

STAGE STORES INC  
Form 10-Q  
December 11, 2014

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

Form 10-Q

(Mark One)

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

For the quarterly period ended November 1, 2014

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 1-14035

Stage Stores, Inc.

(Exact name of registrant as specified in its charter)

NEVADA

91-1826900

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

10201 Main Street, Houston, Texas

77025

(Address of principal executive offices)

(Zip Code)

(800) 579-2302

(Registrant's telephone number, including area code)

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

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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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 ☒

As of December 2, 2014, there were 31,629,430 shares of the registrant's common stock outstanding.

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## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Stage Stores, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except par value)

(Unaudited)

|  | November 1,<br>2014 | February 1,<br>2014 |
|--|---------------------|---------------------|
| <b>ASSETS</b>  |                     |                     |
| Cash and cash equivalents  | \$20,786            | \$14,762            |
| Merchandise inventories, net   | 574,976             | 434,407             |
| Prepaid expenses and other current assets  | 45,312              | 40,082              |
| Total current assets   | 641,074             | 489,251             |
| Property, equipment and leasehold improvements, net of accumulated depreciation of \$566,577 and \$537,752, respectively | 285,293             | 282,534             |
| Intangible asset   | 14,910              | 14,910              |
| Other non-current assets, net  | 22,810              | 24,142              |
| Total assets   | \$964,087           | \$810,837           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                     |                     |
| Accounts payable   | \$232,134           | \$125,707           |
| Accrued expenses and other current liabilities   | 69,260              | 69,549              |
| Total current liabilities  | 301,394             | 195,256             |
| Long-term debt obligations   | 127,955             | 60,871              |
| Other long-term liabilities  | 95,441              | 100,266             |
| Total liabilities  | 524,790             | 356,393             |
| Commitments and contingencies  | —                   | —                   |
| Common stock, par value \$0.01, 100,000 shares authorized, 31,796 and 31,222 shares issued, respectively                 | 318                 | 312                 |
| Additional paid-in capital   | 394,211             | 384,295             |
| Less treasury stock - at cost, 0 and 0 shares, respectively  | (868)               | (967)               |
| Accumulated other comprehensive loss   | (4,431)             | (4,616)             |
| Retained earnings  | 50,067              | 75,420              |
| Total stockholders' equity   | 439,297             | 454,444             |
| Total liabilities and stockholders' equity   | \$964,087           | \$810,837           |

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

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Stage Stores, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(in thousands, except per share data)

(Unaudited)

|   | Three Months Ended  |                     | Nine Months Ended   |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | November 1,<br>2014 | November 2,<br>2013 | November 1,<br>2014 | November 2,<br>2013 |
| Net sales   | \$364,197           | \$354,850           | \$1,113,683         | \$1,116,944         |
| Cost of sales and related buying, occupancy and distribution expenses                                   | 276,031             | 271,560             | 835,236             | 828,450             |
| Gross profit  | 88,166              | 83,290              | 278,447             | 288,494             |
| Selling, general and administrative expenses  | 94,652              | 96,551              | 283,814             | 291,987             |
| Store opening costs   | 998                 | 1,355               | 2,030               | 2,452               |
| Interest expense  | 814                 | 718                 | 2,293               | 2,012               |
| Loss from continuing operations before income tax   | (8,298)             | ) (15,334           | ) (9,690            | ) (7,957            |
| Income tax benefit  | (3,191)             | ) (5,761            | ) (3,729            | ) (3,028            |
| Loss from continuing operations   | (5,107)             | ) (9,573            | ) (5,961            | ) (4,929            |
| Loss from discontinued operations, net of tax benefit of \$65, \$909, \$4,322 and \$2,023 respectively  | (161)               | ) (1,398            | ) (6,909            | ) (3,291            |
| Net loss  | \$(5,268)           | ) \$(10,971         | ) \$(12,870         | ) \$(8,220          |
| Other comprehensive income:   |                     |                     |                     |                     |
| Amortization of employee benefit related costs, net of tax of \$38, \$58, \$114 and \$174, respectively | \$62                | \$95                | 185                 | 284                 |
| Total other comprehensive income  | 62                  | 95                  | 185                 | 284                 |
| Comprehensive loss  | \$(5,206)           | ) \$(10,876         | ) \$(12,685         | ) \$(7,936          |
| Basic loss per share data:  |                     |                     |                     |                     |
| Continuing operations   | \$(0.16)            | ) \$(0.30           | ) \$(0.19           | ) \$(0.15           |
| Discontinued operations   | (0.01)              | ) (0.04             | ) (0.22             | ) (0.10             |
| Basic loss per share  | \$(0.17)            | ) \$(0.34           | ) \$(0.41           | ) \$(0.25           |
| Basic weighted average shares outstanding   | 31,794              | 31,854              | 31,681              | 32,307              |
| Diluted loss per share data:  |                     |                     |                     |                     |
| Continuing operations   | \$(0.16)            | ) \$(0.30           | ) \$(0.19           | ) \$(0.15           |
| Discontinued operations   | (0.01)              | ) (0.04             | ) (0.22             | ) (0.10             |
| Diluted loss per share  | \$(0.17)            | ) \$(0.34           | ) \$(0.41           | ) \$(0.25           |
| Diluted weighted average shares outstanding   | 31,794              | 31,854              | 31,681              | 32,307              |

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

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Stage Stores, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

|   | Nine Months Ended   |                     |
|---|---------------------|---------------------|
|   | November 1,<br>2014 | November 2,<br>2013 |
| Cash flows from operating activities:                                       |                     |                     |
| Net loss  | \$(12,870           | ) \$(8,220 )        |
| Adjustments to reconcile net loss to net cash used in operating activities: |                     |                     |
| Depreciation, amortization and impairment of long-lived assets              | 46,896              | 46,052              |
| Loss on retirements of property, equipment and leasehold improvements       | 854                 | 257                 |
| Deferred income taxes   | (451                | ) (847 )            |
| Tax benefit from stock-based compensation                                   | 109                 | 1,798               |
| Stock-based compensation expense  | 7,018               | 6,580               |
| Amortization of debt issuance costs   | 220                 | 204                 |
| Excess tax benefits from stock-based compensation                           | (829                | ) (2,041 )          |
| Deferred compensation obligation  | (104                | ) 236               |
| Amortization of employee benefit related costs                              | 299                 | 458                 |
| Construction allowances from landlords                                      | 5,529               | 4,162               |
| Changes in operating assets and liabilities:                                |                     |                     |
| Increase in merchandise inventories   | (140,569            | ) (137,622 )        |
| Increase in other assets  | (3,500              | ) (14,733 )         |
| Increase in accounts payable and other liabilities                          | 93,021              | 58,248              |
| Total adjustments   | 8,493               | (37,248 )           |
| Net cash used in operating activities                                       | (4,377              | ) (45,468 )         |
| Cash flows from investing activities:                                       |                     |                     |
| Additions to property, equipment and leasehold improvements                 | (48,308             | ) (46,717 )         |
| Proceeds from disposal of assets  | 1,468               | 11                  |
| Net cash used in investing activities                                       | (46,840             | ) (46,706 )         |
| Cash flows from financing activities:                                       |                     |                     |
| Proceeds from revolving credit facility borrowings                          | 331,518             | 382,510             |
| Payments of revolving credit facility borrowings                            | (262,970            | ) (250,910 )        |
| Payments of long-term debt obligations                                      | (2,017              | ) (551 )            |
| Payments of debt issuance costs   | (634                | ) (128 )            |
| Repurchases of common stock   | (5                  | ) (31,367 )         |
| Payments for stock related compensation                                     | (2,038              | ) (2,257 )          |
| Proceeds from exercise of stock awards                                      | 5,041               | 10,126              |
| Excess tax benefits from stock-based compensation                           | 829                 | 2,041               |
| Cash dividends paid   | (12,483             | ) (11,510 )         |
| Net cash provided by financing activities                                   | 57,241              | 97,954              |
| Net increase in cash and cash equivalents                                   | 6,024               | 5,780               |
| Cash and cash equivalents:  |                     |                     |
| Beginning of period   | 14,762              | 17,937              |
| End of period   | \$20,786            | \$23,717            |

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Supplemental disclosures including non-cash investing and financing activities:

|   |         |          |
|---|---------|----------|
| Interest paid                               | \$2,092 | \$1,772  |
| Income taxes paid                           | \$7,117 | \$22,390 |
| Unpaid liabilities for capital expenditures | \$8,571 | \$8,655  |

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

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Stage Stores, Inc.

Condensed Consolidated Statement of Stockholders' Equity

For the Nine Months Ended November 1, 2014

(in thousands, except per share data)

(Unaudited)

|  | Common Stock |        | Additional<br>Paid-in<br>Capital | Treasury Stock |          | Accumulated<br>Other<br>Comprehensive<br>Loss | Retained<br>Earnings | Total     |
|--|--------------|--------|----------------------------------|----------------|----------|---|----------------------|-----------|
|  | Shares       | Amount |                                  | Shares         | Amount   |   |                      |           |
| Balance at February 1, 2014                              | 31,222       | \$312  | \$384,295                        | —              | \$(967 ) | \$(4,616 )                                    | \$75,420             | \$454,444 |
| Net loss   | —            | —      | —                                | —              | —        | —   | (12,870 )            | (12,870 ) |
| Other comprehensive income                               | —            | —      | —                                | —              | —        | 185   | —                    | 185       |
| Dividends on common stock, \$0.39 per share              | —            | —      | —                                | —              | —        | —   | (12,483 )            | (12,483 ) |
| Deferred compensation                                    | —            | —      | (104 )                           | —              | 104      | —   | —                    | —         |
| Repurchases of common stock                              | —            | —      | —                                | —              | (5 )     | —   | —                    | (5 )      |
| Issuance of equity awards, net                           | 574          | 6      | 5,035                            | —              | —        | —   | —                    | 5,041     |
| Tax withholdings paid for net settlement of stock awards | —            | —      | (2,142 )                         | —              | —        | —   | —                    | (2,142 )  |
| Stock-based compensation expense                         | —            | —      | 7,018                            | —              | —        | —   | —                    | 7,018     |
| Tax benefit from stock-based compensation                | —            | —      | 109                              | —              | —        | —   | —                    | 109       |
| Balance at November 1, 2014                              | 31,796       | \$318  | \$394,211                        | —              | \$(868 ) | \$(4,431 )                                    | \$50,067             | \$439,297 |

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



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Stage Stores, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

## 1. Basis of Presentation

The accompanying condensed consolidated financial statements of Stage Stores, Inc. and its subsidiary ("we," "us" or "our") have been prepared in accordance with the requirements of the U.S. Securities and Exchange Commission ("SEC") for interim financial information and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP") for complete financial statements. Those adjustments that are, in the opinion of management, necessary for a fair presentation of the results of the interim periods have been made. Results of operations for such interim periods are not necessarily indicative of the results of operations for a full year due to seasonal and other factors. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto filed with our Annual Report on Form 10-K for the year ended February 1, 2014 ("Form 10-K").

**Recent Accounting Standards.** In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the criteria for reporting discontinued operations and also requires additional disclosures about discontinued operations. For public companies, the standard is effective prospectively for disposals that occur beginning on or after December 15, 2014, and interim periods within those years, with early adoption permitted. We did not early adopt this ASU.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle of the guidance is that a company should recognize revenue when it transfers promised goods or services to customers in an amount that reflects what a company expects to be entitled to in exchange for those goods or services. This update will be effective for us retrospectively in the first quarter of fiscal 2017 with early adoption not permitted. We are currently assessing the impact this ASU will have on our financial statements.

## 2. Discontinued Operations

In the first quarter of 2014, we decided to divest Steele's, an off-price concept that we launched in November 2011, in order to focus solely on our core specialty department store business. On March 7, 2014, we completed the sale of Steele's. Accordingly, the results of operations of Steele's are reflected in discontinued operations for all periods presented.

Revenues and pre-tax loss of Steele's, which includes the loss on the sale of Steele's of \$9.7 million, for each period presented were as follows (in thousands):

|   | Three Months Ended  |                     | Nine Months Ended   |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | November 1,<br>2014 | November 2,<br>2013 | November 1,<br>2014 | November 2,<br>2013 |
| Net sales                                 | \$—                 | \$5,327             | \$2,414             | \$17,201            |
| Pre-tax loss from discontinued operations | 226                 | 2,307               | 11,231              | 5,314               |

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There were no assets or liabilities related to Steele's included in the condensed consolidated financial statements as of November 1, 2014. The carrying values of the major assets and liabilities related to Steele's included in the consolidated financial statements as of February 1, 2014 were as follows (in thousands):

|   | February 1, 2014 |
|---|------------------|
| Merchandise inventories, net                        | \$ 10,498        |
| Property, equipment and leasehold improvements, net | 732              |
| Other assets  | 442              |
| Liabilities   | 809              |

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## 3. Stock-Based Compensation

The following table summarizes stock-based compensation expense by type of grant for each period presented (in thousands):

|  | Three Months Ended  |                     | Nine Months Ended   |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | November 1,<br>2014 | November 2,<br>2013 | November 1,<br>2014 | November 2,<br>2013 |
| Stock options and stock appreciation rights ("SARs") | \$ 184              | \$ 470              | \$ 521              | \$ 1,266            |
| Non-vested stock                                     | 1,294               | 1,207               | 3,690               | 3,179               |
| Performance shares                                   | 1,104               | 878                 | 2,807               | 2,135               |
| Total compensation expense                           | 2,582               | 2,555               | 7,018               | 6,580               |
| Related tax benefit                                  | (971)               | (985)               | (2,639)             | (2,474)             |
|  | \$ 1,611            | \$ 1,570            | \$ 4,379            | \$ 4,106            |

As of November 1, 2014, we have unrecognized compensation cost of \$18.4 million related to stock-based compensation awards granted. That cost is expected to be recognized over a weighted average period of 2.4 years.

## Stock Options and SARs

The following table summarizes stock option and SAR activity for the nine months ended November 1, 2014:

|  | Number of<br>Shares | Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (years) | Aggregate<br>Intrinsic Value<br>(in thousands) |
|--|---------------------|---------------------------------------|---|--|
| Outstanding at February 1, 2014                | 1,062,851           | \$ 16.52                              |   |  |
| Exercised                                      | (532,943)           | 16.48                                 |   |  |
| Forfeited                                      | (56,008)            | 17.82                                 |   |  |
| Outstanding at November 1, 2014                | 473,900             | \$ 16.41                              | 2.3   | \$ 624   |
| Vested or expected to vest at November 1, 2014 | 458,247             | \$ 16.34                              | 2.3   | \$ 624   |
| Exercisable at November 1, 2014                | 395,637             | \$ 15.98                              | 2.1   | \$ 620   |

The following table summarizes non-vested stock options and SARs activity for the nine months ended November 1, 2014:

| Stock Options/SARs             | Number of Shares | Weighted<br>Average Grant<br>Date Fair Value |
|--------------------------------|------------------|--|
| Non-vested at February 1, 2014 | 292,075          | \$ 7.97                                      |
| Vested                         | (197,187)        | 7.68   |
| Forfeited                      | (16,625)         | 8.60   |
| Non-vested at November 1, 2014 | 78,263           | \$ 8.56                                      |

The aggregate intrinsic value of stock options and SARs exercised during the nine months ended November 1, 2014 and November 2, 2013, was \$3.5 million and \$5.8 million, respectively.

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## Non-vested Stock

The following table summarizes non-vested stock activity for the nine months ended November 1, 2014:

| Non-vested Stock                | Number of Shares | Weighted<br>Average Grant<br>Date Fair Value |
|---------------------------------|------------------|--|
| Outstanding at February 1, 2014 | 652,459          | \$20.40                                      |
| Granted                         | 344,354          | 22.96  |
| Vested                          | (254,220 )       | 19.89  |
| Forfeited                       | (73,009 )        | 21.21  |
| Outstanding at November 1, 2014 | 669,584          | \$21.82                                      |

The aggregate intrinsic value of non-vested stock that vested during the nine months ended November 1, 2014 was \$5.7 million. The payment of the employees' tax liability for a portion of the vested shares was satisfied by withholding shares with a fair value equal to the tax liability. As a result, the actual number of shares issued was 188,920.

## Performance Shares

We grant performance shares as a means of rewarding management for our long-term performance based on shareholder return performance measures. The actual number of shares that may be issued ranges from 0 to a maximum of twice the number of granted shares outstanding, as reflected in the table below and is based on our shareholder return performance relative to a specific group of companies over a 3-year performance cycle. If earned, the performance shares vest following the 3-year cycle. Compensation expense, which is recorded ratably over the vesting period, is based on the fair value at grant date and the anticipated number of shares of our common stock, which is determined using a Monte Carlo probability model.

The following table summarizes performance shares that remained outstanding as of November 1, 2014:

| Period<br>Granted | Target Shares<br>Outstanding at<br>February 1, 2014 | Target Shares<br>Granted | Target Shares<br>Vested | Target Shares<br>Forfeited | Target Shares<br>Outstanding at<br>November 1,<br>2014 | Weighted<br>Average<br>Grant Date Fair<br>Value Per Share |
|-------------------|---|--------------------------|-------------------------|----------------------------|--|---|
| 2012              | 198,200   | —                        | (8,300 )                | (20,800 )                  | 169,100  | \$18.04   |
| 2013              | 151,250   | —                        | (9,941 )                | (23,059 )                  | 118,250  | 33.81   |
| 2014              | —   | 168,445                  | —                       | (2,292 )                   | 166,153  | 33.84   |
| Total             | 349,450   | 168,445                  | (18,241 )               | (46,151 )                  | 453,503  |   |

During the nine months ended November 1, 2014, 16,620 shares vested related to the 2011 performance share grant. The aggregate intrinsic value of shares that vested during the nine months ended November 1, 2014 was \$0.8 million. The payment of the recipients' tax liability for shares that vested during the nine months ended November 1, 2014 of approximately \$0.2 million was satisfied by withholding shares with a fair value equal to the tax liability. As a result, the actual number of shares issued was 24,508.

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## 4. Debt Obligations

Debt obligations as of November 1, 2014 and February 1, 2014 consisted of the following (in thousands):

|   | November 1, 2014 | February 1, 2014 |
|---|------------------|------------------|
| Revolving Credit Facility                 | \$123,943        | \$55,395         |
| Finance lease obligations                 | 4,948            | 5,584            |
| Other financing                           | 865              | 2,246            |
| Total debt obligations                    | 129,756          | 63,225           |
| Less: Current portion of debt obligations | 1,801            | 2,354            |
| Long-term debt obligations                | \$127,955        | \$60,871         |

On October 6, 2014, we entered into a Second Amended and Restated Credit Agreement for a \$350.0 million senior secured revolving credit facility ("Revolving Credit Facility"). The Revolving Credit Facility replaces our former \$250.0 million senior secured revolving credit facility, which was set to mature on June 30, 2016. The Revolving Credit Facility (i) increases availability to \$300.0 million, with a seasonal increase to \$350.0 million, (ii) includes a \$50.0 million letter of credit subfacility, (iii) provides better pricing terms, and (iv) extends the maturity date to October 6, 2019.

We use the Revolving Credit Facility to provide financing for working capital and general corporate purposes, as well as to finance capital expenditures and to support our letter of credit requirements. Borrowings are limited to the availability under a borrowing base that is determined principally on eligible inventory as defined by the Revolving Credit Facility agreement. Inventory, cash and cash equivalents are pledged as collateral. The daily interest rates are determined by a prime rate or LIBOR, plus an applicable margin, as set forth in the Revolving Credit Facility agreement. For the nine months ended November 1, 2014, the weighted average interest rate on outstanding borrowings and the average daily borrowings were 1.69% and \$82.1 million, respectively.

Letters of credit issued under the Revolving Credit Facility support certain merchandise purchases and collateralize retained risks and deductibles under various insurance programs. At November 1, 2014, outstanding letters of credit totaled approximately \$7.0 million. These letters of credit expire within twelve months of issuance. Excess borrowing availability under the Revolving Credit Facility at November 1, 2014 was \$169.0 million.

The Revolving Credit Facility agreement contains covenants which, among other things, restrict, based on required levels of excess availability, (i) the amount of additional debt or capital lease obligations, (ii) the payment of dividends and repurchase of common stock under certain circumstances and (iii) related party transactions. The agreement also contains a fixed charge coverage ratio covenant in the event excess availability is below a defined threshold or an event of default has occurred. At November 1, 2014, we were in compliance with all of the debt covenants of the agreement and expect to remain in compliance.

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## 5. Earnings per Share

The following tables show the computation of basic and diluted earnings per share from continuing operations for each period presented (in thousands, except per share amounts):

|  | Three Months Ended  |                     | Nine Months Ended   |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | November 1,<br>2014 | November 2,<br>2013 | November 1,<br>2014 | November 2,<br>2013 |
| Basic EPS from continuing operations:                          |                     |                     |                     |                     |
| Loss from continuing operations                                | \$(5,107            | ) \$(9,573          | ) \$(5,961          | ) \$(4,929          |
| Less: Allocation of earnings to participating securities       | —                   | —                   | —                   | —                   |
| Net loss from continuing operations allocated to common shares | (5,107              | ) (9,573            | ) (5,961            | ) (4,929            |
| Basic weighted average shares outstanding                      | 31,794              | 31,854              | 31,681              | 32,307              |
| Basic EPS from continuing operations                           | \$(0.16             | ) \$(0.30           | ) \$(0.19           | ) \$(0.15           |
|  |                     |                     |                     |                     |
|  | Three Months Ended  |                     | Nine Months Ended   |                     |
|  | November 1,<br>2014 | November 2,<br>2013 | November 1,<br>2014 | November 2,<br>2013 |
| Diluted EPS from continuing operations:                        |                     |                     |                     |                     |
| Loss from continuing operations                                | \$(5,107            | ) \$(9,573          | ) \$(5,961          | ) \$(4,929          |
| Less: Allocation of earnings to participating securities       | —                   | —                   | —                   | —                   |
| Net loss from continuing operations allocated to common shares | (5,107              | ) (9,573            | ) (5,961            | ) (4,929            |
| Basic weighted average shares outstanding                      | 31,794              | 31,854              | 31,681              | 32,307              |
| Add: Dilutive effect of stock awards                           | —                   | —                   | —                   | —                   |
| Diluted weighted average shares outstanding                    | 31,794              | 31,854              | 31,681              | 32,307              |
| Diluted EPS from continuing operations                         | \$(0.16             | ) \$(0.30           | ) \$(0.19           | ) \$(0.15           |

The number of shares attributable to stock options, SARs and non-vested stock grants that would have been considered dilutive securities, but were excluded from the calculation of diluted earnings per share because the effect was anti-dilutive were as follows (in thousands):

|  | Three Months Ended  |                     | Nine Months Ended   |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | November 1,<br>2014 | November 2,<br>2013 | November 1,<br>2014 | November 2,<br>2013 |
| Number of anti-dilutive shares due to net loss for the period  | 50                  | 218                 | 90                  | 308                 |
| Number of anti-dilutive SARs due to exercise price greater than average market price of our common stock | 240                 | 451                 | 246                 | 129                 |

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### 6. Stockholders' Equity

On June 11, 2014, we announced that our Board of Directors ("Board") approved a 12% increase in our quarterly cash dividend rate to \$0.14 per share from the previous quarterly rate of \$0.125 per share. The quarterly rate of \$0.14 per share is applicable to dividends declared by the Board beginning August 21, 2014. On November 20, 2014, our Board declared a quarterly cash dividend of \$0.14 per share of common stock, payable on December 17, 2014 to shareholders of record at the close of business on December 2, 2014.

Subsequent to November 1, 2014, we repurchased 171,914 shares of our common stock for approximately \$2.8 million under the Board's authorization to repurchase our outstanding common stock from the proceeds and related tax benefits from the exercise of stock options, SARs and other equity grants. Purchases of shares of our common stock under this authorization may be made from time to time, either on the open market or through privately negotiated transactions and are financed by our existing cash, cash flow and other liquidity sources, as appropriate.

### 7. Pension Plan

We sponsor a frozen defined benefit pension plan. The components of net periodic pension cost were as follows (in thousands):

|                                | Three Months Ended |                  | Nine Months Ended |                  |
|--------------------------------|--------------------|------------------|-------------------|------------------|
|                                | November 1, 2014   | November 2, 2013 | November 1, 2014  | November 2, 2013 |
| Employer service cost          | \$52               | \$90             | \$158             | \$270            |
| Interest cost                  | 423                | 430              | 1,269             | 1,292            |
| Expected return on plan assets | (533)              | (559)            | (1,601)           | (1,678)          |
| Net loss amortization          | 100                | 153              | 299               | 458              |
| Net periodic pension cost      | \$42               | \$114            | \$125             | \$342            |

Our funding policy is to make contributions to maintain the minimum funding requirements for our pension obligations in accordance with the Employee Retirement Income Security Act. We may elect to contribute additional amounts to maintain a level of funding to minimize the Pension Benefit Guaranty Corporation premium costs or to cover the short-term liquidity needs of the plan in order to maintain current invested positions. We made no contributions during the nine months ended November 1, 2014.

### 8. Fair Value Measurements

We recognize or disclose the fair value of our financial and non-financial assets and liabilities on a recurring and non-recurring basis. Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities which are required to be recorded at fair value, we assume the highest and best use of the asset by market participants in which we would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability.

We apply the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels, and base the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable



or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Inputs that are both unobservable and significant to the overall fair value measurement reflect our estimates of assumptions that market participants would use in pricing the asset or liability.

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Financial assets and liabilities measured at fair value on a recurring basis were as follows (in thousands):

November 1, 2014

|   | Balance  | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---|----------|--|---|--|
| Other assets:   |          |  |   |  |
| Securities held in grantor trust for deferred compensation plans (1)(2) | \$19,197 | \$19,197   | \$—   | \$—  |

February 1, 2014

|   | Balance  | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---|----------|--|---|--|
| Other assets:   |          |  |   |  |
| Securities held in grantor trust for deferred compensation plans (1)(2) | \$21,023 | \$21,023   | \$—   | \$—  |
| Accrued expenses and other current liabilities:                         |          |  |   |  |
| Deferred non-employee director equity compensation plan liability (2)   | \$226    | \$226  | \$—   | \$—  |

(1) The liability for the amount due to participants corresponding in value to the securities held in the grantor trust is recorded in other long-term liabilities.

(2) Using the market approach, the fair values of these items represent quoted market prices multiplied by the quantities held. Net gains and losses related to the changes in fair value in the assets and liabilities under the various deferred compensation plans are recorded in selling, general and administrative expenses and were nil for the nine months ended November 1, 2014 and for the fiscal year ended February 1, 2014.

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Non-financial assets measured at fair value on a nonrecurring basis were as follows (in thousands):

| November 1, 2014  |         |  |   |  |
|---|---------|--|---|--|
|   | Balance | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Assets:   |         |  |   |  |
| Store property, equipment and leasehold improvements<br>(3) | \$343   | \$—  | \$—   | \$343  |

| February 1, 2014  |         |  |   |  |
|---|---------|--|---|--|
|   | Balance | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Assets:   |         |  |   |  |
| Store property, equipment and leasehold improvements<br>(3) | \$4,562 | \$—  | \$—   | \$4,562  |

In accordance with ASC No. 360-10, Accounting for the Impairment or Disposal of Long-Lived Assets, using an undiscounted cash flow model, we identified certain stores whose cash flow trends indicated that the carrying value of store property, equipment and leasehold improvements may not be fully recoverable and recognized impairment charges to reflect the assets at fair value. We use a discounted cash flow model to determine the fair value of our (3) impaired assets. Key assumptions in determining future cash flows include, among other things, expected future operating performance and changes in economic conditions. Impairment charges of \$0.4 million recognized during the nine months ended November 1, 2014 and \$0.6 million recognized during fiscal year 2013 are recorded in cost of sales and related buying, occupancy and distribution expenses. In addition, approximately \$7.4 million of impairment charges for Steele's were recognized in fiscal year 2013.

The fair values of cash and cash equivalents, payables and short-term debt obligations approximate their carrying values due to the short-term nature of these instruments. In addition, we believe that the Revolving Credit Facility approximates fair value since interest rates are adjusted to reflect current rates.

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9. South Hill Consolidation

On February 11, 2013, we announced plans to consolidate our South Hill, Virginia operations into our Houston, Texas corporate headquarters ("South Hill Consolidation"). This action was the culmination of an initiative that began in 2012. The reasons for the South Hill Consolidation were: (i) to have department store functions and processes entirely together in one location, (ii) to strengthen collaboration, teamwork and communications, while streamlining operations, enhancing overall operational efficiency and reducing costs, and (iii) to create consistency in merchandising, marketing and eCommerce.

The South Hill Consolidation was completed during 2013, and all liabilities related to the consolidation have been paid. Total expenses associated with the South Hill Consolidation for the nine months ended November 2, 2013 were \$9.0 million. The costs, which were primarily for severance and transitional payroll and related benefits, recruiting and relocation costs, and visual presentation supplies and other, were recorded in selling, general and administrative expenses. Merchandise cost of sales for the nine months ended November 2, 2013 also included approximately \$11.5 million related to the South Hill Consolidation due to inventory liquidation costs associated with discontinued vendors and merchandise and advertising allowances deferred in inventory.

During 2013, we committed to a plan to sell the building which housed our former South Hill operations. Accordingly, the disposal group with a carrying value of \$0.6 million has been reclassified as held for sale and included in prepaid expenses and other current assets as of November 1, 2014.

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

Cautionary Statement Concerning Forward-Looking Statements for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995

The Private Securities Litigation Reform Act of 1995 ("Act") provides a safe harbor for forward-looking statements to encourage companies to provide prospective information, so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the statements. We wish to take advantage of the "safe harbor" provisions of the Act.

Certain statements in this report are forward-looking statements within the meaning of the Act, and such statements are intended to qualify for the protection of the safe harbor provided by the Act. The words "anticipate," "estimate," "expect," "objective," "goal," "project," "intend," "plan," "believe," "will," "should," "may," "target," "forecast," "guidance," "outlook," and similar expressions generally identify forward-looking statements. Similarly, descriptions of our objectives, strategies, plans, goals or targets are also forward-looking statements. Forward-looking statements relate to the expectations of management as to future occurrences and trends, including statements expressing optimism or pessimism about future operating results or events and projected sales, earnings, capital expenditures and business strategy.

Forward-looking statements are based upon a number of assumptions and factors concerning future conditions that may ultimately prove to be inaccurate and could cause actual results to differ materially from those in the forward-looking statements. Forward-looking statements that are made herein and in other reports and releases are not guarantees of future performance and actual results may differ materially from those discussed in such forward-looking statements as a result of various factors. These factors include, but are not limited to, the ability for us to maintain normal trade terms with vendors, the ability for us to comply with the various covenant requirements contained in the Revolving Credit Facility agreement, the demand for apparel, and other factors. The demand for apparel and sales volume can be affected by significant changes in economic conditions, including an economic downturn, employment levels in our markets, consumer confidence, energy and gasoline prices and other factors influencing discretionary consumer spending. Other factors affecting the demand for apparel and sales volume include unusual weather patterns, an increase in the level of competition in our market areas, competitors' marketing strategies, changes in fashion trends, changes in the average cost of merchandise purchased for resale, availability of product on normal payment terms and the failure to achieve the expected results of our merchandising and marketing plans as well as our store opening or relocation plans. Additional assumptions, factors and risks concerning future conditions are discussed in the Risk Factors section of the Form 10-K, and may be discussed from time to time in our other filings with the SEC, including Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. Most of these factors are difficult to predict accurately and are generally beyond our control.

Forward-looking statements are and will be based upon management's then-current views and assumptions regarding future events and operating performance, and are applicable only as of the dates of such statements. Although management believes the expectations expressed in forward-looking statements are based on reasonable assumptions within the bounds of our knowledge, forward-looking statements, by their nature, involve risks, uncertainties and other factors, any one or a combination of which could materially affect our business, financial condition, results of operations or liquidity.

Readers should carefully review the Form 10-K in its entirety including, but not limited to, our financial statements and the notes thereto and the risks and uncertainties described in Item 1A - "Risk Factors" of the Form 10-K. This report should be read in conjunction with the Form 10-K, and you should consider all of these risks, uncertainties and

other factors carefully in evaluating forward-looking statements.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to publicly update forward-looking statements whether as a result of new information, future events or otherwise. Readers are advised, however, to consult any further disclosures we make on related subjects in our public announcements and SEC filings.

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For purposes of the following discussion, all references to the "third quarter 2014" and the "third quarter 2013" are for the 13-week fiscal periods ended November 1, 2014 and November 2, 2013, respectively, and all references to "year-to-date 2014" and "year-to-date 2013" are for the 39-week fiscal periods ended November 1, 2014 and November 2, 2013, respectively.

The financial information, discussion and analysis that follow should be read in conjunction with our consolidated financial statements and the related notes included in this Form 10-Q as well as the financial and other information included in the Form 10-K.

### Our Business

As of November 1, 2014, we operated 855 specialty department stores located in 40 states under the BEALLS, GOODY'S, PALAIS ROYAL, PEEBLES and STAGE nameplates and an eCommerce website. Our stores, which operate primarily in small and mid-sized towns and communities, offer moderately priced, nationally recognized brand name and private label apparel, accessories, cosmetics, footwear and home goods for the entire family. Our eCommerce website features assortments of merchandise similar to that found in our stores, as well as products available exclusively online. Our direct-to-consumer channel includes our eCommerce website and Send program. The Send program allows customers in the stores to have merchandise shipped directly to their homes if the merchandise is not available in the local store.

In the first quarter of 2014, we made the decision to divest Steele's, an off-price concept that we launched in November 2011, in order to focus solely on our core specialty department store business. On March 7, 2014, we completed the sale of Steele's. Accordingly, the results of operations of Steele's and loss on the sale are reflected in discontinued operations for all periods presented.

### Overview

Financial highlights for the third quarter 2014 were as follows (comparisons are to the third quarter 2013):

- Net sales increased \$9.3 million, or 2.6%.
- Comparable sales, which includes direct-to-consumer sales, increased 2.3%.
- Direct-to-consumer sales increased 43%.
- Gross profit increased \$4.9 million, or 5.9%.
- Loss from continuing operations improved \$4.5 million, or 46.7%.
- Adjusted loss per share improved 27% (see non-GAAP financial measures on page 18).

In addition, during year-to-date 2014:

- We paid cash dividends of \$12.5 million (\$0.39 per share).
- On October 6, 2014, we entered into a \$350.0 million senior secured revolving credit facility that replaced our previous facility and increased our borrowing capacity by \$100 million.

We made progress on our key strategic initiatives during year-to-date 2014, as we:

- Continued to grow our cosmetics business with the installation of 53 new Estee Lauder and 54 new Clinique counters. Since November 1, 2014, we have installed 22 Estee Lauder and 22 Clinique counters, and now have counters in over 300 stores.
- Refined our assortments with updated styles, new brands, additional categories within existing brands, and extended existing brands to additional stores.

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- Opened 15 new stores. Since November 1, 2014, we opened three additional stores, completing our 2014 openings.
- Implemented store-level mark down optimization and continued to make progress on size pack optimization with plans to implement it by year end.
- Expanded direct-to-consumer assortments and broadened our centralized fulfillment.
- Re-launched our home category with a focus on offering a highly edited selection of kitchen, textile and gift assortments.
- Continued to roll out our new fixtures package in order to improve the presentation of our products and make our stores easier to shop. New fixtures are now in approximately 20% of our stores.



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## Non-GAAP Financial Measures

The following supplemental information presents the results from operations for the three and nine months ended November 1, 2014 and November 2, 2013. All periods are presented on a GAAP basis and on a non-GAAP basis to show earnings with and without charges associated with the South Hill Consolidation. We believe this supplemental financial information enhances an investor's understanding of our financial performance as it excludes those items which impact comparability of operating trends. The non-GAAP financial information should not be considered in isolation or viewed as a substitute for net income, cash flow from operations or other measures of performance as defined by GAAP. Moreover, the inclusion of non-GAAP financial information as used herein is not necessarily comparable to other similarly titled measures of other companies due to the potential inconsistencies in the method of presentation and items considered. The following tables set forth the supplemental financial information and the reconciliation of GAAP disclosures to non-GAAP financial measures (in thousands, except diluted earnings per share):

|  | Three Months Ended  |                     | Nine Months Ended   |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | November 1,<br>2014 | November 2,<br>2013 | November 1,<br>2014 | November 2,<br>2013 |
| Net loss (GAAP)  | \$ (5,268 )         | \$ (10,971 )        | \$ (12,870 )        | \$ (8,220 )         |
| Loss from discontinued operations  | 161                 | 1,398               | 6,909               | 3,291               |
| Loss from continuing operations  | (5,107 )            | (9,573 )            | (5,961 )            | (4,929 )            |
| South Hill Consolidation related charges, net of tax<br>of \$1,832 and \$7,815, respectively | —                   | 2,552               | —                   | 12,718              |
| Adjusted earnings (loss) (non-GAAP)  | \$ (5,107 )         | \$ (7,021 )         | \$ (5,961 )         | \$ 7,789            |
| Diluted loss per share (GAAP)  | \$ (0.17 )          | \$ (0.34 )          | \$ (0.41 )          | \$ (0.25 )          |
| Loss from discontinued operations  | 0.01                | 0.04                | 0.22                | 0.10                |
| Loss from continuing operations  | (0.16 )             | (0.30 )             | (0.19 )             | (0.15 )             |
| South Hill Consolidation related charges   | —                   | 0.08                | —                   | 0.39                |
| Adjusted diluted earnings (loss) per share<br>(non-GAAP)                                     | \$ (0.16 )          | \$ (0.22 )          | \$ (0.19 )          | \$ 0.24             |

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## Third Quarter 2014 Compared to Third Quarter 2013

The following table sets forth the results of operations for the periods presented (in thousands, except percentages):

|   | Three Months Ended<br>November 1, 2014 |                   |   | November 2, 2013 |                   |   | Change   |        |   |
|---|--|-------------------|---|------------------|-------------------|---|----------|--------|---|
|   | Amount                                 | % to Sales<br>(1) |   | Amount           | % to Sales<br>(1) |   | Amount   | %      |   |
| Net sales   | \$ 364,197                             | 100.0             | % | \$ 354,850       | 100.0             | % | \$ 9,347 | 2.6    | % |
| Cost of sales and related buying, occupancy and distribution expenses                 | 276,031                                | 75.8              | % | 271,560          | 76.5              | % | 4,471    | 1.6    | % |
| Gross profit  | 88,166                                 | 24.2              | % | 83,290           | 23.5              | % | 4,876    | 5.9    | % |
| Selling, general and administrative expenses  | 94,652                                 | 26.0              | % | 96,551           | 27.2              | % | (1,899)  | (2.0)  | % |
| Store opening costs   | 998                                    | 0.3               | % | 1,355            | 0.4               | % | (357)    | (26.3) | % |
| Interest expense  | 814                                    | 0.2               | % | 718              | 0.2               | % | 96       | 13.4   | % |
| Loss before income tax  | (8,298)                                | (2.3)             | % | (15,334)         | (4.3)             | % | 7,036    | (45.9) | % |
| Income tax benefit  | (3,191)                                | (0.9)             | % | (5,761)          | (1.6)             | % | 2,570    | (44.6) | % |
| Loss from continuing operations   | (5,107)                                | (1.4)             | % | (9,573)          | (2.7)             | % | 4,466    | (46.7) | % |
| Loss from discontinued operations, net of tax benefit of \$65 and \$909, respectively | (161)                                  | —                 | % | (1,398)          | (0.4)             | % | 1,237    | (88.5) | % |
| Net loss  | \$ (5,268)                             | (1.4)             | % | \$ (10,971)      | (3.1)             | % | \$ 5,703 | (52.0) | % |

(1) Percentages may not foot due to rounding.

## Net Sales

Sales for the third quarter 2014 of \$364.2 million increased \$9.3 million, or 2.6%, from \$354.9 million for the third quarter 2013. Comparable sales, which are sales in stores that are open for at least 14 full months prior to the reporting period, including direct-to-consumer sales, increased 2.3% in the third quarter 2014 compared to a 4.6% decrease in the third quarter 2013. Excluding direct-to-consumer sales, comparable sales increased 1.5% in third quarter 2014, compared to a 4.8% decrease in the third quarter 2013. For the third quarter 2014, the increase in sales was driven primarily by a 5.8% gain in average unit retail, which was partially offset by a slight decline in units per transaction and in the number of transactions. The higher average selling price was achieved through balancing regular priced and clearance goods, which we attribute to both improvements in the flow of goods and markdown cadence.

Sales performance was relatively consistent across market sizes and geographies. On a market population basis, utilizing a ten-mile radius from each store, small market stores (populations less than 50,000), mid-sized market stores (populations of 50,000 to 150,000) and higher-density market stores (populations greater than 150,000) for the third quarter 2014 had comparable sales increases of 1.3%, 0.8% and 2.3%, respectively.

On a merchandise category basis, almost all of our key categories delivered positive comparable sales increases. The best performing categories were cosmetics, due to the ongoing growth in Clinique and Estee Lauder counters, juniors and home.



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## Cost of Sales

The following is a summary of the changes in the components of the cost of sales rate between the third quarter 2014 and the third quarter 2013, expressed as a percent of sales:

|  | Increase (Decrease) |   |
|--|---------------------|---|
| Merchandise cost of sales rate                   | (0.9)               | % |
| Buying, occupancy and distribution expenses rate | 0.2                 |   |
| Cost of sales rate                               | (0.7)               | % |

## Gross Profit

Gross profit for the third quarter 2014 was \$88.2 million, an increase of \$4.9 million or 5.9%, from \$83.3 million for the third quarter 2013. Gross profit, as a percent of sales, increased to 24.2% for the third quarter 2014 from 23.5% for the third quarter 2013. The decrease in merchandise cost of sales rate reflects the impact, in the third quarter 2013, of charges totaling approximately \$4.4 million, or 1.2% of sales, related to the South Hill Consolidation due to inventory liquidation costs associated with discontinued vendors and merchandise and advertising allowances deferred in inventory. The increase in the buying, occupancy and distribution expense rate is a result of higher rent expense and depreciation in the third quarter 2014 compared to the third quarter 2013.

## Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses for the third quarter 2014 decreased \$1.9 million to \$94.7 million from \$96.6 million for the third quarter 2013. As a percent of sales, SG&A expenses decreased to 26.0% for the third quarter 2014 from 27.2% for the third quarter 2013. The third quarter 2014 benefited from lower medical insurance expense, lower advertising costs and increased credit income from our private label credit card program.

## Store Opening Costs

Store opening costs of \$1.0 million in the third quarter 2014 include costs related to the opening of 8 stores and the relocation of 1 store. During the third quarter 2013, we incurred \$1.4 million in store opening costs related to the opening of 12 stores. Store opening costs are expensed as incurred and include costs of stores opening in future quarters.

## Interest Expense

Net interest expense was \$0.8 million for the third quarter 2014, compared to \$0.7 million for third quarter 2013.

Interest expense is primarily comprised of interest on borrowings under the Revolving Credit Facility (see "Liquidity and Capital Resources"), related letters of credit and commitment fees, amortization of debt issuance costs and interest on finance lease obligations.

## Income Taxes

Our effective income tax rate for the third quarter 2014 was 38.5%, resulting in an estimated tax benefit from continuing operations of \$3.2 million. This compares to an effective tax rate of 37.6% and an income tax benefit from continuing operations of \$5.8 million for the third quarter 2013.



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## Year-to-Date 2014 Compared to Year-to-Date 2013

The following table sets forth the results of operations for the periods presented (in thousands, except percentages):

|  | Nine Months Ended<br>November 1, 2014 |                   |   | November 2, 2013 |                   |   | Change      |         |   |
|--|---------------------------------------|-------------------|---|------------------|-------------------|---|-------------|---------|---|
|  | Amount                                | % to Sales<br>(1) |   | Amount           | % to Sales<br>(1) |   | Amount      | %       |   |
| Net sales  | \$ 1,113,683                          | 100.0             | % | \$ 1,116,944     | 100.0             | % | \$ (3,261 ) | (0.3 )  | % |
| Cost of sales and related buying,<br>occupancy and distribution expenses                         | 835,236                               | 75.0              | % | 828,450          | 74.2              | % | 6,786       | 0.8     | % |
| Gross profit   | 278,447                               | 25.0              | % | 288,494          | 25.8              | % | (10,047 )   | (3.5 )  | % |
| Selling, general and administrative<br>expenses  | 283,814                               | 25.5              | % | 291,987          | 26.1              | % | (8,173 )    | (2.8 )  | % |
| Store opening costs  | 2,030                                 | 0.2               | % | 2,452            | 0.2               | % | (422 )      | (17.2 ) | % |
| Interest expense   | 2,293                                 | 0.2               | % | 2,012            | 0.2               | % | 281         | 14.0    | % |
| Loss before income tax   | (9,690 )                              | (0.9 )            | % | (7,957 )         | (0.7 )            | % | (1,733 )    | 21.8    | % |
| Income tax benefit   | (3,729 )                              | (0.3 )            | % | (3,028 )         | (0.3 )            | % | (701 )      | 23.2    | % |
| Loss from continuing operations  | (5,961 )                              | (0.5 )            | % | (4,929 )         | (0.4 )            | % | (1,032 )    | 20.9    | % |
| Loss from discontinued operations, net of<br>tax benefit of \$4,322 and \$2,023,<br>respectively | (6,909 )                              | (0.6 )            | % | (3,291 )         | (0.3 )            | % | (3,618 )    | 109.9   | % |
| Net loss   | \$ (12,870 )                          | (1.2 )            | % | \$ (8,220 )      | (0.7 )            | % | \$ (4,650 ) | 56.6    | % |

(1) Percentages may not foot due to rounding.

## Net Sales

Sales for the year-to-date 2014 of \$1,113.7 million decreased \$3.2 million, or 0.3%, from \$1,116.9 million for the year-to-date 2013. Comparable sales, which are sales in stores that are open for at least 14 full months prior to the reporting period, including direct-to-consumer sales, decreased 0.8% for the year-to-date 2014 compared to a 0.7% decrease for year-to-date 2013. Excluding direct-to-consumer sales, comparable sales decreased 1.2% for both the year-to-date 2014 and 2013. The 0.8% decrease in comparable sales reflects a decline in number of transactions, partially offset by an increase in average unit retail and units per transaction.

Sales performance was relatively consistent across market sizes and geographies. On a market population basis, utilizing a ten-mile radius from each store, small market stores (populations less than 50,000), mid-sized market stores (populations of 50,000 to 150,000) and higher-density market stores (populations greater than 150,000) for the year-to-date 2014 had comparable sales decreases of 1.0%, 2.0% and 1.0%, respectively.

On a merchandise category basis, the cosmetics business continued to be a positive performer and is a growth area for us. During the year to date 2014, we installed 53 new Estee Lauder and 54 new Clinique counters. We also continue to focus on sales growth through the introduction of new styles and product offerings and the expansion of existing sought-after brand names.



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## Cost of Sales

The following is a summary of the changes in the components of the cost of sales rate between the year-to-date 2014 and the year-to-date 2013, expressed as a percent of sales:

|  | Increase |   |
|--|----------|---|
| Merchandise cost of sales rate                   | 0.5      | % |
| Buying, occupancy and distribution expenses rate | 0.3      |   |
| Cost of sales rate                               | 0.8      | % |

## Gross Profit

Gross profit for the year-to-date 2014 was \$278.4 million, a decrease of \$10.1 million, or 3.5%, compared to \$288.5 million for the year-to-date 2013. Gross profit, as a percent of sales, decreased to 25.0% for the year-to-date 2014 from 25.8% for the year-to-date 2013. The increase in the merchandise cost of sales rate is primarily the result of the highly promotional retail environment and elevated clearance sales in the first quarter of 2014 as compared with the first quarter of 2013. This was partially offset by costs associated with the South Hill Consolidation in the year-to-date 2013 of approximately \$11.5 million, or 1.0% of sales, due to inventory liquidation costs associated with discontinued vendors and merchandise and advertising allowances deferred in inventory. The increase in buying, occupancy and distribution expense is a result of higher rent expense and depreciation in the year-to-date 2014 as compared with the year-to-date 2013.

## Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses for the year-to-date 2014 decreased \$8.2 million to \$283.8 million, from \$292.0 million for the year-to-date 2013. As a percent of sales, SG&A expenses decreased to 25.5% for the year-to-date 2014 from 26.1% for the year-to-date 2013. The decrease in SG&A expenses is primarily due to charges of approximately \$9.0 million incurred in the year-to-date 2013 related to the South Hill Consolidation, and increased credit income from our private label credit card program, partially offset by higher medical, workers compensation and general liabilities claims expense in the year-to-date 2014.

## Store Opening Costs

Store opening costs of \$2.0 million for the year-to-date 2014 include costs related to the opening of 15 new stores and the relocation of 4 stores. During the year-to-date 2013, we incurred \$2.5 million in store opening costs related to the opening of 22 new stores and the relocation of 2 stores.

## Interest Expense

Net interest expense was \$2.3 million for the year-to-date 2014 and \$2.0 million for the year-to-date 2013. Interest expense is primarily comprised of interest on borrowings under the Revolving Credit Facility (see "Liquidity and Capital Resources"), related letters of credit and commitment fees, amortization of debt issuance costs and interest on finance lease obligations. The increase in interest expense is primarily due to an increase in the average daily borrowings under the Revolving Credit Facility for the year-to-date 2014 as compared with the year-to-date 2013.

## Income Taxes

Our effective income tax rate for the year-to-date 2014 was 38.5%, resulting in an estimated tax benefit from continuing operations of \$3.7 million. This compares to an income tax benefit from continuing operations of \$3.0



million for the year-to-date 2013 at an effective rate 38.1%.

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## Seasonality and Inflation

Historically, our business is seasonal and sales are traditionally lower during the first three quarters of the fiscal year (February through October) and higher during the last quarter of the fiscal year (November through January). The fourth quarter usually accounts for slightly more than 30% of our annual sales, with the other quarters accounting for approximately 22% to 24% each. Working capital requirements fluctuate during the year and generally reach their highest levels during the third and fourth quarters. We do not expect inflation will have a material impact on our operations. However, there can be no assurance that our business will not be affected by inflation in the future.

## Liquidity and Capital Resources

Our liquidity is currently provided by (i) existing cash balances, (ii) operating cash flows, (iii) normal trade credit terms from the vendor and factor community and (iv) the Revolving Credit Facility. Our primary cash requirements are for seasonal and new store inventory purchases, as well as capital investments in our existing store fleet, information technology and new stores, and the payment of our quarterly cash dividends.

While there can be no assurances, we believe that there will be sufficient liquidity to cover both our short-term and long-term funding needs. We anticipate that we have adequate cash flows to cover our working capital needs, planned capital expenditures and debt service requirements for the remainder of 2014 and the foreseeable future.

Key components of our cash flow for the year-to-date 2014 and the year-to-date 2013 are summarized below (in thousands):

|                                 | Nine Months Ended   |                     |
|---------------------------------|---------------------|---------------------|
|                                 | November 1,<br>2014 | November 2,<br>2013 |
| Net cash provided by (used in): |                     |                     |
| Operating activities            | \$ (4,377           | ) \$ (45,468 )      |
| Investing activities            | (46,840             | ) (46,706 )         |
| Financing activities            | 57,241              | 97,954              |

## Operating Activities

During the year-to-date 2014, we used \$4.4 million in cash from operating activities. Net loss, adjusted for non-cash expenses, provided cash of approximately \$41.1 million. Changes in operating assets and liabilities used net cash of approximately \$51.0 million, which included a \$140.6 million increase in merchandise inventories primarily due to the seasonal build of inventories and strategic investments in cosmetics, partially offset by the reduction associated with the sale of the Steele's operations, an increase in other assets of \$3.5 million and an increase in accounts payable and other liabilities of \$93.0 million. Additionally, cash flows from operating activities included construction allowances from landlords of \$5.5 million, which funded a portion of the capital expenditures related to store leasehold improvements in new and relocated stores.

During the year-to-date 2013, we used \$45.5 million in cash from operating activities. Net loss, adjusted for non-cash expenses, provided cash of approximately \$44.5 million. Changes in operating assets and liabilities used net cash of approximately \$94.1 million, which included a \$137.6 million increase in merchandise inventories primarily due to planned investments in inventory, the seasonal build of inventories and higher number of open stores, an increase in other assets of \$14.7 million, partially offset by an increase in accounts payable and other liabilities of \$58.2 million. Additionally, cash flows from operating activities included construction allowances from landlords of \$4.2 million, which funded a portion of the capital expenditures related to store leasehold improvements in new and relocated stores.



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### Investing Activities

Capital expenditures were \$48.3 million for the year-to-date 2014 compared to \$46.7 million for the year-to-date 2013. Capital expenditures during the year-to-date 2014 reflect increased investments in our current stores through cosmetic counter installations and store expansions, partially offset by a decrease in store openings compared to the year-to-date 2013. We received construction allowances from landlords of \$5.5 million in the year-to-date 2014 and \$4.2 million in the year-to-date 2013 to fund a portion of the capital expenditures related to store leasehold improvements in new and relocated stores. These funds are recorded as a deferred rent credit on the balance sheet and are recognized as an offset to rent expense over the lease term commencing with the date the allowances are earned.

We estimate that capital expenditures in 2014, net of construction allowances to be received from landlords, will be approximately \$65 million. The expenditures are principally for the opening of new stores, store expansions, relocations and remodels, the roll-out of new cosmetic counters and fixture packages and investments in technology.

### Financing Activities

On October 6, 2014, we entered into a Second Amended and Restated Credit Agreement for a \$350.0 million senior secured revolving credit facility. The Revolving Credit Facility (i) increases availability to \$300.0 million, with a seasonal increase to \$350.0 million, (ii) includes a \$50.0 million letter of credit subfacility, (iii) provides better pricing terms, and (iv) extends the maturity date to October 6, 2019.

We use the Revolving Credit Facility to provide financing for working capital and general corporate purposes, as well as to finance capital expenditures and to support our letter of credit requirements. Borrowings are limited to the availability under a borrowing base that is determined principally on eligible inventory as defined by the Revolving Credit Facility agreement. Inventory, cash and cash equivalents are pledged as collateral. The daily interest rates are determined by a prime rate or LIBOR, plus an applicable margin, as set forth in the Revolving Credit Facility agreement. For the year-to-date 2014, the weighted average interest rate on outstanding borrowings and the average daily borrowings were 1.69% and \$82.1 million, respectively.

Letters of credit issued under the Revolving Credit Facility support certain merchandise purchases and collateralize retained risks and deductibles under various insurance programs. At November 1, 2014, outstanding letters of credit totaled approximately \$7.0 million. These letters of credit expire within twelve months of issuance. Excess borrowing availability under the Revolving Credit Facility at November 1, 2014 was \$169.0 million.

The Revolving Credit Facility agreement contains covenants which, among other things, restrict, based on required levels of excess availability, (i) the amount of additional debt or capital lease obligations, (ii) the payment of dividends and repurchase of common stock under certain circumstances and (iii) related party transactions. The agreement also contains a fixed charge coverage ratio covenant in the event excess availability is below a defined threshold or an event of default has occurred. At November 1, 2014, we were in compliance with all of the debt covenants of the agreement and expect to remain in compliance.

On June 11, 2014, we announced that our Board approved a 12% increase in our quarterly cash dividend rate to \$0.14 per share from the previous quarterly rate of \$0.125 per share. The quarterly rate of \$0.14 per share is applicable to dividends declared by the Board beginning August 21, 2014. During the year-to-date 2014, we paid cash dividends totaling \$12.5 million. On November 20, 2014, our Board declared a quarterly cash dividend of \$0.14 per share of common stock, payable on December 17, 2014 to shareholders of record at the close of business on December 2, 2014.



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Recent Accounting Standards

Disclosure concerning recent accounting standards is incorporated by reference to Note 1 of our Condensed Consolidated Financial Statements (Unaudited) contained in this Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to market risk from exposure to changes in interest rates on borrowings under the Revolving Credit Facility. An increase or decrease of 10% in interest rates would not have a material effect on our financial condition, results of operations, or liquidity.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act"), the term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures and concluded that our disclosure controls and procedures were effective as of November 1, 2014.

Internal Control Over Financial Reporting

As defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act, the term "internal control over financial reporting" means a process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material adverse effect on the financial statements.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. There were no changes in our internal control over financial reporting during the three months ended November 1, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

No response is required under Item 103 of Regulation S-K.

ITEM 1A. RISK FACTORS

There have not been any material changes from the risk factors as previously disclosed in the Form 10-K.



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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On March 7, 2011, our Board approved a stock repurchase program (the "2011 Stock Repurchase Program") which authorized us to repurchase up to \$200 million of our outstanding common stock. The 2011 Stock Repurchase Program will expire when we have repurchased \$200 million of our outstanding common stock, unless terminated earlier by the Board. Through June 10, 2012, we repurchased approximately \$100.1 million of our outstanding common stock under the 2011 Stock Repurchase Program. On June 11, 2012, we announced that our Board had chosen not to spend additional capital under the 2011 Stock Repurchase Program for the time being. However, the Board has authorized us to repurchase our outstanding common stock from the proceeds and related tax benefits from the exercise of stock options, SARs and other equity grants. Purchases of shares of our common stock under this authorization may be made from time to time, either on the open market or through privately negotiated transactions and are financed by our existing cash, cash flow and other liquidity sources, as appropriate.

The table below sets forth information regarding our repurchases of common stock during the three months ended November 1, 2014:

## ISSUER PURCHASES OF EQUITY SECURITIES

| Period                              | Total Number of Shares Purchased (1) | Average Price Paid Per Share (1) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2) |
|-------------------------------------|--------------------------------------|----------------------------------|--|--|
| August 3, 2014 to August 30, 2014   | 1,703                                | \$18.01                          | —  | \$99,938,428   |
| August 31, 2014 to October 4, 2014  | 1,666                                | 17.13                            | —  | \$99,938,428   |
| October 5, 2014 to November 1, 2014 | 1,573                                | 16.77                            | —  | \$99,938,428   |
| Total                               | 4,942                                | \$17.32                          | —  |  |

(1) Although we did not repurchase any of our common stock during the three months ended November 1, 2014 under the 2011 Stock Repurchase Program:

We repurchased 300 shares of common stock for approximately \$4.8 thousand at a weighted average price of \$16.01 associated with the proceeds and related tax benefits from the exercise of stock options, SARs and other equity grants;

We acquired 2,359 shares of common stock from certain employees to cover tax withholding obligations from exercises of SARs and the vesting of restricted stock and performance shares at a weighted average acquisition price of \$17.63 per share; and

The trustee of the grantor trust established by us for the purpose of holding assets under our Deferred Compensation Plan (the "Plan") purchased an aggregate of 2,283 shares of our common stock in the open market at a weighted average price of \$17.17 in connection with the option to invest in our stock under the Plan and in connection with the reinvestment of dividends paid on our common stock held in trust in the Plan.

(2)

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Reflects the \$200.0 million authorized under the 2011 Stock Purchase Program, less the \$100.1 million repurchased using our existing cash, cash flow and other liquidity sources since March 2011.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following documents are the exhibits to this Form 10-Q. For convenient reference, each exhibit is listed according to the Exhibit Table of Item 601 of Regulation S-K.

| Exhibit Number | Description  |
|----------------|--|
| <u>10.1</u>    | <u>Second Amended and Restated Credit Agreement dated October 6, 2014, among Specialty Retailers, Inc., as borrower, Stage Stores, Inc., as guarantor, and the banks named therein is incorporated by reference to Exhibit 10.1 to Stage Stores' Current Report on Form 8-K (Commission File No. 1-14035) filed October 10, 2014. Some schedules to this Exhibit have been omitted. The registrant agrees to furnish supplementally a copy of any of the omitted schedules to this Exhibit to the Securities and Exchange Commission upon its request.</u> |
| <u>31.1*</u>   | <u>Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>  |
| <u>31.2*</u>   | <u>Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>  |
| <u>32*</u>     | <u>Certification Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| 101.INS        | XBRL Instance Document   |
| 101.SCH        | XBRL Taxonomy Extension Schema Document  |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF        | XBRL Taxonomy Extension Definition Linkbase Document   |

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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\* Filed electronically herewith.

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SIGNATURES

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

STAGE STORES, INC.

Dated: December 11, 2014

/s/ Michael L. Glazer  
Michael L. Glazer  
President and Chief Executive Officer  
(Principal Executive Officer)

Dated: December 11, 2014

/s/ Oded Shein  
Oded Shein  
Executive Vice President, Chief Financial Officer and  
Treasurer  
(Principal Financial Officer)