A C MOORE ARTS & CRAFTS INC
Form 10-Q
August 09, 2002

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 June 30, 2002

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 August 8, 2002
Common Stock, no par value	18,736,370

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

	June 30, 2002 (unaudited)	December 2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 47,118	$ 10

Inventories	94,473	85
Prepaid expenses and other current assets	2,300	1
	143,891	98
Property and equipment, net	27,008	24
Other assets	808	
	$ 171,707	$ 123
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of capital leases	$ 1,329	$ 1
Trade accounts payable	22,606	23
Accrued payroll and payroll taxes	3,943	5
Accrued expenses	6,248	7
Income taxes payable	920	4
	35,046	41
Long-term liabilities:		
Capitalized equipment leases, less current portion	1,201	1
Deferred tax liability	3,425	3
Other long-term liabilities	3,566	3
	8,192	8
	43,238	50
SHAREHOLDERS' EQUITY		
Preferred stock, no par value, 10,000,000 shares authorized, none issued		
Common stock, no par value, 40,000,000 shares authorized, 18,723,670 shares outstanding at June 30, 2002 and 14,932,012 outstanding at December 31, 2001	97,088	43
Retained earnings	31,381	29
	128,469	73
	$ 171,707	$ 123

See accompanying notes to financial statements

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

	Three months ended June 30,	Six m J

	2002	2001	2002
Net sales	$ 82,866	$ 67,132	$ 168,71
Cost of sales (including buying and distribution costs)	52,170	42,265	106,33
Gross margin	30,696	24,867	62,38
Selling, general and administrative expenses	29,514	24,718	59,09
Pre-opening expenses	384	374	1,03
Income (loss) from operations	798	(225)	2,25
Net interest expense (income)	(187)	149	(17
Income (loss) before income taxes	985	(374)	2,42
Income tax expense (benefit)	401	(142)	96
Net income (loss)	$ 584	$ (232)	$ 1,46
Basic net income (loss) per share	$ 0.03	$ (0.02)	$ 0.0
Weighted average shares outstanding	18,682,222	14,857,666	17,083,44
Diluted net income (loss) per share	$ 0.03	$ (0.02)	$ 0.0
Weighted average shares outstanding plus impact of stock options	19,779,186	14,857,666	18,134,65

See accompanying notes to financial statements

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

	Six Mo J
	2002
Cash flows from operating activities:	
Net Income (loss)	$ 1,460
Adjustments to reconcile net income (loss) to net cash (used in) operating activities:	
Depreciation and amortization	2,968
Compensation expense related to stock options	-
Changes in assets and liabilities:	
Inventories	(8,799)
Prepaid expenses and other current assets	(774)
Accounts payable, accrued payroll	

payroll taxes and accrued expenses	(2,870)
Income taxes payable	(3,680)
Other long-term liabilities	350
Other	16
Net cash (used in) operating activities	(11,329)
Cash flows (used in) investing activities: Capital expenditures	(5,008)
Cash flows from financing activities:	
Proceeds from sale of shares	52,130
Proceeds from line of credit	2,000
Repayment of line of credit	(2,000)
Exercise of stock options	1,151
Proceeds from capital leases	-
Payment of capital leases	(644)
Net cash provided by financing activities	52,637
Net increase (decrease) in cash	36,300
Cash and cash equivalents at beginning of period	10,818
Cash and cash equivalents at end of period	$ 47,118

See accompanying notes to financial statements

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 65 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, 2001. 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) Common Stock and Earnings per Share

On June 25, 2002, the Company's Board of Directors declared a two-for-one stock split to stockholders of record as of the close of business on July 15, 2002 payable on July 31, 2002. All references to the number of shares of common stock, per share prices and earnings per share amounts in the consolidated financial statements and accompanying notes included in this Quarterly Report on Form 10-Q have been adjusted to reflect the split on a retroactive basis.

The weighted average shares outstanding plus impact of stock options for the three and six month periods ended June 30, 2001 excludes potentially dilutive shares as the result would be antidilutive.

(3) 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 six month periods ended June 30, 2002 and 2001 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.

(4) Recent Accounting Pronouncements

Statement No. 143, "Accounting for Asset Retirement Obligations" requires the recognition of a liability for the estimated cost of disposal as part of the initial cost of a long-lived asset. We must adopt Statement No. 143 in 2003. We believe that adopting this pronouncement will not have a material impact on our consolidated results of operation, financial position or cash flows.

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 our peak selling season, which includes Fall/Halloween, Thanksgiving and Christmas, 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.

Our quarterly results of operations also may fluctuate based upon such factors as the length of holiday seasons, the date on which holidays fall, the number and timing of new store openings, the amount of store pre-opening expenses, the amount of net sales contributed by new and existing stores, the mix of products sold, the amount of sales returns, the timing and level of markdowns and other competitive factors.

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 June 30,		S
	2002	2001	200
Net sales	100.0%	100.0%	100
Cost of sales	63.0%	63.0%	63
Gross margin	37.0%	37.0%	37
Selling, general and administrative expenses	35.6%	36.8%	35
Store pre-opening expenses	0.4%	0.5%	0
Income (loss) from operations	1.0%	(0.3)%	1
Net interest expense (income)	(0.2)%	0.2%	(0.
Income (loss) before income taxes	1.2%	(0.5)%	1
Income tax expense (benefit)	0.5%	(0.2)%	0
Net income (loss)	0.7%	(0.3)%	0
Number of stores open at end of period	65	55	

Three Months Ended June 30, 2002 Compared to Three Months Ended June 30, 2001

Net Sales. Net sales increased $15.7 million, or 23.4%, to $82.9 million in the three months ended June 30, 2002 from $67.1 million in the comparable 2001 period. This increase resulted from (i) net sales of $3.1 million from four new stores opened in 2002, (ii) net sales of $6.1 million from stores opened in 2001 not included in the comparable store base, and (iii) a comparable store sales increase of $6.5 million, or 10%. Stores are added to the comparable store base at the beginning of the fourteenth full month of operation.

Gross Margin. Cost of sales is net sales minus the cost of merchandise and certain distribution and purchasing costs. The gross margin was 37.0% of net sales in both the three month periods ended June 30, 2002 and June 30, 2001.

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 $4.8 million, or 19.4%, in the three months ended June 30, 2002 to $29.5 million from $24.7 million in the three months ended June 30, 2001. Of the increase, $4.1 million was attributable to the stores opened in 2002 which were not open during 2001 and the stores opened in 2001 not in the comparable store base. Of the remainder, $500,000 is due to increases in the comparable stores and $200,000 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 decreased to 35.6% of net sales in the three months ended June 30, 2002 from 36.8% of net sales in the three months ended June 30, 2001. This decrease is primarily due to leveraging store and central costs over a greater sales base.

Store Pre-Opening Expenses. The Company expenses store pre-opening expenses as incurred. Pre-opening expense for the two new stores opened in the second quarter of 2002 and the two new stores which opened in July amounted to $384,000. In the second quarter of 2001, the Company incurred store pre-opening costs of $374,000 related to the two stores opened in that quarter, one store which opened in July and one store which was relocated.

Net Interest Expense (Income). In the second quarter of 2002, the Company had net interest income of $187,000 compared with interest expense of $149,000 in 2001. The change is due to interest earned from the proceeds of the Company's sale of shares in March 2002.

Income Taxes. The Company's effective income tax rate was 40.7% for the second quarter ended June 30, 2002 and 38.0% for the second quarter ended June 30, 2001. The increase in the effective tax rate is the result of additional state income taxes on the higher level of income.

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Six Months Ended June 30, 2002 Compared to Six Months Ended June 30, 2001.

Net Sales. Net sales increased $35.2 million, or 26.3%, to $168.7 million in the six months ended June 30, 2002 from $133.6 million in the comparable 2001 period. This increase resulted from (i) net sales of $4.8 million from four new stores opened in 2002, (ii) net sales of $14.9 million from stores opened in 2001 not included in the comparable store base, and (iii) a comparable store sales increase of $15.5 million, or 12%.

Gross Margin. The gross margin increased to 37.0% of net sales in the six months ended June 30, 2002 from 36.9% in the six months ended June 30, 2001.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased $10.9 million, or 22.7% in the six months ended June 30, 2002 to $59.1 million from $48.2 million in the six months ended June 30, 2001. Of the increase, $7.9 million was attributable to the stores opened in 2002 which were not open during 2001 and the stores opened in 2001 not in the comparable store base. Of the remainder, $2.1 million is due to increases in the comparable stores and $900,000 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 decreased to 35.0% of net sales in the six months ended June 30, 2002 from 36.0% of net sales in the six months ended June 30, 2001. This decrease is primarily due to leveraging store and central costs over a greater sales base.

Store Pre-Opening Expenses. Pre-opening expense for the four new stores opened in the first half of 2002 and the two stores which opened in July amounted to $1.0 million. In the first six months of 2001 the Company opened five new stores and relocated two stores and incurred pre-opening expenses of $1.4 million.

Net Interest Expense (Income). In the first six months of 2002 the Company had net interest income of $176,000 compared with interest expense of $181,000 in 2001. The change is due to interest earned from the proceeds of the Company's sale of shares in March, 2002.

Income Taxes. The Company's effective income tax rate was 39.8% for the six months ended June 30, 2002 and 38.0% for the six months ended June 30, 2001. The increase in the effective tax rate is the result of additional state income taxes on the higher level of income.

Liquidity and Capital Resources

Our cash is used primarily for working capital to support inventory requirements and capital expenditures, pre-opening costs and beginning inventory for new stores. In recent years, we have financed our operations and new store openings primarily with cash from operations, the net proceeds we received from our initial public offering in 1997 and with borrowing under bank financing agreements. In March 2002 we completed a secondary offering in which we sold 1,750,000 new shares, with net cash proceeds of $52,130,000.

At June 30, 2002 and December 31, 2001 our working capital was $108.8 million and $56.4 million, respectively. Cash used in operations was $11.3 million for the six months ended June 30, 2002 as a result of an increase in inventory of $8.8 million to support the new stores, the seasonal reduction of accounts payable and accrued payroll in the amount of $2.9 million and a reduction in income taxes payable of $3.7 million.

Net cash used in investing activities during the six months ended June 30, 2002 was $5.0 million. This use of cash was for capital expenditures, primarily related to new stores. In 2002, we expect to spend approximately $11.0 million on capital expenditures, which includes approximately $8.0 million for new store openings, and the remainder for remodeling existing stores, upgrading systems in existing stores, warehouse equipment and corporate systems development.

We are currently negotiating to build a new distribution center and office complex which we plan to open in 2004. We anticipate that this new facility, which will be located near our existing distribution center, will be 800,000 square feet for distribution plus 30,000 square feet of office space. The total cost of the land and building for this facility is expected to be financed by long-term debt. We will use our working capital to pay for systems and equipment.

Net cash provided by financing activities includes the $52.1 million proceeds from the sale of shares.

On July 11, 2002 the Company signed a new $25 million one year line of credit agreement with First Union National Bank. With the successful completion of the sales of shares in March, 2002, the Company no longer required the existing $50 million revolving credit agreement which contained several restrictive covenants and was far more expensive to maintain. Borrowing under this new line will bear interest at LIBOR plus 125 basis points. The Company believes the cash generated from operations during the year and available borrowings under the new financing agreement will be sufficient to finance its working capital and capital expenditures requirements for at least the next 12 months.

General

On June 25, 2002, our Board of Directors approved a two-for-one stock split to shareholders of record as of the close of business on July 15, 2002, payable on July 31, 2002.

Critical Accounting Policies

Financial Reporting Release No. 60, recently issued by the Securities and Exchange Commission, requires all registrants to discuss "critical" accounting policies or methods used in the preparation of financial statements. Our critical accounting policies relate to merchandise inventories. We value our inventories at stores at the lower of cost or market as determined using the retail inventory method. Because we do not have perpetual inventory records for inventory in our stores, we perform complete physical inventories in each of our stores at the end of each year. The actual physical count of merchandise is made principally by third party inventory counting service firms. We believe our process results in reasonable estimates of our retail inventory on hand at year end.

Inventory valuation methods also require certain management estimates and judgments. These include estimates of net realizable value on product designated for clearance or on slow moving merchandise. The accuracy of our estimates can be affected by many factors, some of which are outside of our control, including changes in economic conditions and consumer buying trends. Historically, we have not experienced significant differences in our estimates of recovery compared with actual results.

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

The Company held its Annual Meeting of Shareholders on May 16, 2002. At the meeting, shareholders voted on the following:

1. To elect two Class C directors to hold office for a term of three years until their successors are duly elected and qualified.

2. To approve the adoption of the 2002 Stock Option Plan.

3. To ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent auditors for the fiscal year ending December 31, 2002.

The results of the voting was as follows:

	For	Against	Absta
Richard Lesser	8,375,270	--	
Patricia A. Parker	8,288,324	--	
Approval of 2002 Stock Option Plan	5,160,391	2,516,485	6,
Ratification of PricewaterhouseCoopers LLP	8,541,715	146,280	

The term of office for each of the following directors continued after the meeting: William Kaplan, John E. (Jack) Parker, Richard J. Bauer and Richard J. Drake.

ITEM 5. OTHER INFORMATION

Not Applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

(b) There were no reports on Form 8-K filed during the quarter ended June 30, 2002.

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SIGNATURES

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

A.C. MOORE ARTS & CRAFTS, INC.

Date: August 9, 2002 By: /s/ Leslie H. Gordon

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