A C MOORE ARTS & CRAFTS INC
Form 10-Q
November 09, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2001

OR

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

For the transition period from ______ to ______

Commission File Number: 000-23157

A.C. MOORE ARTS & CRAFTS, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	22-3527763
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

500 University Court, Blackwood, NJ 08012
(Address of principal executive offices)
(Zip Code)

(856) 228-6700
(Registrant's telephone number, including area code)

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

Yes X No

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

Class	Outstanding at November 6, 2001
Common Stock, no par value	7,457,146

A.C. MOORE ARTS & CRAFTS, INC.

TABLE OF CONTENTS

2

A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

	September 30, 2001 (unaudited)	December 31, 2000

ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,722	$ 10,310
Inventories	86,864	72,786
Prepaid expenses and other current assets	1,920	2,052
	92,506	85,148
Property and equipment, net	24,938	21,517
Other assets	1,112	727
	$118,556	$107,392
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$ 16,500	$ --
Current portion of capital leases	1,260	389
Accounts payable to trade and others	21,128	26,237
Accrued payroll and payroll taxes	3,084	3,822
Accrued expenses	4,803	4,274
Income taxes payable	273	3,258
	47,048	37,980
Long-term liabilities:		
Capital leases	2,230	812
Deferred taxes	2,320	2,320
Other long-term liabilities	3,013	2,599
	7,563	5,731
	54,611	43,711
SHAREHOLDERS' EQUITY		
Preferred stock, no par value, 5,000,000 shares authorized, none issued		
Common stock, no par value, 20,000,000 shares authorized, 7,454,597 shares outstanding at September 30, 2001 and 7,415,333 outsanding at December 31, 2000	43,572	43,268
Retained earnings	20,373	20,413
	63,945	63,681
	$118,556	$107,392

See accompanying notes to financial statements

A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands, except per share data)
(unaudited)

	Three months ended September 30, 2001	Three months ended September 30, 2000	Nine months ended September 30, 2001	Nine months ended September 30, 200
Net sales	$ 76,220	$ 60,906	$ 209,774	$ 16
Cost of sales (including buying and distribution costs)	47,951	38,550	132,193	10
Gross margin	28,269	22,356	77,581	6
Selling, general and administrative expenses	26,936	21,778	75,092	6
Pre-opening expenses	625	576	2,074	
Income from operations	708	2	415	
Net interest expense	297	149	478	
Income (loss) before income taxes	411	(147)	(63)	
Income tax expense (benefit)	156	(56)	(23)	
Net income (loss)	$ 255	$ (91)	$ (40)	$
Basic net income (loss) per share	$ 0.03	$ (0.01)	$ (0.01)	$
Weighted average shares outstanding	7,437,940	7,405,167	7,429,526	7,40
Diluted net income (loss) per share	$ 0.03	$ (0.01)	$ (0.01)	$
Weighted average shares outstanding plus impact of stock options	7,787,798	7,405,167	7,429,526	7,44

See accompanying notes to financial statements

A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2000
Cash flows from operating activities:		
Net Income (loss)	$ (40)	$ 68
Adjustments to reconcile net income (loss) to net cash (used in) operating activities:		
Depreciation and amortization	3,644	2,690
Compensation expense related to stock options	--	102

Changes in assets and liabilities:		
Inventories	(14,078)	(13,604)
Prepaid expenses and other current assets	132	(627)
Accounts payable, accrued payroll payroll taxes and accrued expenses	(8,303)	(1,283)
Other long-term liabilities	414	371
Other	(385)	(63)
Net cash (used in) operating activities	(18,616)	(12,346)
Cash flows (used in) investing activities: Capital expenditures	(7,065)	(7,580)
Cash flows from financing activities:		
Proceeds from line of credit	16,500	7,750
Exercise of stock options	304	--
Proceeds from equipment financing	2,791	--
Repayment of equipment financing	(502)	(273)
Net cash provided by financing activities	19,093	7,477
Net (decrease) in cash	(6,588)	(12,449)
Cash and cash equivalents at beginning of period	10,310	14,553
Cash and cash equivalents at end of period	$ 3,722	$ 2,104

See accompanying notes to financial statements

A.C. MOORE ARTS & CRAFTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) Basis of Presentation

The consolidated financial statements included herein include the accounts of A.C. Moore Arts & Crafts, Inc. and its wholly owned subsidiaries (collectively the "Company"). The Company is a chain of 58 retail stores selling arts and crafts merchandise. The stores are located throughout the Eastern United States.

These financial statements have been prepared by management without audit and should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000. Due to the seasonality of the Company's business, the results for the interim periods are not necessarily indicative of the results for the year. The accompanying consolidated financial statements reflect, in the opinion of management, all adjustments necessary for a fair presentation of the interim financial statements. In the opinion of management, all such adjustments are of a normal and recurring nature.

(2) Management Estimates

The preparation of these consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reported period and related disclosures. Significant estimates made as of and for the three and nine month periods ended September 30, 2001 and 2000 include provisions for shrinkage, capitalized buying, warehousing and distribution costs related to inventory and markdowns of merchandise inventories. Actual results could differ materially from those estimates.

(3) Earnings Per Share

The weighted average shares outstanding plus impact of stock options for the three months ended September 30, 2000 and for the nine month period ended September 30, 2001 excludes potentially dilutive shares as the result would be antidilutive.

(4) New Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging Activities, which requires that all derivative financial instruments be recognized as either assets or liabilities in the balance sheet. SFAS No. 133, which was effective for the Company's first quarter of 2001, has not had a material impact on the Company's consolidated results of operation, financial position or cash flows.

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. SFAS No. 142 requires the use of a non-amortization approach to account for purchased goodwill and certain intangibles, effective January 1, 2002. We do not believe that the adoption of these pronouncements will have a material impact on our financial statements. FASB also recently issued Statement No. 143, "Accounting for Asset Retirement Obligations" and Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Statement No. 143 requires the recognition of a liability for the estimated cost of disposal as part of the initial cost of a long-lived asset. Statement No. 144 supersedes Statement No. 121 to supply a single accounting approach for measuring impairment of long-lived assets, including segment of a business accounted for as a discontinued operation or those to be sold or disposed of other than by sale. We must adopt Statement No. 143 in 2003 and Statement No. 144 in 2002. We have not determined the impact, if any, of adopting these pronouncements on our financial statements.

6

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

The following discussion and analysis contains certain forward-looking statements. These forward-looking statements do not constitute historical facts and involve risks and uncertainties. Actual results could differ materially from those referred to in the forward-looking statements due to a number of factors, including, but not limited to, the following: customer demand, the effect of economic conditions, the impact of competitors' locations or pricing, the availability of acceptable real estate locations for new stores, difficulties with respect to new information system technologies, supply constraints or difficulties, the effectiveness of advertising strategies and the ability to meet capital needs. For additional information concerning factors that could cause actual results to differ materially from the information contained herein, reference is made to the information under the heading "Cautionary Statement Relating to Forward Looking Statements" in the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission.

Due to the importance of the fall selling season, the fourth quarter has historically contributed, and the Company expects it will continue to contribute, disproportionately to the Company's profitability for the entire year. As a result, the Company's quarterly results of operations may fluctuate. In addition, results of a period shorter than a full year may not be indicative of results expected for the entire year.

Results of Operations

The following table sets forth, for the periods indicated, selected statement of operations data expressed as a percentage of net sales and the number of stores open at the end of each such period:

	Three months ended September 30,		Nine months ended September 30,	
	2001	2000	2001	2000
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	62.9%	63.3%	63.0%	63.3%
Gross Margin	37.1%	36.7%	37.0%	36.7%
Selling, general and administrative expenses	35.3%	35.8%	35.8%	35.7%
Store pre-opening expenses	0.8%	0.9%	1.0%	0.9%
Income from operations	0.9%	0.0%	0.2%	0.1%
Net interest expense	0.4%	0.2%	0.2%	0.1%
Income (loss) before income taxes	0.5%	(0.2)%	0.0%	0.0%
Income tax expense (benefit)	0.2%	(0.1)%	0.0%	0.0%
Net income (loss)	0.3%	(0.1)%	0.0%	0.0%
Number of stores open at end of period	58	48		

Three Months Ended September 30, 2001 Compared to Three Months Ended September

30, 2000

Net Sales. Net sales increased $15.3 million, or 25.1%, to $76.2 million in the three months ended September 30, 2001 from $60.9 million in the comparable 2000 period. This increase resulted from (i) net sales of $7.0 million from eight new stores opened in 2001, (ii) net sales of $4.1 million from stores opened in 2000 not included in the comparable store base, and (iii) a comparable store sales increase of $4.2 million, or 7%. Stores are added to the comparable store base at the beginning of the fourteenth full month of operation.

Gross Margin. Cost of sales includes the cost of merchandise, plus certain distribution and purchasing costs. Cost of sales increased $9.4 million, or 24.4%, to $48.0 million in the three months ended September 30, 2001 from $38.6 million in the three months ended September 30, 2000. The gross margin increased $5.9 million, or 26.4%, to $28.3 million in the three months ended September 30, 2001 from $22.4 million in the three months ended September 30, 2000. The gross margin increased to 37.1% of net sales in the three months ended September 30, 2001 from 36.7% in the three months ended September 30, 2000. The increase is due to the mix of sales, cost reductions achieved from our vendors and leveraging of our buying and distribution expense, offset somewhat by higher freight costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses include (a) direct store level expenses, including rent and related operating costs, payroll, advertising, depreciation and other direct costs, and (b) corporate level costs not directly associated with or allocable to cost of sales including executive salaries, accounting and finance, corporate information systems, office facilities and other corporate expenses. Selling, general and administrative expenses increased $5.1 million, or 23.7%, in the three months ended September 30, 2001 to $26.9 million from $21.8 million in the three months ended September 30, 2000. Of the increase, $4.2 million was attributable to the stores opened in 2001 which were not open during 2000 and the stores opened in 2000 not in the comparable store base. Of the remainder, $800,000 is due to increases in the comparable stores and $100,000 is attributable to the increase in corporate costs. As a percentage of sales, selling, general and administrative costs decreased to 35.3% of net sales in the three months ended September 30, 2001 from 35.8% of net sales in the three months ended September 30, 2000. This decrease is primarily due to the leveraging of corporate overhead costs offset in part by the impact of new stores, which, on average, have higher operating costs as a percent of sales than older stores.

Store Pre-Opening Expenses. The Company expenses store pre-opening expenses as incurred. Pre-opening expense for the three new stores opened in the third quarter of 2001, and the new store which opened in October 2001 amounted to $625,000. In the third quarter of 2000, the Company incurred store pre-opening costs of $576,000 related to the three stores opened in that quarter.

Net Interest Expense. In the third quarter of 2001, the Company had net interest expense of $297,000 compared with interest expense of $149,000 in 2000. The increase is due to the use of short-term borrowing to fund the new stores added in 2000 and 2001.

Income Taxes. The Company's effective income tax rate was 38.0% for both the third quarters ended September 30, 2001 and September 30, 2000.

Nine Months Ended September 30, 2001 Compared to Nine Months Ended September 30, 2000

Net Sales. Net sales increased $40.9 million, or 24.2%, to $209.8 million in the nine months ended September 30, 2001 from $168.9 million in the comparable 2000 period. This increase resulted from (i) net sales of $13.5 million from eight new stores opened in 2001, (ii) net sales of $19.3 million from stores opened in 2000 not included in the comparable store base, and (iii) a comparable store sales increase of $8.1 million, or 5%.

Gross Margin. Cost of sales increased $25.3 million, or 23.7%, to $132.2 million in the nine months ended September 30, 2001 from $106.8 million in the nine months ended September 30, 2000. The gross margin increased $15.6 million, or 25.1%, to $77.6 million in the nine months ended September 30, 2001 from $62.0 million in the nine months ended September 30, 2000. The gross margin increased to 37.0% of net sales in the nine months ended September 30, 2001 from 36.7% in the nine months ended September 30, 2000. The increase is due to the mix of sales, cost reductions achieved from our vendors and leveraging of our buying and distribution expense, offset somewhat by higher freight costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased $14.8 million, or 24.5% in the nine months ended September 30, 2001 to $75.1 million from $60.3 million in the nine months ended September 30, 2000. Of the increase, $11.9 million was attributable to the stores opened in 2001 which were not open during 2000 and the stores opened in 2000 not in the comparable store base. Of the remainder, $2.1 million is due to increases in the comparable stores and $800,000 is attributable to the increase in corporate costs to support the growth of the Company. As a percentage of sales, selling, general and administrative costs increased to 35.8% of net sales in the nine months ended September 30, 2001 from 35.7% of net sales in the nine months ended September 30, 2000. This increase is primarily due to the newer stores which, on average, have higher operating costs as a percent to sales than older stores, offset by leveraging of corporate costs.

Store Pre-Opening Expenses. Pre-opening expenses for the eight new stores opened in the first nine months of 2001, the new store which opened in October 2001 and two stores which were relocated during the period amounted to $2.1 million. In the first nine months of 2000, the Company opened eight new stores and incurred pre-opening expenses of $1.5 million.

Net Interest Expense. In the first nine months of 2001 the Company had interest expense of $478,000 compared with interest expense of $95,000 in 2000. The increase is due to the use of short term borrowing to fund the new stores added in 2000 and 2001.

Income Taxes. The Company's effective income tax rate was 37% for the nine months ended September 30, 2001 and 38% for the comparable period in 2000.

Liquidity and Capital Resources

The Company's cash needs are primarily for working capital to support its inventory requirements and capital expenditures, store pre-opening costs and beginning inventory for new stores.

At September 30, 2001 and December 31, 2000, the Company's working capital was $45.5 million and $47.2 million, respectively. Cash used in operations was $18.6 million for the nine months ended September 30, 2001 primarily as a result of seasonal reduction of accounts payable and accrued liabilities in the amount of $5.2 million, payments for income taxes of $3.1 million and an increase in inventory of $14.1 million to support the new stores and for the building of inventory for the fall and Christmas selling seasons.

Net cash used in investing activities during the nine months ended September 30, 2001 was $7.1 million. This use of cash was for capital expenditures, primarily related to new stores. In 2001, the Company expects to spend approximately $10.0 million on capital expenditures, which includes approximately $8.0 million for new store openings, and the remainder for remodeling and systems in existing stores, warehouse equipment and systems development. There are no other material commitments for capital expenditures other than new store openings in the next 12 months.

Net cash provided by financing activities principally represents $16.5 million in borrowings under the Company's $50 million revolving credit facility and $2.8 million of proceeds from equipment financing. The proceeds were used to fund new store openings, including related capital expenditures.

The Company believes the cash generated from operations during the year and available borrowings under the financing agreement will be sufficient to finance its working capital and capital expenditure requirements for at least the next 12 months.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not Applicable.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

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

Not Applicable.

ITEM 5. OTHER INFORMATION

Not Applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None

(b) There were no reports on Form 8-K filed during the quarter ended September 30, 2001.

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.

A.C. MOORE ARTS & CRAFTS, INC.

Date: November 9, 2001

By: /s/ Leslie H. Gordon

Executive Vice President
and Chief Financial Officer
(duly authorized officer
and principal financial
officer)