

J JILL GROUP INC
Form 10-Q
August 11, 2003

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**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 QUARTER ENDED JUNE 28, 2003**

OR

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

Commission file number 0-22480

The J. Jill Group, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

04-2973769
(I.R.S. Employer
Identification No.)

4 Batterymarch Park, Quincy, MA
(Address of Principal Executive Offices)

02169
(Zip Code)

Registrant's telephone number, including area code: **(617) 376-4300**

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

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

Shares outstanding of the registrant's common stock (par value \$0.01) at August 1, 2003: 19,575,504

**THE J. JILL GROUP, INC.
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FOR THE QUARTER ENDED JUNE 28, 2003

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THE J. JILL GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

| | <u>June 28, 2003</u> | <u>June 29, 2002</u> | <u>December 28, 2002</u> |
|-----------------------------|--------------------------|--------------------------|------------------------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 55,194 | \$ 49,335 | \$ 44,734 |
| Cash held in escrow | 998 | 805 | 538 |
| Accounts receivable, net | 11,483 | 5,900 | 21,317 |
| Inventory, net | 34,699 | 29,775 | 33,998 |
| Prepaid catalog expenses | 4,650 | 4,879 | 4,082 |
| Deferred income taxes | 6,331 | 7,202 | 6,149 |
| Other current assets | 6,576 | 4,747 | 5,144 |
| | <u>119,931</u> | <u>102,643</u> | <u>115,962</u> |
| Total current assets | 119,931 | 102,643 | 115,962 |
| Property and equipment, net | 113,401 | 97,429 | 108,676 |
| Other non-current assets | 3,781 | 3,098 | 3,622 |
| | <u>237,113</u> | <u>203,170</u> | <u>228,260</u> |
| Total assets | \$ 237,113 | \$ 203,170 | \$ 228,260 |

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| | June 28, 2003 | June 29, 2002 | December 28, 2002 |
|---|-------------------|-------------------|----------------------|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 14,423 | \$ 14,264 | \$ 13,013 |
| Accrued expenses | 19,523 | 14,726 | 20,609 |
| Accrued customer returns | 5,663 | 6,422 | 7,328 |
| Current portion of long-term debt | 1,678 | 1,731 | 1,788 |
| Total current liabilities | 41,287 | 37,143 | 42,738 |
| Long-term debt, less current portion | 13,100 | 14,707 | 13,802 |
| Deferred credits from landlords | 27,549 | 18,690 | 24,765 |
| Deferred income taxes | 2,746 | 639 | 1,856 |
| Commitments | | | |
| Stockholders' equity: | | | |
| Special preferred stock (par value \$0.01) 1,000,000 shares authorized | | | |
| Common stock (par value \$0.01) 30,000,000 shares authorized, 19,575,004, 19,301,799 and 19,495,411 shares issued and outstanding as of June 28, 2003, June 29, 2002 and December 28, 2002, respectively | 196 | 193 | 195 |
| Additional paid-in capital | 107,692 | 103,920 | 107,227 |
| Retained earnings | 44,543 | 27,878 | 37,677 |
| Total stockholders' equity | 152,431 | 131,991 | 145,099 |
| Total liabilities and stockholders' equity | \$ 237,113 | \$ 203,170 | \$ 228,260 |

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

THE J. JILL GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| Net sales | \$ 97,365 | \$ 86,355 | \$ 179,728 | \$ 159,712 |
| Cost of products and merchandising | 60,744 | 50,913 | 117,552 | 98,849 |
| Gross margin | 36,621 | 35,442 | 62,176 | 60,863 |
| Selling, general and administrative expenses | 26,030 | 24,488 | 50,081 | 45,156 |
| Income before interest and taxes | 10,591 | 10,954 | 12,095 | 15,707 |
| Interest, net | 167 | 173 | 363 | 384 |

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| | Three Months Ended | | Six Months Ended | |
|----------------------|--------------------|-----------------|------------------|-----------------|
| | | | | |
| Income before taxes | 10,424 | 10,781 | 11,732 | 15,323 |
| Income tax provision | 4,326 | 4,366 | 4,866 | 6,212 |
| Net income | \$ 6,098 | \$ 6,415 | \$ 6,866 | \$ 9,111 |

Earnings per share:

| | | | | |
|----------------|---------|---------|---------|---------|
| <i>Basic</i> | \$ 0.31 | \$ 0.34 | \$ 0.35 | \$ 0.49 |
| <i>Diluted</i> | \$ 0.30 | \$ 0.32 | \$ 0.34 | \$ 0.46 |

Weighted average shares outstanding:

| | | | | |
|----------------|--------|--------|--------|--------|
| <i>Basic</i> | 19,575 | 19,051 | 19,571 | 18,705 |
| <i>Diluted</i> | 20,100 | 20,153 | 20,044 | 19,879 |

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

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THE J. JILL GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

| | Six Months Ended | |
|---|------------------|---------------|
| | June 28, 2003 | June 29, 2002 |
| Cash flows provided by operating activities: | | |
| Net income | \$ 6,866 | \$ 9,111 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 7,629 | 5,791 |
| (Gain) loss on trust assets | (171) | 53 |
| Deferred income taxes | 708 | 1,105 |
| Changes in assets and liabilities: | | |
| Decrease in accounts receivable | 9,834 | 7,715 |
| (Increase) decrease in inventory | (701) | 2,080 |
| Increase in prepaid catalog expenses | (568) | (296) |
| Increase in other assets | (720) | (925) |
| Increase in accounts payable | 1,293 | 844 |
| Increase (decrease) in accrued expenses | (814) | 2,416 |
| Decrease in accrued customer returns | (1,665) | (140) |
| Increase in deferred credits from landlords | 2,784 | 4,641 |
| Net cash provided by operating activities | 24,475 | 32,395 |

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| | Six Months Ended | |
|---|-------------------------|-----------------|
| Cash flows used in investing activities: | | |
| Additions to property and equipment | (12,509) | (16,396) |
| Investment in trust assets | (700) | (1,921) |
| Increase in cash held in escrow | (460) | (307) |
| Net cash used in investing activities | (13,669) | (18,624) |
| Cash flows (used in) provided by financing activities: | | |
| Borrowings under debt agreements | | 6,260 |
| Payments of debt borrowings | (812) | (7,167) |
| Proceeds from stock transactions | 466 | 6,319 |
| Net cash (used in) provided by financing activities | (346) | 5,412 |
| Net increase in cash and cash equivalents | 10,460 | 19,183 |
| Cash and cash equivalents at: | | |
| Beginning of period | 44,734 | 30,152 |
| End of period | \$ 55,194 | \$ 49,335 |
| Supplemental information: | | |
| Non-cash investing activities: | | |
| Construction costs accrued, not paid | \$ 2,372 | \$ 1,890 |

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

THE J. JILL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The financial statements included herein have been prepared by The J. Jill Group, Inc. (together with its wholly owned consolidated subsidiaries, the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and in the opinion of management contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for the interim periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with Generally Accepted Accounting Principles ("GAAP") have been omitted pursuant to such rules and regulations. Accordingly, although the Company believes that the disclosures are adequate to make the information presented not misleading, these financial statements should be read in conjunction with the Company's consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2002 ("fiscal 2002"). As a retailer, the Company is subject to seasonal fluctuations in net sales. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

A. Nature of business:

The Company is a multi-channel specialty retailer of high quality women's apparel, accessories and footwear that markets its products through catalogs, retail stores and an e-commerce website.

B. Accounting for stock-based compensation:

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At June 28, 2003, the Company had three stock-based plans, which are described in Note G to the financial statements contained in the Company's Annual Report on Form 10-K for fiscal 2002. The Company discloses stock-based compensation information in accordance with Financial Accounting Standards Board ("FASB") issued Statement No. 148 ("SFAS 148"), "Accounting for Stock-Based Compensation Transition and Disclosure - an amendment of FASB Statement No. 123" and FASB issued Statement No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation." The Company has elected to continue to account for its stock-based plans under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" as well as to provide disclosure of stock-based compensation as outlined in SFAS 123 as amended by SFAS 148. No compensation expense has been recognized for the Company's stock-based plans.

A reconciliation of net income, as reported, to pro forma net income including compensation expense for the Company's stock-based plans as calculated based on the fair value at the grant dates for awards made under these plans in accordance with the provisions of SFAS 123 as well as a comparison of as

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reported and pro forma basic and diluted earnings per share ("EPS") follows (in thousands, except per share data):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| Net income: | | | | |
| As reported | \$ 6,098 | \$ 6,415 | \$ 6,866 | \$ 9,111 |
| Total stock-based compensation expense, net of tax | (1,361) | (999) | (2,366) | (2,115) |
| Pro forma | \$ 4,737 | \$ 5,416 | \$ 4,500 | \$ 6,996 |
| Earnings per share: | | | | |
| <i>Basic</i> | | | | |
| As reported | \$ 0.31 | \$ 0.34 | \$ 0.35 | \$ 0.49 |
| Pro forma | 0.24 | 0.28 | 0.23 | 0.37 |
| <i>Diluted</i> | | | | |
| As reported | 0.30 | 0.32 | 0.34 | 0.46 |
| Pro forma | \$ 0.24 | \$ 0.27 | \$ 0.22 | \$ 0.35 |

The Black-Scholes option-pricing model is used to estimate the fair value on the date of grant of each option granted. The Black-Scholes model is also used to estimate the fair value on the date of grant of the employees' purchase rights associated with the Company's amended 1998 Employee Stock Purchase Plan. The assumptions used in the estimation of the fair value of stock option grants and employee purchase right grants for the three and six months ended June 28, 2003 were made on a basis consistent with the assumptions made at December 28, 2002.

C. Debt:

The Company's credit facilities at June 28, 2003 consisted of (i) a \$60,000,000 revolving credit facility (the "Revolving Credit Facility"); (ii) a \$12,000,000 real estate loan (the "Tilton Facility Loan"); and (iii) a \$4,100,000 equipment loan (the "Equipment Loan").

On June 26, 2003, the Company amended its Revolving Credit Facility primarily to extend its term, increase its letter of credit capacity and remove a prior borrowing restriction. The maturity date of the Revolving Credit Facility, as amended, is June 1, 2005. The amount of the Revolving Credit Facility, as amended, was increased from \$50,000,000 to \$60,000,000, providing the Company with an additional \$10,000,000 in letter of credit capacity. Letters of credit are primarily used to procure inventory from foreign vendors. The amount available under the Revolving Credit Facility is reduced by outstanding borrowings and outstanding letters of credit. Outstanding borrowings may not exceed \$20,000,000. The Revolving Credit Facility is collateralized by substantially all of the personal property, both tangible and intangible, of the Company. Outstanding borrowings bear interest at an annual rate equal to the prime lending rate announced by one of the participating banks or the LIBOR lending rate plus 1.75% per annum. At June 28, 2003, the Revolving Credit Facility bore interest at 4.00% per annum. There were no outstanding borrowings on the Revolving Credit Facility at June 28, 2003 or June 29, 2002. Outstanding letters of credit totaled \$29,083,000 and

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\$29,825,000 at June 28, 2003 and June 29, 2002, respectively. Availability under the Revolving Credit Facility at June 28, 2003 and June 29, 2002 was \$30,917,000, and \$20,175,000, respectively, subject in each case to the applicable borrowing cap. Outstanding letters of credit do not bear interest. The Company is required to pay a commitment fee of $\frac{1}{4}$ of 1% per annum on the unused portion of the Revolving Credit Facility.

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The Tilton Facility Loan is collateralized by a mortgage lien on the Company's operations, fulfillment and distribution center in Tilton, New Hampshire (the "Tilton facility"). The Tilton facility is owned by Birch Pond Realty Corporation, a wholly owned subsidiary of The J. Jill Group, Inc., and leased to The J. Jill Group, Inc. Payments of principal and interest on the Tilton Facility Loan, a 10-year loan, are due monthly, based on a 20-year amortization, with a balloon payment of the remaining balance payable on April 1, 2009. The interest rate on the Tilton Facility Loan is fixed at 7.30% per annum.

The Equipment Loan is collateralized by substantially all of the Company's materials handling equipment. On May 30, 2003, the Company refinanced the promissory notes outstanding under the Equipment Loan in order to reduce the weighted average interest rate of the Equipment Loan. Payments of principal and interest on the Equipment Loan, as amended, are due monthly with a balloon payment of the remaining balance payable on June 1, 2006. The interest rate on the Equipment Loan is fixed at 5.00% per annum.

The Company's credit facilities contain various lending conditions and covenants including restrictions on permitted liens. In the case of the Revolving Credit Facility, these conditions and covenants include certain financial coverage calculations and ratios, including (i) indebtedness and outstanding letter of credit balance to tangible net worth; (ii) hard current assets to current liabilities; (iii) debt service coverage; (iv) indebtedness, outstanding letter of credit balance and net present value of operating leases to tangible net worth; (v) minimum tangible net worth; and (vi) minimum annual net profit. The manner of making these calculations and computing these ratios is defined by the provisions of the Fifth Amended and Restated Loan Agreement, as amended, which is part of the Revolving Credit Facility. The Company was in compliance with the covenants associated with its credit facilities as of and for the quarters ended June 28, 2003 and June 29, 2002.

A summary of the Company's outstanding long-term debt follows (in thousands):

| | June 28, 2003 | June 29, 2002 | December 28, 2002 |
|-------------------------------|------------------|------------------|----------------------|
| Real estate loans | \$ 10,767 | \$ 11,099 | \$ 10,937 |
| Equipment loans | 3,993 | 5,270 | 4,609 |
| Capitalized lease obligations | 18 | 69 | 44 |
| | 14,778 | 16,438 | 15,590 |
| Less current maturities | (1,678) | (1,731) | (1,788) |
| | \$ 13,100 | \$ 14,707 | \$ 13,802 |

At June 28, 2003, the Company estimated the fair value of its outstanding borrowings, including current maturities, to be \$16,773,000.

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D. Earnings per share:

A reconciliation of the numerators and denominators of the basic and diluted EPS computations follows (in thousands, except per share data):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |

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| | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------|------------------|----------|
| | | | | |
| Numerator: | | | | |
| Net income | \$ 6,098 | \$ 6,415 | \$ 6,866 | \$ 9,111 |
| Denominator (shares): | | | | |
| Basic weighted average shares outstanding | 19,575 | 19,051 | 19,571 | 18,705 |
| Assumed exercise of stock options | 525 | 1,102 | 473 | 1,174 |
| Diluted weighted average shares outstanding | 20,100 | 20,153 | 20,044 | 19,879 |
| Earnings per share: | | | | |
| <i>Basic</i> | \$ 0.31 | \$ 0.34 | \$ 0.35 | \$ 0.49 |
| <i>Diluted</i> | \$ 0.30 | \$ 0.32 | \$ 0.34 | \$ 0.46 |

For the three-month and six-month periods ending June 28, 2003, of the options then outstanding, options to purchase 1,357,000 and 1,793,500 shares of common stock, respectively were excluded from the computation of diluted EPS on the basis that such options were antidilutive. For the three-month and six-month periods ending June 29, 2002, there were no options excluded from the computation.

During the second quarter of fiscal 2003, options to purchase 264,500 shares of the Company's common stock were granted and no options were exercised pursuant to the Company's stock option plans. During the second quarter of fiscal 2002, options to purchase 669,000 shares of the Company's common stock were granted and options to purchase 704,091 shares of common stock were exercised. Also during the second quarter of fiscal 2002, the Company received \$3,491,000 in cash from the exercise of stock options and recorded a related tax benefit of \$2,062,000 as an increase to additional paid-in capital.

During the six months ended June 28, 2003, options to purchase 264,500 shares of the Company's common stock were granted and options to purchase 48,602 shares of common stock were exercised pursuant to the Company's stock option plans in connection with which the Company received \$98,000 in cash and did not record any related tax benefit. During the six months ended June 29, 2002, options to purchase 1,060,500 shares of the Company's common stock were granted and options to purchase 1,158,695 shares of common stock were exercised. Also, during the six months ended June 29, 2002, the Company received \$5,979,000 in cash from the exercise of stock options and recorded a related tax benefit of \$3,624,000 as an increase to additional paid-in capital.

E. Commitments:

The Company leases certain of its facilities under non-cancelable operating leases having initial or remaining terms of more than one year. Many of the Company's leases contain scheduled increases in annual rent payments and the majority of the Company's real estate leases also require the Company to pay maintenance, insurance and real estate taxes. Additionally, certain of the Company's leases include provisions for the payment of additional rent based on a percentage of sales over an established minimum.

During the six months ended June 28, 2003, the Company entered into leases for 19 retail stores, each having terms not exceeding 10 years. At June 28, 2003, the future minimum lease payments for operating

leases having a remaining term in excess of one year at such date, including the 19 operating leases entered into during the six-month period, were as follows (in thousands):

| | |
|----------------------------------|-----------|
| For the remainder of fiscal 2003 | \$ 10,886 |
| Fiscal 2004 | 22,891 |
| Fiscal 2005 | 23,678 |
| Fiscal 2006 | 23,963 |
| Fiscal 2007 | 24,300 |
| Thereafter | 105,088 |

| | |
|-------|------------|
| Total | \$ 210,806 |
|-------|------------|

In addition to the commitments represented in the above table, the Company enters into a number of cancelable and non-cancelable commitments during the year. Typically, these commitments are for less than a year in duration and are principally focused on the construction of new retail stores and the procurement of inventory. The Company typically commits to construction costs one to six months in advance of a new retail store opening. Preliminary commitments with the Company's private label merchandise vendors typically are made five to seven months in advance of planned receipt date. Initial merchandise commitments for branded merchandise typically are made four to six months before planned receipt date.

Most of the Company's retail store leases contain provisions that allow for early termination of the lease if certain predetermined annual sales levels are not met. Generally, these provisions allow the lease to be terminated between the third and fifth year of the lease. Should the lease be terminated under these provisions, the unamortized portion of any landlord allowances related to that property would be payable to the landlord. The unamortized portion of landlord allowances included in deferred credits from landlords at June 28, 2003 was \$25,513,000. The Company is currently considering utilizing the early termination option for one of its retail stores. The unamortized portion of the landlord allowance related to this store was \$78,000 at June 28, 2003. In addition, during the six months ended June 28, 2003 the Company received a \$250,000 deposit from one of its vendors, which is refundable to the vendor in the event of an early termination of the contract. The Company is recognizing this deposit over the term of the contract. The unamortized portion of this deposit at June 28, 2003 was \$235,000.

F. Segment information:

The Company currently has two reportable business segments, direct and retail. Each segment is separately managed and utilizes distinct distribution, marketing and inventory management strategies. The direct segment markets merchandise through catalogs and an e-commerce website. The retail segment markets merchandise through retail stores. Results from the Company's catalog outlet stores are included in the direct segment. Results from the Company's retail outlet store are included in the retail segment. Segment reporting is intended to give financial statement users a view of the Company "through the eyes of management." The Company's internal management reporting is the basis for the information disclosed for its business segments. In accordance with GAAP, the Company's internally defined measure of segment profit or loss, direct contribution, is required to be disclosed, but it is not a GAAP measure. Information related to segment direct contribution should be read in conjunction with the reconciliation to "Income before interest and taxes" as determined by GAAP.

The Company evaluates its segment profitability based on the direct contribution of each segment. Direct contribution represents each segment's net sales less direct costs related to the segment's operations. Direct costs for both segments include merchandise acquisition and control costs and

provisions for markdowns. Direct costs also include catalog costs, certain order processing costs and e-commerce selling costs for the direct segment and retail store selling, occupancy, depreciation and administrative costs for the retail segment. Direct contribution less unallocated shared-service costs and general and administrative expenses is equal to income before interest and taxes. Unallocated shared-service costs include distribution and warehousing costs as well as merchandising and product development costs. General and administrative expenses include corporate executive management costs, support service costs (e.g., shared information systems, finance and human resources) and corporate headquarters occupancy costs.

Segment assets are those that are directly used in or identified with segment operations, including inventory, fixed assets primarily related to store construction, accounts receivable and other operating assets. Unallocated assets include corporate cash and cash equivalents, the Company's corporate headquarters and distribution facility, corporate information systems, deferred tax amounts and other corporate assets. In the third quarter of fiscal 2002, the Company changed its internal segment reporting related to identifiable assets such that all inventory is now fully allocated to each operating segment. Segment information at June 29, 2002 has been presented to conform to current period presentation.

The accounting policies of the Company's segments are the same as those described in Note B to the financial statements contained in the Company's Annual Report on Form 10-K for fiscal 2002. In addition, inter-segment balances and transactions have been eliminated.

The following tables summarize financial information by segment and provide a reconciliation of segment direct contribution to income before interest and taxes (in thousands):

Three Months Ended

Six Months Ended

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| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
|--|------------------|------------------|-------------------|-------------------|
| Net sales: | | | | |
| Direct | \$ 54,470 | \$ 56,010 | \$ 105,532 | \$ 107,188 |
| Retail | 43,087 | 30,591 | 74,614 | 53,002 |
| Other (1) | (192) | (246) | (418) | (478) |
| Total net sales | \$ 97,365 | \$ 86,355 | \$ 179,728 | \$ 159,712 |
| Direct contribution reconciliation: | | | | |
| Direct | \$ 16,989 | \$ 18,953 | \$ 33,035 | \$ 35,367 |
| Retail | 4,672 | 4,462 | 1,498 | 3,607 |
| Total direct contribution | 21,661 | 23,415 | 34,533 | 38,974 |
| Unallocated shared-service costs | (5,874) | (5,940) | (12,117) | (12,039) |
| General and administrative expenses | (5,196) | (6,521) | (10,321) | (11,228) |
| Income before interest and taxes | \$ 10,591 | \$ 10,954 | \$ 12,095 | \$ 15,707 |

(1) Other represents certain sales allowances not specifically attributable to the direct or retail business segments.

| | Direct | Retail | Unallocated Assets | Total |
|-----------------------------|-----------|------------|-----------------------|------------|
| Identifiable assets: | | | | |
| June 28, 2003 | \$ 22,023 | \$ 107,010 | \$ 108,080 | \$ 237,113 |
| June 29, 2002 | \$ 19,372 | \$ 79,584 | \$ 104,214 | \$ 203,170 |

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G. Reclassifications:

Certain amounts in the prior year financial statements and related notes have been reclassified to conform to the current period presentation. In addition, certain segment information at June 29, 2002 has been presented to conform to current period presentation and management's current internal reporting structure.

H. Recent accounting standards:

In May 2003, the FASB issued Statement No. 150 ("SFAS 150"), "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The Company has evaluated the provisions of SFAS 150 and determined that this standard will have no effect on its consolidated financial statements.

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

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This Quarterly Report on Form 10-Q, including the following discussion, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve substantial risks and uncertainties. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the generality of the foregoing, the words "projected," "anticipated," "planned," "expected" and similar expressions are intended to identify forward-looking statements. In particular, statements regarding future financial targets or trends are forward-looking statements. Forward-looking statements are not guarantees of our future financial performance, and undue reliance should not be placed on them. Our actual results, performance or achievements may differ significantly from the results discussed in or implied by the forward-looking statements. Factors that might cause such a difference include, but are not limited to, the following: the continued success or possible future failure of the retail store initiative; our ability to effectively manage our operations and growth in a multiple distribution channel environment; significant changes in customer acceptance of our product offerings; changes in competition in the apparel industry; changes in consumer spending, fashion trends and consumer preferences; changes in, or the failure to comply with, federal and state tax and other government regulations; the customary risks of purchasing merchandise abroad, including longer lead times, higher initial purchase commitments and foreign currency fluctuations; timely receipts of inventory from vendors; possible future increases in expenses and labor and employee benefit costs; our ability to attract and retain qualified personnel; business abilities and judgment of management; the existence or absence of brand awareness; the existence or absence of publicity, advertising and promotional efforts; the success or failure of operating initiatives; the mix of our sales between full price and liquidation merchandise; general political, economic and business conditions and other factors. See also Item 1A, "Risk Factors," included in our Annual Report on Form 10-K for the fiscal year ended December 28, 2002 ("fiscal 2002"). We disclaim any intent or obligation to update any forward-looking statements.

Overview

We are a multi-channel specialty retailer of high quality women's apparel, accessories and footwear. We market our products through catalogs, retail stores and an e-commerce website. We currently have two reportable business segments, direct and retail. Each segment is separately managed and utilizes distinct distribution, marketing and inventory management strategies. The direct segment markets merchandise through catalogs and an e-commerce website. The retail segment markets merchandise through retail stores.

Net sales for the three months ended June 28, 2003 ("second quarter fiscal 2003") increased by 12.7% to \$97.4 million from \$86.4 million for the three months ended June 29, 2002 ("second quarter fiscal 2002"). Income before interest and taxes ("operating income") for second quarter fiscal 2003 was \$10.6 million, or 10.9% of net sales, compared to \$11.0 million, or 12.7% of net sales, for second quarter fiscal 2002. Net income was \$6.1 million, or \$0.30 per diluted share, for second quarter fiscal 2003 compared to \$6.4 million, or \$0.32 per diluted share, for second quarter fiscal 2002.

For the six months ended June 28, 2003, net sales increased by 12.5% to \$179.7 million from \$159.7 million during the six months ended June 29, 2002. Operating income for the six months ended June 28, 2003 was \$12.1 million, or 6.7% of net sales, compared to \$15.7 million, or 9.8% of net sales, for the six months ended June 29, 2002. Net income was \$6.9 million, or \$0.34 per diluted share, for the six months ended June 28, 2003, compared to \$9.1 million, or \$0.46 per diluted share, for the six months ended June 29, 2002.

During the three and six months ended June 28, 2003 we continued to experience difficulty from a top-line perspective. Some of this difficulty can be attributed to external factors weak mall traffic and continued economic uncertainty. At the same time, we have identified major areas that we feel require

investments, upgrades and changes. We are currently in the process of enhancing our existing infrastructure as it relates to design, product development, sourcing and our in-store visual presentation.

In addition, in July 2003 we merged our catalog/e-commerce subsidiary, J. Jill Direct, Inc. into our retail store subsidiary, The Birch Pond Group, Inc. We expect this restructuring to provide us with enhanced customer service and cross-channel marketing opportunities which will allow us, among other things, to (i) promote our retail stores within our catalogs; (ii) distribute catalogs in our retail stores; (iii) test accepting catalog returns in our retail stores; (iv) offer the J. Jill credit card "Take 5" discount on catalog and e-commerce orders; (v) maximize and leverage our inventory more effectively across all three distribution channels; and (vi) develop a comprehensive, multi-channel database of customer purchase information that will drive future cross-channel marketing initiatives for catalog, e-commerce and retail. One negative result of these changes is that we will now be required to collect sales tax on catalog and e-commerce sales to consumers in states where we have retail stores. Although we are unable to predict the impact that this will have on our direct segment sales, we anticipate that our direct segment sales may be adversely affected in the short-term.

Results of Operations

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The following table presents our consolidated statements of operations expressed as a percentage of net sales:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| Net sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of products and merchandising | 62.4 | 59.0 | 65.4 | 61.9 |
| Gross margin | 37.6 | 41.0 | 34.6 | 38.1 |
| Selling, general and administrative expenses | 26.7 | 28.3 | 27.9 | 28.3 |
| Income before interest and taxes | 10.9 | 12.7 | 6.7 | 9.8 |
| Interest, net | 0.2 | 0.2 | 0.2 | 0.2 |
| Income before taxes | 10.7 | 12.5 | 6.5 | 9.6 |
| Income tax provision | 4.4 | 5.1 | 2.7 | 3.9 |
| Net income | 6.3% | 7.4% | 3.8% | 5.7% |

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The following table presents certain selected operating data:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| Direct: | | | | |
| Circulation (1) | | | | |
| Catalogs (in thousands) | 19,200 | 20,100 | 35,100 | 36,100 |
| Square inches (in millions) | 120,300 | 119,600 | 230,700 | 228,400 |
| Twelve-month buyers (2) | 1,055,000 | 1,036,000 | 1,055,000 | 1,036,000 |
| Customer e-mail addresses | 781,000 | 695,000 | 781,000 | 695,000 |
| Retail: (3) | | | | |
| Stores open | | | | |
| Beginning of period | 89 | 55 | 88 | 51 |
| End of period | 96 | 67 | 96 | 67 |
| Weighted average stores open (4) | 93.7 | 60.7 | 90.9 | 56.2 |
| Weighted average square footage (5) | 444,500 | 299,100 | 431,700 | 278,000 |
| Total Company: | | | | |
| J. Jill private label credit cardholders | 492,000 | 360,000 | 492,000 | 360,000 |

(1)

In order to more closely match net sales to circulation, we calculate circulation on a percentage of completion basis. Catalog circulation takes into account the total number of catalogs mailed during all periods and our estimate of the expected sales life of each catalog edition. Square inches circulated also takes into account the page count and page size of the catalogs circulated during the period.

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- (2) As used throughout this Form 10-Q, the term "twelve-month buyers" means customers who have placed a catalog, e-commerce or intranet order with us within the previous twelve months.
- (3) Retail information relates to our retail stores only and does not include data for our direct outlet stores or our retail outlet store.
- (4) Weighted average stores open refers to the number of retail stores open during the period weighted for the number of days that each store was open during the period.
- (5) Weighted average square footage refers to the square footage of retail stores open during the period weighted for the number of days that each store was open during the period.

The following table summarizes net sales by segment (in thousands):

| | Three Months Ended | | Six Months Ended | |
|------------------|--------------------|------------------|------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| Direct | \$ 54,470 | \$ 56,010 | \$ 105,532 | \$ 107,188 |
| Retail | 43,087 | 30,591 | 74,614 | 53,002 |
| Other (1) | (192) | (246) | (418) | (478) |
| | | | | |
| Total net sales | \$ 97,365 | \$ 86,355 | \$ 179,728 | \$ 159,712 |

- (1) Other represents certain sales allowances not specifically attributable to the direct or retail business segments.

Comparison of the Three and Six Months Ended June 28, 2003 with the Three and Six Months Ended June 29, 2002

Net sales increased by \$11.0 million, or 12.7%, to \$97.4 million during second quarter fiscal 2003 from \$86.4 million during second quarter fiscal 2002. During the six months ended June 28, 2003, net sales increased by \$20.0 million, or 12.5%, to \$179.7 million from \$159.7 million during the six months ended June 29, 2002. Retail segment net sales increased by 40.8% for both the three-month and six-month periods ended June 28, 2003 as compared to the three-month and six-month periods ended June 29, 2002, primarily as a result of increased store count. Retail segment sales productivity, as measured by sales per square foot, declined by 6.0% and 10.1% in the three-month and six-month periods ended June 28, 2003, respectively, as compared to the three-month and six-month periods ended June 29, 2002. During the six months ended June 28, 2003, we opened eight retail stores, of which seven were opened during second quarter fiscal 2003. At June 28, 2003, we had 96 retail stores open compared to 67 at June 29, 2002. Direct segment net sales decreased by 2.7% and square inches circulated increased by 0.6% during second quarter fiscal 2003 compared to second quarter fiscal 2002. During the six months ended June 28, 2003, direct segment net sales decreased by 1.5% and square inches circulated increased by 1.0% compared to the six months ended June 29, 2002. Direct segment sales productivity, as measured by demand per 1,000 square inches circulated, declined by 3.3% and 2.4% in the three-month and six-month periods ended June 28, 2003, respectively, as compared to the three-month and six-month periods ended June 29, 2002. E-commerce net sales represented 33.6% of total direct segment net sales during second quarter fiscal 2003 compared to 29.5% during second quarter fiscal 2002. During the six months ended June 28, 2003, e-commerce net sales represented 33.7% of total direct segment net sales compared to 28.2% during the six months ended June 29, 2002.

Gross margin represents net sales less cost of products and merchandising. Cost of products and merchandising consists primarily of merchandise development, control and acquisition costs, provisions for markdowns, order processing and customer service costs, distribution facility costs and occupancy and depreciation costs for our stores. During second quarter fiscal 2003, gross margin increased by \$1.2 million, or

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3.3%, to \$36.6 million from \$35.4 million during second quarter fiscal 2002. As a percentage of net sales, gross margin decreased to 37.6% during second quarter fiscal 2003 from 41.0% during second quarter fiscal 2002. During the six months ended June 28, 2003, gross margin increased by \$1.3 million, or 2.2%, to \$62.2 million from \$60.9 million during the six months ended June 29, 2002. As a percentage of net sales, gross margin decreased to 34.6% during the six months ended June 28, 2003 from 38.1% during the six months ended June 29, 2002. These decreases in gross margin as a percentage of net sales were primarily attributable to the de-leveraging of retail occupancy and depreciation costs as a result of lower sales productivity, higher markdown charges as a result of lower than expected sales volumes and increased off price sales as a percentage of total sales. These factors were partially offset by the leveraging of direct order processing costs over higher total company net sales as well as increased order processing productivity.

Selling, general and administrative expenses consist primarily of costs to produce, print and distribute catalogs, as well as e-commerce website, retail store selling and corporate administrative costs. During second quarter fiscal 2003, selling, general and administrative expenses increased by \$1.5 million, or 6.3%, to \$26.0 million from \$24.5 million during second quarter fiscal 2002. As a percentage of net sales, selling, general and administrative expenses decreased to 26.7% during second quarter fiscal 2003 from 28.3% during second quarter fiscal 2002. During the six months ended June 28, 2003, selling, general and administrative expenses increased by \$4.9 million, or 10.9%, to \$50.1 million from \$45.2 million during the six months ended June 29, 2002. As a percentage of net sales, selling, general and administrative expenses decreased to 27.9% during the six months ended June 28, 2003 from 28.3% during the six months ended June 29, 2002. These decreases in selling, general and administrative expenses as a percentage of net sales were attributable to lower employee benefit and compensation expenses primarily related to a \$1.0 million fully vested discretionary Company contribution into the deferred compensation plan made during second

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quarter fiscal 2002 that did not repeat this year. In addition, we did not achieve our bonus targets this spring, and therefore we did not pay a spring season bonus this year. These factors were partially offset by higher selling expenses as a percentage of net sales as a result of lower top-line productivity and the growing impact of the retail segment on our overall results and the current tendency for retail selling costs to be higher as a percentage of net sales than direct selling costs.

Interest income decreased to \$134,000 in second quarter fiscal 2003 from \$178,000 in second quarter fiscal 2002. Interest expense decreased to \$301,000 in second quarter fiscal 2003 from \$351,000 in second quarter fiscal 2002. During the six months ended June 28, 2003, interest income decreased to \$256,000 from \$326,000 for the six months ended June 29, 2002. Interest expense during the six months ended June 28, 2003 decreased to \$619,000 from \$710,000 for the six months ended June 29, 2002.

We provide for income taxes at an effective tax rate that includes the full federal and state statutory tax rates. Our effective tax rate for both the three-month and six-month periods ended June 28, 2003 was 41.5% compared to 40.5% for both the three-month and six-month periods ended June 29, 2002. The higher effective tax rate reflects an increase in the projected amount of non-deductible expenses for fiscal 2003. In the third quarter of fiscal 2003, we merged our catalog/e-commerce subsidiary into our retail store subsidiary. Once this merger was effected, we determined that it was more likely than not that we will be able to utilize certain state net operating loss ("NOL") carryforwards that we had previously believed were not realizable. In addition we expect our effective state tax rate to decrease as a result of apportioning more income to states with lower tax rates. The effect of these changes on the year to date current and deferred tax provision and the reversal of the valuation allowance associated with certain state NOL carryforwards will result in a net tax benefit of approximately \$50,000 that will be reflected in the third quarter of fiscal 2003. We expect our third quarter effective tax rate to differ from the annual effective tax rate due to the effect of this benefit. Our effective annual tax rate for fiscal 2003, as adjusted for these changes, is estimated to be 41.0%.

Segment Direct Contribution

We currently have two reportable business segments, direct and retail. Segment reporting is intended to give financial statement users a view of our business "through the eyes of management." Our internal management reporting is the basis for the information disclosed for our business segments. In accordance with Generally Accepted Accounting Principles ("GAAP"), our internally defined measure of segment profit or loss, direct contribution, is required to be disclosed, but it is not a GAAP measure. Information related to segment direct contribution should be read in conjunction with the reconciliation to "Income before interest and taxes" as determined by GAAP.

We evaluate our segment profitability based on the direct contribution of each segment. Direct contribution represents each segment's net sales less direct costs related to the segment's operations. Direct costs for both segments include merchandise acquisition and control costs and provisions for markdowns. Direct costs also include catalog costs, certain order processing costs and e-commerce selling costs for the direct segment and retail store selling, occupancy, depreciation and administrative costs for the retail segment. Direct contribution less unallocated shared-service costs and general and administrative expenses is equal to income before interest and taxes. Unallocated shared-service costs include distribution and warehousing costs as well as merchandising and product development costs. General and administrative expenses include corporate executive management costs, support service costs (e.g., shared information systems, finance and human resources) and corporate headquarters occupancy costs.

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The accounting policies of our segments are the same as those described in Note B to the financial statements contained in our Annual Report on Form 10-K for fiscal 2002. In addition, inter-segment balances and transactions have been eliminated.

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The following table summarizes direct contribution by segment and provides a reconciliation of segment direct contribution to income before interest and taxes (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 28, 2003 | June 29, 2002 | June 28, 2003 | June 29, 2002 |
| Direct | \$ 16,989 | \$ 18,953 | \$ 33,035 | \$ 35,367 |
| Retail | 4,672 | 4,462 | 1,498 | 3,607 |
| Total direct contribution | 21,661 | 23,415 | 34,533 | 38,974 |
| Unallocated shared-service costs | (5,874) | (5,940) | (12,117) | (12,039) |
| General and administrative expenses | (5,196) | (6,521) | (10,321) | (11,228) |
| Income before interest and taxes | \$ 10,591 | \$ 10,954 | \$ 12,095 | \$ 15,707 |

Direct Segment

The direct segment's second quarter fiscal 2003 direct contribution decreased by \$2.0 million, or 10.4%, compared to second quarter fiscal 2002. As a percentage of segment net sales, direct contribution decreased to 31.2% during second quarter fiscal 2003 from 33.8% during second quarter fiscal 2002. For the six months ended June 28, 2003, direct contribution decreased by \$2.3 million, or 6.6%, compared to the six months ended June 29, 2002. As a percentage of segment net sales, direct contribution decreased to 31.3% during the six months ended June 28, 2003 from 33.0% for the six months ended June 29, 2002. These decreases in direct contribution as a percentage of segment net sales were primarily attributable to increased off price sales as a percentage of total sales, higher markdown charges and the de-leveraging of certain order processing and selling costs over lower overall catalog productivity.

Retail Segment

The retail segment's second quarter fiscal 2003 direct contribution increased by \$0.2 million, or 4.7%, compared to second quarter fiscal 2002. As a percentage of segment net sales, direct contribution decreased to 10.8% during second quarter fiscal 2003 from 14.6% during second quarter fiscal 2002. For the six months ended June 28, 2003, direct contribution decreased by \$2.1 million, or 58.5%, compared to the six months ended June 29, 2002. As a percentage of segment net sales, direct contribution decreased to 2.0% during the six months ended June 28, 2003 from 6.8% for the six months ended June 29, 2002. These decreases in direct contribution as a percentage of segment net sales were primarily attributable to increased off price sales as a percentage of total sales, higher markdown charges and the de-leveraging of occupancy and depreciation costs as a result of lower sales productivity. For the three-month period ended June 28, 2003, these factors were partially offset by lower selling costs as a percentage of segment net sales as compared to the three-month period ended June 29, 2002, largely as a result of leveraging certain fixed selling costs over higher sales.

Seasonality and Quarterly Fluctuations

As our retail store sales become a greater portion of our overall business, we expect that our business will become more seasonal. Our retail store rollout plan is expected to materially impact year-over-year comparisons of our operating results. Also, January is included in the first fiscal quarter for us, but is included in the fourth fiscal quarter for many other retailers. Because January is a month that traditionally involves significant promotional pricing, this difference needs to be taken into account when making comparisons of our financial performance for interim periods with that of other retailers.

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Liquidity and Capital Resources

Our principal working capital needs arise from the need to support costs incurred in advance of revenue generation, primarily inventory acquisition and catalog development, production and mailing costs. We have two selling seasons that correspond to the fashion seasons. The spring season begins in January and ends in July. The fall season begins in July and ends in January. Our capital investment needs arise from initiatives intended to support our growth, including the retail store rollout and improvements to our physical and operating infrastructure. During the six months ended June 28, 2003, we funded our working capital and capital investment needs primarily with cash generated from operations and our existing cash on hand.

Cash and cash equivalents ("cash") increased by \$10.5 million during the six months ended June 28, 2003. Approximately \$24.5 million in cash was generated from operations and \$12.5 million was invested in property and equipment, primarily related to our retail store rollout. During the six months ended June 28, 2003, net income before depreciation and amortization and collections on accounts receivable were the primary sources of cash from operations. The primary use of cash from operations was related to payments of amounts accrued for customer returns.

Cash increased by \$19.2 million during the six months ended June 29, 2002. Approximately \$32.4 million in cash was generated from operations and \$6.3 million in cash was received from stock transactions, primarily from the exercise of stock options during the period. Approximately \$16.4 million was invested in property and equipment, primarily related to our retail store rollout and \$1.9 million was invested in trust assets associated with our deferred compensation plan. During the six months ended June 29, 2002, net income before depreciation and amortization, collections on accounts receivable and additional deferred credits from landlords were the primary sources of cash from operations. The primary use of cash from operations was related to increased other assets, including increased prepaid rent and prepaid insurance expenses.

Accounts receivable balances at June 28, 2003 were 46.1% lower than at December 28, 2002 primarily as a result of collections associated with our Holiday deferred billing program and landlord allowance receivables. Accounts receivable balances at June 28, 2003 were 94.6% higher than at June 29, 2002 primarily as a result of the addition of a deferred billing promotion in our spring Bestseller catalog this year.

Inventory levels at June 28, 2003 were 2.1% higher than at December 28, 2002 and 16.5% higher than at June 29, 2002. Retail segment inventory totaled \$22.1 million at June 28, 2003, \$18.4 million at December 28, 2002 and \$15.0 million at June 29, 2002. Direct segment inventory totaled \$12.6 million at June 28, 2003, \$15.6 million at December 28, 2002 and \$14.8 million at June 29, 2002. The growth in retail segment inventory is a result of increased store count and our decision to increase merchandise availability in our stores for the spring 2003 season as compared to the spring 2002 season. This strategy, coupled with lower than expected sales, resulted in higher inventory balances and higher overstocks at June 28, 2003 as compared to June 29, 2002. The higher inventory balances associated with the spring season were somewhat offset by lower amounts of upcoming fall season merchandise on hand at June 28, 2003 than at June 29, 2002 due to the timing of receipts.

Accrued expense balances at June 28, 2003 were 5.3% lower than at December 28, 2002 primarily as a result of lower amounts accrued for gift certificates. Accrued expense balances at June 28, 2003 were 32.6% higher than at June 29, 2002, primarily as a result of higher amounts accrued for taxes, gift certificates and our deferred compensation plan.

Deferred credits from landlords include step rent and allowances from landlords primarily related to our retail store leases. Deferred credits from landlords at June 28, 2003 were 11.2% higher than at December 28, 2002 and 47.4% higher than at June 29, 2002, primarily as a result of the additional retail stores opened since those dates.

Our credit facilities at June 28, 2003 consisted of (i) a \$60.0 million revolving credit facility (the "Revolving Credit Facility"); (ii) a \$12.0 million real estate loan (the "Tilton Facility Loan"); and (iii) a \$4.1 million equipment loan (the "Equipment Loan").

On June 26, 2003, we amended our Revolving Credit Facility primarily to extend its term, increase its letter of credit capacity and remove a prior borrowing restrictions. The maturity date of the Revolving Credit Facility, as amended, is June 1, 2005. The amount of the Revolving Credit Facility, as amended, was increased from \$50.0 million to \$60.0 million, providing us with an additional \$10.0 million in letter of credit capacity. Letters of credit are primarily used to procure inventory from foreign vendors. The amount available under the Revolving Credit Facility is reduced by outstanding borrowings and outstanding letters of credit. Outstanding borrowings may not exceed \$20.0 million. The Revolving Credit Facility is collateralized by substantially all of our personal property, both tangible and intangible. Outstanding borrowings bear interest at an annual rate equal to the prime lending rate announced by one of the participating banks or the LIBOR lending rate plus 1.75% per annum. At June 28, 2003, the Revolving Credit Facility bore interest at 4.00% per annum. There were no outstanding borrowings on the

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Revolving Credit Facility at June 28, 2003 or June 29, 2002. Outstanding letters of credit totaled \$29.1 million and \$29.8 million at June 28, 2003 and June 29, 2002, respectively. Availability under the Revolving Credit Facility at June 28, 2003 and June 29, 2002 was \$30.9 million and \$20.2 million, respectively, subject in each case to the applicable borrowing cap. Outstanding letters of credit do not bear interest. We are required to pay a commitment fee of $\frac{1}{4}$ of 1% per annum on the unused portion of the Revolving Credit Facility.

The Tilton Facility Loan is collateralized by a mortgage lien on our operations, fulfillment and distribution center in Tilton, New Hampshire (the "Tilton facility"). The Tilton facility is owned by Birch Pond Realty Corporation, a wholly owned subsidiary of The J. Jill Group, Inc., and leased to The J. Jill Group, Inc. Payments of principal and interest on the Tilton Facility Loan, a 10-year loan, are due monthly, based on a 20-year amortization, with a balloon payment of the remaining balance payable on April 1, 2009. The interest rate on the Tilton Facility Loan is fixed at 7.30% per annum.

The Equipment Loan is collateralized by substantially all of our materials handling equipment. On May 30, 2003, we refinanced the promissory notes outstanding under the Equipment Loan in order to reduce the weighted average interest rate of the Equipment Loan. Payments of principal and interest on the Equipment Loan, as amended, are due monthly with a balloon payment of the remaining balance payable on June 1, 2006. The interest rate on the Equipment Loan is fixed at 5.00% per annum.

The weighted average interest rate for amounts outstanding under our credit facilities during the six months ended June 28, 2003 was 7.28% per annum.

Our credit facilities contain various lending conditions and covenants including restrictions on permitted liens. In the case of the Revolving Credit Facility, these conditions and covenants include certain financial coverage calculations and ratios, including (i) indebtedness and outstanding letter of credit balance to tangible net worth; (ii) hard current assets to current liabilities; (iii) debt service coverage; (iv) indebtedness, outstanding letter of credit balance and net present value of operating leases to tangible net worth; (v) minimum tangible net worth; and (vi) minimum annual net profit. The manner of making these calculations and computing these ratios is defined by the provisions of the Fifth Amended and Restated Loan Agreement, as amended, which is part of the Revolving Credit Facility. We were in compliance with the covenants associated with our credit facilities as of and for the quarters ended June 28, 2003 and June 29, 2002.

At June 28, 2003, we had 96 retail stores, one retail outlet store and three direct outlet stores open. We expect to open 35 retail stores in fiscal 2003, eight of which were opened in the first six months of fiscal 2003. The cash requirements related to our retail store initiative are significant and are primarily comprised of expenditures for leasehold improvements, net of landlord allowances, and initial inventory acquisition costs. The initial cash requirements for opening a new retail store are currently estimated at an average of approximately \$0.7 million per store.

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At June 28, 2003, our cash requirements related to our outstanding long-term debt and our future minimum lease payments for operating leases having a remaining term in excess of one year at such date were as follows (in thousands):

| | Long-Term Debt | Lease Commitments | Total |
|----------------------------------|---------------------------|------------------------------|-------------------|
| For the remainder of fiscal 2003 | \$ 836 | \$ 10,886 | \$ 11,722 |
| Fiscal 2004 | 1,706 | 22,891 | 24,597 |
| Fiscal 2005 | 1,805 | 23,678 | 25,483 |
| Fiscal 2006 | 1,036 | 23,963 | 24,999 |
| Fiscal 2007 | 463 | 24,300 | 24,763 |
| Thereafter | 8,932 | 105,088 | 114,020 |
| Total | \$ 14,778 | \$ 210,806 | \$ 225,584 |

At June 28, 2003, the maximum annual future minimum lease payments were \$24.9 million in 2009.

In addition to the debt payments and lease commitments represented in the above table, we enter into a number of cancelable and non-cancelable commitments during the year. Typically, these commitments are for less than a year in duration and are principally focused on the construction of new retail stores and the procurement of inventory. We typically commit to construction costs one to six months in advance of a new retail store opening. Preliminary commitments with our private label merchandise vendors typically are made five to seven months in advance of planned receipt date. Initial merchandise commitments for branded merchandise typically are made four to six months before

planned receipt date.

Most of our retail store leases contain provisions that allow for early termination of the lease by either party if certain predetermined annual sales levels are not met. Generally, these provisions allow the lease to be terminated between the third and fifth year of the lease. Should the lease be terminated under these provisions, the unamortized portion of any landlord allowances related to that property would be payable to the landlord.

Our sources of cash include cash on hand (\$55.2 million at June 28, 2003), available borrowing capacity under our Revolving Credit Facility (\$20.0 million at June 28, 2003) and anticipated cash flow from operations. If the current trend of business continues, we expect to fund our entire retail store rollout in fiscal 2003 with cash generated from operations in fiscal 2003. We estimate that approximately \$26.0 million in cash, before landlord allowances, will be invested in property and equipment during the remaining six months of fiscal 2003, primarily for retail store construction. Based on current operating conditions, we believe we have sufficient sources of cash to execute our operating plans. Should current operating conditions deteriorate, we may generate less cash flow from operating activities than expected and be required to use more of our cash on hand than planned. In addition, we may need to borrow on our Revolving Credit Facility. We believe that we have some flexibility to adjust our mid-to-long-term operating plans to respond to any significant decrease in our cash resources. For example, we could adjust the timing and extent of our retail store rollout for fiscal 2004 and beyond or change our catalog circulation strategy.

Future Financial Targets

With respect to the remainder of fiscal 2003, we are targeting diluted earnings per share for the third and fourth quarter combined to range between \$0.35 and \$0.40, compared to \$0.48 last year, with the third quarter potentially coming in at a loss. We expect gross margins as a percentage of net sales for the third and fourth quarter combined to decline by 120 to 150 basis points and selling, general and administrative expenses as a percentage of net sales to increase by 170 to 200 basis points as compared to last year's comparable period. The projected decline in combined third and fourth quarter results versus a year ago is due to increased off price selling resulting from excess spring inventory, lower catalog productivity as the

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direct segment continues to be adversely affected by the shift of customers to our retail stores and greater than anticipated infrastructure investments in design, product development, sourcing, in-store visual presentation and our multi-channel database.

These are our targets, not predictions of actual performance. Historically, our performance has deviated, often materially, from our targets. See the first paragraph of this Item 2 for factors that might cause such deviations.

Recent Developments

During the second quarter of fiscal 2003, Patricia C. Lee, our President J. Jill Merchandising, requested and was granted a three-month leave of absence for personal reasons. Ms. Lee is currently scheduled to return in early September.

Recent Accounting Standards

In May 2003, the Financial Accounting Standards Board ("FASB") issued Statement No. 150 ("SFAS 150"), "*Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*." SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. We have evaluated the provisions of SFAS 150 and determined that this standard will have no effect on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our objective in managing our long-term exposure to interest rate changes and foreign currency rate changes is to limit the material impact of the changes on cash flows and earnings and to lower our overall borrowing costs. To achieve our objectives, we periodically identify these risks and manage them through our regular operating and financing activities, including periodic refinancing of debt obligations to increase availability while minimizing financing costs and considering fixed and variable rate debt positions. We do not currently use derivative financial instruments or enter into foreign currency denominated contracts. We have calculated the effect of a 10% change in interest rates over a month and determined the effect to be immaterial. We do not foresee or expect any significant changes in the management of foreign currency or interest rate exposures or in the strategies we employ to manage such exposures in the near future.

We have established a trust in connection with our deferred compensation plan. The trust assets are invested in corporate owned life insurance in a manner that is designed to approximate the measurement designations of the plan participants, for both vested and unvested balances. Investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investments, it is at least reasonably possible that changes in the values of these investments will occur in the near term and that such changes will also impact participant deferred compensation balances based on the measurement designations made by the participant. Changes in value of the trust assets are intended to mirror changes in the value of the participants' deferred compensation accounts.

Item 4. Controls and Procedures

We carried out an evaluation, with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures as of June 28, 2003. Based on this evaluation, our principal executive officer and principal financial officer concluded that as of June 28, 2003 our disclosure controls and procedures were effective in timely alerting them to material information required to be included in our reports filed or submitted under the Securities Exchange Act of 1934. No change in our internal control over financial reporting occurred during second quarter fiscal 2003 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Three civil actions have been brought against us and two of our executive officers (Gordon R. Cooke, President and Chief Executive Officer, and Olga Conley, President Corporate Services and Chief Financial Officer) in the United States District Court for the District of Massachusetts, each allegedly on behalf of a class of purchasers of our Common Stock, and each alleging violations of Section 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder (the "Securities Actions"). The Securities Actions were filed on May 15, 2003, June 6, 2003 and July 14, 2003. The complaints in the Securities Actions are substantively identical, allege a class period from February 12, 2002 through December 4, 2002, and allege that we failed to disclose and misrepresented certain adverse facts. The complaints seek unspecified monetary damages and costs and expenses, including attorneys' fees. We intend to vigorously defend ourselves against these claims.

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

We held an Annual Meeting of Stockholders on May 30, 2003. At the Annual Meeting, our stockholders voted to approve the following actions by the following votes:

- To elect the following nominees as Class A Directors of the Company.

| | Number of Shares | |
|--------------------|------------------|-----------------------|
| | For | Withholding Authority |
| William E. Engbers | 16,453,195 | 1,097,029 |
| Samuel L. Shanaman | 16,452,195 | 1,098,029 |

- To amend the Amended and Restated 2001 Incentive and Non-Statutory Stock Option Plan of The J. Jill Group, Inc., as amended to date (the "2001 Plan"), to increase the number of shares of Common Stock available for issuance upon exercise of options granted under the 2001 Plan from 2,250,000 shares to 3,250,000 shares.

| | Number of Shares |
|------------------|-----------------------------|
| For | 10,065,162 |
| Against | 4,940,823 |
| Abstain | 7,093 |
| Broker Non-Votes | 2,537,146 |

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Item 6. Exhibits and Reports on Form 8-K**(a) Exhibits****Certificate of Incorporation and By-Laws**

- 3.1 Restated Certificate of Incorporation of the Company (included as Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 25, 1993, File No. 0-22480, and incorporated herein by reference)
- 3.2 Certificate of Amendment of Restated Certificate of Incorporation of the Company, dated June 1, 1999 (included as Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 26, 1999, File No. 0-22480, and incorporated herein by reference)
- 3.3 Certificate of Amendment of Restated Certificate of Incorporation of the Company, dated June 5, 2001 (included as Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, File No. 0-22480, and incorporated herein by reference)
- 3.4 By-Laws of the Company, as amended (included as Exhibit 99.1 to the Company's Current Report on Form 8-K filed November 24, 1999, File No. 0-22480, and incorporated herein by reference)

Material Contracts

- 10.1 Secured Promissory Note No. 5, dated May 30, 2003, between the Company and Citizens Leasing Corporation
- 10.2 Guaranty, dated May 30, 2003, between The Birch Pond Group, Inc. and Citizens Leasing Corporation
- 10.3 Guaranty, dated May 30, 2003, between J. Jill Direct, Inc. and Citizens Leasing Corporation
- 10.4 Guaranty, dated May 30, 2003, between QT Services Group, Inc. and Citizens Leasing Corporation
- 10.5 Third Amendment to Fifth Amended and Restated Loan Agreement, dated June 26, 2003, by and among the Company and Citizens Bank of Massachusetts, HSBC Bank USA, Banknorth, N.A. and Citizens Bank of Massachusetts as agent for the lenders
- 10.6 Amended and Restated Revolving Note, dated June 26, 2003, between the Company and Citizens Bank of Massachusetts
- 10.7 Amended and Restated Revolving Note, dated June 26, 2003, between the Company and HSBC Bank USA
- 10.8 Amended and Restated Revolving Note, dated June 26, 2003, between the Company and Banknorth, N.A.

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- 10.9 Confirmation of Guaranty and Agreement, dated June 26, 2003, by The Birch Pond Group, Inc. to

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Olga L. Conley
Authorized Officer
President Corporate Services,
Chief Financial Officer and Treasurer
(Principal Financial Officer)

Date: August 11, 2003

By: /s/ LINDA L. TRUDEL

Linda L. Trudel
Authorized Officer
Vice President / Corporate Controller
(Principal Accounting Officer)

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THE J. JILL GROUP, INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 28, 2003

EXHIBIT INDEX

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 - 10.15 Security Agreement Confirmation, dated June 26, 2003, by The J. Jill Group, Inc. to Citizens Bank of Massachusetts, individually and as agent for the benefit of, and on behalf of, all lenders
 - 10.16 Pledge Agreement Confirmation, dated June 26, 2003, by The J. Jill Group, Inc. to Citizens Bank of Massachusetts, individually and as agent for the benefit of, and on behalf of, all lenders
- Certifications**
- 31.1 Certification of Principal Executive Officer of Periodic Report Pursuant to Rule 13a-14(a) or Rule 15d-14(a)
 - 31.2 Certification of Principal Financial Officer of Periodic Report Pursuant to Rule 13a-14(a) or Rule 15d-14(a)
 - 32.1 Certification by Chief Executive Officer and Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350

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