report on Form 10-Q contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve a number of risks and uncertainties. A number of factors could cause our actual results, performance, achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These factors include, but are not limited to: general economic conditions in the areas of the United States in which our stores are located; changes in the overall retail environment and more specifically in the apparel and footwear retail sectors; our ability to generate increased sales at our stores; the potential impact of national and international security concerns on the retail environment; changes in our relationships with key suppliers; the impact of competition and pricing; changes in weather patterns, consumer buying trends and our ability to identify and respond to emerging fashion trends; the impact of disruptions in our distribution or information technology operations; the effectiveness of our inventory management; the impact of hurricanes or other natural disasters on our stores, as well as on consumer confidence and purchasing in general; risks associated with the seasonality of the retail industry; our ability to successfully execute our growth strategy, including the availability of desirable store locations at acceptable lease terms, our ability to open new stores in a timely and profitable manner and the availability of sufficient funds to implement our growth plans; higher than anticipated costs associated with the closing of underperforming stores; the inability of manufacturers to deliver products in a timely manner; changes in the political and economic environments in the People's Republic of China, Brazil, Spain and East Asia, the primary manufacturers of footwear; and the continued favorable trade relations between the United States and China and the other countries which are the major manufacturers of footwear. For a more detailed discussion of certain risk factors see the "Risk Factors" section of our Annual Report on Form 10-K for the fiscal year ended February 2, 2008.

### **General**

Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to provide information to assist the reader in better understanding and evaluating our financial condition and results of operations. We encourage you to read this in conjunction with our condensed consolidated financial statements and the notes to those statements included in PART I, ITEM 1 FINANCIAL STATEMENTS of this Quarterly Report on Form 10-Q, as well as our Annual Report on Form 10-K for the fiscal year ended February 2, 2008 as filed with the SEC.

### **Overview of Our Business**

Shoe Carnival, Inc. is one of the nation's largest family footwear retailers. As of August 2, 2008, we operated 303 stores in 29 states primarily in the Midwest, South and Southeast regions of the United States. We offer a distinctive shopping experience, a broad merchandise assortment and value to our customers while maintaining an efficient store level cost structure.

Our stores combine competitive pricing with a highly promotional, in-store marketing effort that encourages customer participation and creates a fun and exciting shopping experience. We believe this highly promotional atmosphere results in various competitive advantages, including increased multiple unit sales; the building of a loyal, repeat customer base; the creation of word-of-mouth advertising; and enhanced sell through of in-season goods. Our objective is to be the destination store-of-choice for a wide range of consumers seeking moderately priced, current season name brand and private label footwear. Our product assortment includes dress and casual shoes, sandals, boots and a wide assortment of athletic shoes for the entire family. We believe that by offering a wide selection of both athletic and non-athletic footwear, we are able to reduce our exposure to shifts in fashion preferences between those categories.

Our marketing effort targets moderate income, value-conscious consumers seeking name brand footwear for all age groups. We believe that by offering a wide selection of popular styles of name brand merchandise at competitive prices, we generate broad customer appeal. Our cost-efficient store operations and real estate strategy enable us to price products competitively. Low labor costs are achieved by housing merchandise directly on the selling floor in an open-stock format, enabling customers to serve themselves, if they choose. This reduces the staffing required to assist customers and reduces store level labor costs as a percentage of sales. We locate stores predominantly in strip shopping centers in order to take advantage of lower occupancy costs and maximize our exposure to value-oriented shoppers.

In fiscal 2006, our Board of Directors authorized a \$50.0 million share repurchase program, which will terminate upon the earlier of the repurchase of the maximum amount or December 31, 2008. Share repurchases under this authorization may be made in the open market or in privately negotiated transactions. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements and other market conditions. As of August 2, 2008, approximately 1.2 million shares had been repurchased at an aggregate cost of \$28.1 million. The amount that remained available under the existing repurchase authorization at August 2, 2008 was \$21.9 million. No shares were repurchased during the first half of fiscal 2008.

### **Critical Accounting Policies**

It is necessary for us to include certain judgements in our reported financial results. These judgements involve estimates that are inherently uncertain and actual results could differ materially from these estimates. The accounting policies that require the more significant judgements are:

*Merchandise Inventories* - Merchandise inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) method. In determining market value, we estimate the future sales price of items of merchandise contained in the inventory as of the balance sheet date. Factors considered in this determination include, among others, current and recently recorded sales prices, the length of time product has been held in inventory and quantities of various product styles contained in inventory. The ultimate amount realized from the sale of certain product could differ materially from our estimates. We also estimate a shrinkage reserve for the period between the last physical count and the balance sheet date. The estimate for the shrinkage reserve can be affected by changes in merchandise mix and changes in actual shrinkage trends.

*Valuation of Long-Lived Assets* - We review long-lived assets whenever events or circumstances indicate the carrying value of an asset may not be recoverable and annually when no such event has occurred. We evaluate the ongoing value of assets associated with retail stores that have been open longer than one year. When events such as these occur, the assets subject to impairment are adjusted to estimated fair value and, if applicable, an impairment loss is recorded in selling, general and administrative expenses. Our assumptions and estimates used in the evaluation of impairment, including current and future economic trends for stores, are subject to a high degree of judgement and if actual results or market conditions differ from those anticipated, additional losses may be recorded.

*Income Taxes* - We calculate income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109") and account for uncertain tax positions in accordance with Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" an interpretation of FASB Statement No. 109 ("FIN 48"). Under SFAS No. 109, deferred tax assets and liabilities are recognized based on the difference between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the estimated tax rates in effect in the years when those temporary differences are expected to reverse. Under FIN 48, we are required to make many subjective assumptions and judgments regarding our income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations are often complex, ambiguous and change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in the consolidated financial statements.

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*Insurance Reserves* - We use a combination of self-insurance and third-party insurance for workers' compensation, employee medical and general liability insurance. These plans have stop-loss provisions that protect us from individual and aggregate losses over specified dollar values. When estimating our self-insured liabilities, we consider a number of factors, including historical claims experience, severity factors, statistical trends and, in certain instances, valuation assistance provided by independent third-parties. We will continue to

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evaluate our self-insured liabilities and the underlying assumptions on a quarterly basis and make adjustments as needed. The ultimate cost of these claims may be greater than or less than the established accruals. While we believe that the recorded amounts are adequate, there can be no assurance that changes to management's estimates will not occur due to limitations inherent in the estimating process. In the event we determine an accrual should be increased or reduced, we will record such adjustments in the period in which such determination is made.

**Results of Operations Summary Information**

Quarter Ended	Number of Stores			End of Period	Store Square Footage Net Change	Store Square Footage End of Period	Comparable Store Sales
	Beginning Of Period	Opened	Closed				
May 3, 2008	291	2	0	293	16,000	3,254,000	(4.9)%
August 2, 2008	293	12	2	303	87,000	3,341,000	(1.0)%
Year-to-date 2008	291	14	2	303	103,000	3,341,000	(3.0)%
May 5, 2007	271	7	0	278	66,000	3,128,000	(3.7)%
August 4, 2007	278	6	0	284	59,000	3,187,000	(7.1)%
Year-to-date 2007	271	13	0	284	125,000	3,187,000	(5.4)%

Comparable store sales for the periods indicated include stores that have been open for 13 full months prior to the beginning of the period, including those stores that have been relocated or remodeled. Therefore, stores opened or closed during the periods indicated are not included in comparable store sales.

The following table sets forth our results of operations expressed as a percentage of net sales for the periods indicated:

	Thirteen Weeks Ended August 2, 2008	Thirteen Weeks Ended August 4, 2007	Twenty-six Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 4, 2007
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales (including buying, distribution and occupancy costs)	73.4	74.0	72.2	71.9
Gross profit	26.6	26.0	27.8	28.1
Selling, general and administrative expenses	25.7	25.9	24.9	24.8
Operating income	0.9	0.1	2.9	3.3
Interest income	0.0	(0.1)	0.0	(0.1)
Interest expense	0.0	0.0	0.0	0.0
Income before income taxes	0.9	0.2	2.9	3.4
Income tax expense	0.3	0.1	1.1	1.1
Net income	0.6%	0.1%	1.8%	2.3%

**Operational Summary**

The second quarter found us again challenged by the slowdown in consumer spending. We believe the federal economic stimulus program helped to mitigate our year-over-year decline in comparable store traffic during June and early July. However, as the influx of this additional disposable income tapered off, the consumer once again retreated to a very conservative shopping pattern in the last two weeks of July.

Total comparable store sales decreased 1% for the second quarter and decreased 3% for the first six months of fiscal 2008 when compared to the same periods in the prior year. The decline for both periods came from our women's non-athletic department due in part to the lack of fashion direction for the spring season and the

reduction in discretionary spending by our targeted moderate income consumer.

We were able to achieve a year-over-year net realized price increase on our footwear sales during both the first and second quarters, particularly within our adult and children's athletic categories. These athletic price increases have been primarily driven by performance running, which is continuing to play a larger part of our overall athletic business. Despite a decline in consumer traffic through our doors which resulted in selling fewer footwear units, these price increases enabled us to generate positive comparable store sales of athletic footwear in both quarters.

We realize the current level of economic uncertainty within the US marketplace is altering the spending habits of all consumers. We believe our targeted moderate income consumers will continue to experience a negative effect on their disposable income as a result of rising fuel and food prices, issues in the home mortgage industry, and rising unemployment in many regions of the US. Additionally, the footwear industry is one of many industries facing the rising cost of Chinese imports. Our strategy for mitigating the effect of these challenges will include tightly controlling our inventories, continuing to increase the net realized price of our footwear, maintaining a low cost structure and enhancing delivery of our value and fashion proposition to our customer. We believe these strategies will enable us to continue to maintain profitable operations in addition to differentiating ourselves from our competitors and increasing market share.

### **Results of Operations for the Second Quarter Ended August 2, 2008**

#### *Net Sales*

Net sales increased \$3.7 million to \$158.5 million during the second quarter ended August 2, 2008, a 2.4% increase from net sales of \$154.8 million in the second quarter ended August 4, 2007. The increase in net sales was primarily due to the \$5.2 million increase in sales generated by the 33 new stores opened since April of fiscal 2007, net of sales lost from the seven stores which were closed during this same period. This increase was partially offset by a comparable store sales decline of 1.0%.

#### *Gross Profit*

Gross profit increased \$1.9 million to \$42.1 million in the second quarter of fiscal 2008 from gross profit of \$40.2 million in the comparable prior year period. Our gross profit margin in the second quarter of fiscal 2008 increased to 26.6% from 26.0% in the comparable prior year period. As a percentage of sales, the merchandise margin increased 0.9%, while buying, distribution and occupancy costs increased 0.3%. The increase in merchandise margin, as a percentage of sales, was largely related to a more balanced markdown rate between the first and second quarters as compared to the prior year where the second quarter saw markdowns accelerate considerably in order to sell through slow moving product. We experienced a 0.4% increase in occupancy costs, as a percentage of sales, primarily as a result of the lower comparable store sales and an increase in costs due to the additional stores we operated in the second quarter of 2008.

#### *Selling, General and Administrative Expenses*

In the second quarter of fiscal 2008, selling, general and administrative expenses increased \$543,000 to \$40.7 million, or 25.7% of sales, from \$40.1 million, or 25.9% of sales, in the comparable prior year period. The \$543,000 increase was primarily the result of the \$1.5 million of additional costs incurred from the operation and support of the net new stores opened since April of fiscal 2007, along with a \$700,000 increase in self-insured health care costs resulting predominantly from several large medical claims. These increases were partially offset by a \$2.0 million decrease in advertising costs. The decrease in advertising resulted from changes in our media mix and a market level analysis whereby we revised the level of advertising for each location based on current market trends and store performance.

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Pre-opening costs were \$406,000, or 0.3% of sales, for the second quarter of fiscal 2008 as compared to \$268,000, or 0.2% of sales, for the second quarter of fiscal 2007. We opened 12 stores in the second quarter of fiscal 2008 as compared to six stores in the second quarter of fiscal 2007. Pre-opening costs, such as advertising, payroll and supplies, incurred prior to the opening of a new store are charged to expense in the period they are incurred. The total amount of pre-opening expense incurred will vary by store depending on the specific market and the promotional activities involved.

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Store closing costs included in selling, general and administrative expenses were \$387,000, or 0.2% of sales, for the second quarter of fiscal 2008 as compared to \$375,000, or 0.2% of sales, for the second quarter of fiscal 2007. Two stores were closed during the second quarter of fiscal 2008 and no stores were closed during the second quarter of fiscal 2007. The timing and actual amount of expense recorded in closing a store can vary significantly depending in part on the period in which management commits to a closing plan, the remaining basis in the fixed assets to be disposed of at closing and the amount of any lease buyout.

### *Interest (Income) Expense, Net*

We recorded net interest income of \$3,000 in the second quarter of fiscal 2008 as compared to net interest income of \$144,000 in the second quarter of the prior year. This decrease in interest income was primarily the result of a decline in the cash available for short-term investment.

### *Income Taxes*

The effective income tax rate for the second quarter of fiscal 2008 decreased to 34.3% from 38.7% for the same time period in fiscal 2007. The change in effective income tax rates between the two periods was primarily due to lower state income taxes.

### *Net Income*

Net income for the second quarter of fiscal 2008 increased to \$977,000 from \$167,000 in the second quarter of fiscal 2007. Diluted earnings per share increased to \$0.08 in the second quarter of fiscal 2008 from \$0.01 in the second quarter of fiscal 2007.

Our average diluted shares outstanding at the end of the second quarter of fiscal 2008 were 12.5 million or approximately 7.0% lower than the 13.4 million average diluted shares outstanding at the end of the second quarter last year. This decrease was primarily due to the 1.2 million shares repurchased in fiscal 2007 as part of our \$50.0 million share repurchase program.

## **Results Of Operations for the Six Months Ended August 2, 2008**

### *Net Sales*

Net sales increased \$141,000 to \$320.6 million during the six months ended August 2, 2008, from net sales of \$320.5 million in the comparable prior year period. We experienced a \$9.4 million increase as a result of the sales generated by the 39 new stores opened since February 3, 2007, net of sales lost from the seven stores which were closed during this same period. This increase was mostly offset by a 3.0% decline in comparable store sales.

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### *Gross Profit*

Gross profit decreased \$812,000 to \$89.2 million in the first six months of fiscal 2008 from gross profit of \$90.0 million in the comparable prior year period. Our gross profit margin in the first half of fiscal 2008 decreased to 27.8% from 28.1% in the comparable prior year period. As a percentage of sales, the merchandise margin remained flat, while buying, distribution and occupancy costs increased 0.3%. Occupancy costs, as a percentage of sales, increased 0.5% primarily as a result of lower comparable store sales and an increase in costs due to the additional stores we operated. This increase, as a percentage of sales, was partially offset by a 0.3% decline in distribution costs. Our distribution costs, both as a percentage of sales and in dollars, declined predominantly as a result of costs associated with the conversion to our new distribution center during the first quarter of the prior year. These additional costs incurred in the first quarter of fiscal 2007 totaled \$936,000, or \$0.04 per diluted share.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased \$541,000 to \$80.0 million or 24.9% of sales in the first half of fiscal 2008 from \$79.4 million or 24.8% of sales in the comparable prior year period. The increase was primarily the result of the \$2.8 million of additional costs incurred as a result of the operation and support of the

net new stores opened since February of fiscal 2007, along with a \$800,000 increase in self-insured health care costs resulting primarily from several large medical claims. These increases were partially offset by a \$2.6 million decrease in advertising costs. The decrease in advertising resulted from changes in our media mix and a market level analysis whereby we revised the level of advertising for each location primarily during the second quarter based on current market trends and store performance. We do not expect to significantly reduce our advertising spending, as compared to the prior year, during the remainder of fiscal 2008.

Pre-opening costs were \$440,000, or 0.1% of sales, for the first half of fiscal 2008 as compared to \$556,000, or 0.2% of sales, for the first six months of fiscal 2007. We opened 14 stores in the first six months of fiscal 2008 as compared to 13 stores in the first six months of fiscal 2007. Pre-opening costs, such as advertising, payroll and supplies, incurred prior to the opening of a new store are charged to expense in the period they are incurred. The total amount of pre-opening expense incurred will vary by store depending on the specific market and the promotional activities involved.

Store closing costs included in selling, general and administrative expenses were \$672,000, or 0.2% of sales, for the first half of fiscal 2008 as compared to \$430,000, or 0.1% of sales, for the first half of fiscal 2007. Two stores were closed during the first half of fiscal 2008 and no stores were closed during the first half of fiscal 2007. We expect to close nine stores during the remainder of fiscal 2008 as compared to five stores in the second half of fiscal 2007. We will continue to evaluate underperforming stores for possible closing on a routine basis, which may result in the identification of additional store closings for the current or future fiscal years. The timing and actual amount of expense recorded in closing a store can vary significantly depending in part on the period in which management commits to a closing plan, the remaining basis in the fixed assets to be disposed of at closing and the amount of any lease buyout.

#### *Interest (Income) Expense, Net*

We recorded net interest income of \$7,000 in the first half of fiscal 2008 as compared to net interest income of \$446,000 in the first half of the prior year. This decrease in interest income was primarily the result of a decline in the cash available for short-term investment.

#### *Income Taxes*

The effective income tax rate for the first six months of fiscal 2008 increased to 37.7% from 32.1% compared to the same time period in 2007. The change in effective income tax rates between the two periods was primarily due to the fiscal 2007 reduction in state income taxes from state incentives related to the investment in our new distribution center. The reduction in income tax expense related to the tax incentives resulted in an increase of approximately \$0.05 in earnings per diluted share for the first six months of fiscal 2007.

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#### *Net Income*

For the first six months of fiscal 2008, net income decreased to \$5.8 million from \$7.5 million in the first six months of fiscal 2007. Diluted earnings per share decreased to \$0.46 in the first six months of fiscal 2008 from \$0.55 in the first six months of fiscal 2007.

Our average diluted shares outstanding at the end of the first half of fiscal 2008 were 12.5 million or approximately 8.7% lower than the 13.6 million average diluted shares outstanding at the end of the first half last year. This decrease was primarily due to the 1.2 million shares repurchased in fiscal 2007 as part of our \$50.0 million share repurchase program.

#### **Liquidity and Capital Resources**

Our primary sources of funds are cash flows from operations and borrowings under our revolving credit facility. Our net cash provided by operations was \$13.8 million in the first six months of fiscal 2008 as compared to \$10.4 million in the first six months of 2007, for an increase of net cash provided by operations of \$3.4 million. This difference, when comparing the two periods of each year, was primarily due to a reduction in the use of cash for the payment of income taxes partially offset by the timing of payments for accounts payable (net of the change in inventory) and accrued liabilities.



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Working capital increased to \$148.4 million at August 2, 2008 from \$141.2 million at August 4, 2007. The current ratio at August 2, 2008 was 2.7 as compared to 2.4 at August 4, 2007. We had no long-term debt as of the end of either period.

We expended \$6.7 million in cash during the first half of fiscal 2008 for the purchase of property and equipment. Of this amount, \$5.8 million was used for new stores, store remodeling and store relocation projects. The remaining capital expenditures were used primarily for information technology and miscellaneous equipment purchases.

During the first half of fiscal 2008, we opened 14 new stores. This compares to 13 store openings in the first half of fiscal 2007. We anticipate opening an additional ten stores and closing nine stores during the remainder of fiscal 2008. Additional capital expenditures of approximately \$10.5 million to \$11.0 million will be made over the course of fiscal 2008 for the opening of new stores, store remodels and various other store improvements, along with continued investments in technology and normal asset replacement activities. The actual amount of cash required for capital expenditures for store operations depends in part on the number of new stores opened, the amount of lease incentives, if any, received from landlords and the number of stores remodeled. The opening of new stores will be dependent upon, among other things, the availability of desirable locations, the negotiation of acceptable lease terms and general economic and business conditions affecting consumer spending in areas we target for expansion.

Our current store prototype uses between 6,500 and 12,000 square feet depending upon, among other factors, the location of the store and the population base the store is expected to service. For fiscal 2008, our new stores will average proximately 8,900 square feet. Capital expenditures for a new store in fiscal 2008 are expected to average approximately \$290,000 and tenant improvement allowances are expected to average \$30,000. The average inventory investment in a new store is expected to range from \$300,000 to \$550,000 depending on the size and sales expectation of the store and the timing of the new store opening. Pre-opening expenses, such as advertising, salaries and supplies, are expected to average approximately \$48,000 per store in fiscal 2008, with individual stores experiencing variances in expenditure levels based on the specific market.

As of August 2, 2008, our unsecured credit facility provided for up to \$95.0 million in cash advances on a revolving basis and commercial letters of credit. Borrowings under the revolving credit line are based on eligible inventory. The agreement governing the credit facility stipulates a minimum threshold for net worth, a maximum ratio of funded debt plus rent to EBITDA plus rent, and a maximum of total distributions for stock repurchases and cash dividends. We were in compliance with these requirements as of August 2, 2008. Should a default condition be reported, the lenders may preclude additional borrowings and call all loans and accrued interest at their discretion. At August 2, 2008, there were no borrowings outstanding under the credit facility and \$9.9 million in letters of credit outstanding. As of August 2, 2008, \$85.1 million was available to us for additional borrowings under the credit facility.

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On June 10, 2008, we entered into an amendment to our credit agreement with our bank group which increased our credit facility by \$25.0 million for a total of \$95.0 million available for both cash advances and the issuance of commercial letters of credit. No other changes to the existing terms of the credit agreement were made in connection with the June 10, 2008 amendment. The credit agreement and amendments thereto are incorporated by reference in this Quarterly Report on Form 10-Q.

During fiscal 2006, our Board of Directors authorized a \$50.0 million share repurchase program, which will terminate upon the earlier of the repurchase of the maximum amount or December 31, 2008. Share repurchases under this authorization may be made in the open market or in privately negotiated transactions. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements and other market conditions. As of August 2, 2008, approximately 1.2 million shares had been repurchased at an aggregate cost of \$28.1 million. The amount that remained available under the existing repurchase authorization at August 2, 2008 was \$21.9 million. No shares have been repurchased during fiscal 2008.

On or about April 22, 2008, an arbitration claim was filed by SDI Industries, Inc. ("SDI") against us with the American Arbitration Association Western Case Management Center in Los Angeles, California, captioned *SDI Industries, Inc. (Claimant and Counter-Respondent) v. Shoe Carnival, Inc. (Respondent and Counterclaimant)*, in which SDI seeks payment of \$1.04 million of unpaid retainage, as defined in our contract with SDI ("Contract"),

plus additional interest and fees. The retainage was withheld from progress billings for work performed on our new distribution center and is recorded in accrued and other liabilities and fixed assets in our consolidated financial statements. On or about May 21, 2008, we filed a Counterclaim and Response in this matter, denying SDI's claim, and seeking monetary damages of more than \$3.0 million. We contend that SDI breached the Contract due to their failure to deliver our distribution center's material handling system pursuant to the specifications of the Contract. The hearing before the arbitration panel is currently scheduled for April 2009.

Although the investment we made in the new distribution center will satisfy our distribution needs throughout fiscal 2008, we have not achieved the productivity that we expect will be required in three to five years, based on our long-term store growth plan. We are currently seeking proposals from other vendors to complete the work that we believe SDI failed to deliver and tentatively expect to have those modifications complete prior to the end of fiscal 2009.

We anticipate that our existing cash and cash flow from operations, supplemented by borrowings under our revolving credit line, will be sufficient to fund our planned store expansion along with other capital expenditures, any future repurchase of our common stock under our current repurchase plan and working capital requirements for at least the next 12 months.

### **Seasonality**

Our quarterly results of operations have fluctuated and are expected to continue to fluctuate in the future primarily as a result of seasonal variances and the timing of sales and costs associated with opening new stores. Non-capital expenditures, such as advertising and payroll, incurred prior to opening a new store are charged to expense as incurred. Therefore, our results of operations may be adversely affected in any quarter in which we incur pre-opening expenses related to the opening of new stores.

We have three distinct peak selling periods: Easter, back-to-school and Christmas.

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### **New Accounting Pronouncements**

Recent accounting pronouncements applicable to our operations are contained in Note 3 □ "Recently Issued Accounting Pronouncements" contained in the Notes to Condensed Consolidated Financial Statements included in PART I, ITEM 1. FINANCIAL STATEMENTS of this Quarterly Report on Form 10-Q.

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

We are exposed to market risk in that the interest payable under our credit facility is based on variable interest rates and therefore is affected by changes in market rates. We do not use interest rate derivative instruments to manage exposure to changes in market interest rates. A 1% change in the weighted average interest rate charged under the credit facility would have resulted in interest expense fluctuating by less than \$1,000 for the first half of fiscal 2008.

### **ITEM 4. CONTROLS AND PROCEDURES**

Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of August 2, 2008, that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management is continuously seeking to improve the efficiency and effectiveness of our operations and internal controls. This results in refinements to processes throughout the company. As part of our continued strategy to grow our store base and increase capacity, we are in the process of redesigning certain elements of the material handling system in our distribution center. The internal controls impacted by this project are mainly automated

and operational in nature. See our Notes to Condensed Consolidated Financial Statements, Note 5 □ "Litigation Matters" included in PART I, ITEM 1. FINANCIAL STATEMENTS of this Quarterly Report on Form 10-Q for further details on this matter. There have been no other changes in our internal control over financial reporting that occurred during the quarter ended August 2, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**SHOE CARNIVAL, INC.**  
**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information set forth in Note 5 □ "Litigation Matters" contained in the Notes to Condensed Consolidated Financial Statement included in PART I, ITEM 1. FINANCIAL STATEMENTS of this Quarterly Report on Form 10-Q is incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

You should carefully consider the risks and uncertainties we describe both in this Quarterly Report on Form 10-Q and in the "Risk Factors" section of our Annual Report on Form 10-K for the fiscal year ended February 2, 2008 before deciding to invest in, or retain, shares of our common stock. These are not the only risks and uncertainties that we face. Additional risks and uncertainties that we do not currently know about, we currently believe are immaterial or we have not predicted may also harm our business operations or adversely affect us. If any of these risks or uncertainties actually occur, our business, financial condition, results of operations or cash flows could be materially adversely affected. There have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the fiscal year ended February 2, 2008.

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

The annual meeting of our common shareholders was held June 12, 2008.

**Election of Directors**

J. Wayne Weaver and Gerald W. Schoor were elected at the annual meeting to serve as our Directors for three-year terms. Mr. Weaver received 11,554,066 votes in favor of his election and 115,094 votes were withheld. Mr. Schoor received 11,591,053 votes in favor of his election and 78,107 votes were withheld.

In addition, the following Directors continue in office until the annual meeting of shareholders in the year indicated:

William E. Bindley 2009  
Kent A. Kleeberger 2009  
Mark L. Lemond 2010

**Other Matters Voted Upon at the Meeting**

The appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2008 was ratified. Votes of 11,651,651 were cast in favor, 13,610 votes were cast against, 3,899 abstentions were recorded, and no broker non-votes were recorded with respect to such ratification.

The amendment to the Shoe Carnival, Inc. 2000 Stock Option and Incentive Plan was approved. This amendment increased the number of shares of our common stock subject to issuance under the Plan from 1,500,000 to 2,000,000. This amendment also extended the term of the Plan until the later of ten years from date of adoption of the plan by our shareholders or the approval of any amendment of the plan by our shareholders. Votes of 7,848,098 were cast in favor, 2,457,322 votes were cast against, 4,094 abstentions were recorded, and 1,359,646 broker non-votes were recorded with respect to the amendment.

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**ITEM 6. EXHIBITS**

- (a) Exhibits
- 3-A Restated Articles of Incorporation of Registrant (incorporated herein by reference from the same exhibit number to the Registrant's Annual Report on Form 10-K for the year ended February 2, 2002)
- 3-B By-laws of Registrant, as amended to date (incorporated herein by reference from the same exhibit number to our Current Report on Form 8-K filed on March 19, 2007)
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- (i) Amended and Restated Credit Agreement and Promissory Notes dated April 16, 1999, between Registrant and Mercantile Bank National Association, First Union National Bank and Old National Bank (incorporated herein by reference from Exhibit 4(I) to the Registrant's Annual Report on Form 10-K for the year ended January 30, 1999)
- (ii) Amendment to Amended and Restated Credit Agreement and Promissory Notes dated March 24, 2000, between Registrant and Mercantile Bank National Association, First Union National Bank and Old National Bank (incorporated herein by reference from the same exhibit number to the Registrant's Annual Report on Form 10-K for the year ended January 29, 2000)
- (iii) Second Amendment to Amended and Restated Credit Agreement and Promissory Notes dated November 8, 2000, between Registrant and Firststar Bank N.A., First Union National Bank, Old National Bank and LaSalle Bank National Association (incorporated herein by reference from the same exhibit number to the Registrant's Quarterly Report on Form 10-Q for the quarter ended October 28, 2000)
- (iv) Third Amendment to Amended and Restated Credit Agreement and Promissory Notes dated March 18, 2002, between Registrant and U.S. Bank National Association, First Union National Bank, Old National Bank and LaSalle Bank National Association (incorporated herein by reference from the same exhibit number to the Registrant's Annual Report on Form 10-K for the year ended February 2, 2002)
- (v) Fourth Amendment to Amended and Restated Credit Agreement and Promissory Notes dated March 12, 2003, between Registrant and U.S. Bank National Association, Wachovia Bank National Association, Old National Bank and LaSalle Bank National Association (incorporated herein by reference from the same exhibit number to the Registrant's Annual Report on Form 10-K for the year ended February 1, 2003)
- (vi) Fifth Amendment to Amended and Restated Credit Agreement and Promissory Notes dated April 5, 2004, between Registrant and U.S. Bank National Association, Wachovia Bank National Association, Old National Bank and LaSalle Bank National Association (incorporated herein by reference from the same exhibit number to the Registrant's Annual Report on Form 10-K for the year ended January 31, 2004)

(vii) Assignment Agreement dated June 1, 2004 among LaSalle Bank National Association as Assignor, Fifth Third Bank (Southern Indiana) as Assignee, Registrant as Borrower and U.S. Bank National Association as Agent relating to the Amended and Restated Credit Agreement as further amended (incorporated herein by reference from the same exhibit number to the Registrant's Quarterly Report on Form 10-Q for the quarter ended May 1, 2004)

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(a) Exhibits (continued)

(ix) Seventh Amendment to Amended and Restated Credit Agreement and Notes dated March 31, 2006, between Registrant and U.S. Bank National Association, Wachovia Bank, National Association and Fifth Third Bank (incorporated herein by reference from the same exhibit number to the Registrant's Current Report on Form 8-K filed on April 4, 2006)

(x) Eighth Amendment to Amended and Restated Credit Agreement and Notes dated December 15, 2006, between Registrant and U.S. Bank National Association, Wachovia Bank, National Association and Fifth Third Bank (incorporated herein by reference from the same exhibit number to the Registrant's Current Report on Form 8-K filed on December 11, 2006)

(xi) Ninth Amendment to Amended and Restated Credit Agreement and Notes dated June 10, 2008, between Registrant and U.S. Bank National Association, Wachovia Bank, National Association and Fifth Third Bank (incorporated herein by reference from the same exhibit number to the Registrant's Quarterly Report on Form 10-Q for the quarter ended May 3, 2008)

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SHOE CARNIVAL, INC.**  
**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed, on its behalf by the undersigned thereunto duly authorized.

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Date: June 11, 2008

SHOE CARNIVAL, INC.  
(Registrant)

By: /s/ W. Kerry Jackson  
W. Kerry Jackson  
Executive Vice President and  
Chief Financial Officer