NEIMAN MARCUS GROUP INC
Form 10-Q
June 08, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended May 1, 2004

OR

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

Commission file no. 1-9659

The Neiman Marcus Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**95-4119509**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Marcus Square
1618 Main Street
Dallas, Texas 75201

(Address of principal executive offices)

(214) 741-6911
(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 ý NO o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES ý NO o

As of June 1, 2004, the number of outstanding shares of each of the issuer s classes of common stock was:

Class	**Outstanding Shares**
Class A Common Stock, $.01 Par Value	29,341,253
Class B Common Stock, $.01 Par Value	19,941,833

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THE NEIMAN MARCUS GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands)	**May 1, 2004**	**August 2, 2003**	**May 3, 2003**
ASSETS			
Current assets:			
Cash and cash equivalents	$ 311,985	$ 206,950	$ 133,670
Undivided interests in NMG Credit Card Master Trust		243,145	279,556
Accounts receivable, net	599,581	22,595	25,132
Merchandise inventories	715,539	687,062	719,118
Other current assets	46,372	86,369	58,681
Total current assets	1,673,477	1,246,121	1,216,157
Property and equipment, net	685,928	674,185	676,059
Other assets	104,158	114,124	107,851
Total assets	$ 2,463,563	$ 2,034,430	$ 2,000,067
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Notes payable and current maturities of long-term liabilities	$ 1,237	$ 1,241	$ 1,799
Current portion of borrowings under Credit Card Facility	37,500		
Accounts payable	234,264	262,909	224,945
Accrued liabilities	316,305	266,259	293,145
Total current liabilities	589,306	530,409	519,889
Long-term liabilities:			
Notes and debentures	249,751	249,733	249,727
Borrowings under Credit Card Facility	187,500		
Other long-term liabilities	97,307	108,234	87,530
Total long-term liabilities	534,558	357,967	337,257
Minority interest	12,799	8,206	9,462
Common stocks	493	479	482
Additional paid-in capital	484,151	458,520	447,456
Accumulated other comprehensive loss	(26,752)	(25,573)	(11,729)

Retained earnings		891,054		719,442		712,270
Treasury stock, at cost (699,777 shares at May 1, 2004 and 524,177 shares at August 2, 2003 and May 3, 2003)		(22,046)		(15,020)		(15,020)
Total shareholders equity		1,326,900		1,137,848		1,133,459
Total liabilities and shareholders equity	$	2,463,563	$	2,034,430	$	2,000,067

See Notes to Condensed Consolidated Financial Statements.

THE NEIMAN MARCUS GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(UNAUDITED)

(in thousands, except per share data)	Thirteen Weeks Ended May 1, 2004	Thirteen Weeks Ended May 3, 2003	Thirty-Nine Weeks Ended May 1, 2004	Thirty-Nine Weeks Ended May 3, 2003
Revenues	$ 877,576	$ 722,917	$ 2,756,563	$ 2,395,467
Cost of goods sold including buying and occupancy costs	543,275	463,713	1,768,852	1,572,222
Selling, general and administrative expenses	214,706	187,372	680,827	617,765
Operating earnings	119,595	71,832	306,884	205,480
Interest expense, net	4,589	4,245	11,814	12,183
Earnings before income taxes, minority interest and change in accounting principle	115,006	67,587	295,070	193,297
Income taxes	44,852	26,020	107,576	74,419
Earnings before minority interest and change in accounting principle	70,154	41,567	187,494	118,878
Minority interest in net earnings of subsidiaries	(1,305)	(437)	(3,249)	(1,946)
Earnings before change in accounting principle	68,849	41,130	184,245	116,932
Change in accounting principle writedown of intangible assets, net of taxes				(14,801)
Net earnings	$ 68,849	$ 41,130	$ 184,245	$ 102,131
Weighted average number of common and common equivalent shares outstanding:				
Basic	48,208	47,240	47,929	47,498
Diluted	49,124	47,497	48,806	47,772
Basic earnings per share:				
	$ 1.43	$ 0.87	$ 3.84	$ 2.46

Earnings before change in accounting principle								
Change in accounting principle writedown of intangible assets, net of taxes								(0.31)
Basic earnings per share	$	1.43	$	0.87	$	3.84	$	2.15
Diluted earnings per share:								
Earnings before change in accounting principle	$	1.40	$	0.87	$	3.78	$	2.45
Change in accounting principle writedown of intangible assets, net of taxes								(0.31)
Diluted earnings per share	$	1.40	$	0.87	$	3.78	$	2.14

See Notes to Condensed Consolidated Financial Statements.

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THE NEIMAN MARCUS GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)	**Thirty-Nine Weeks Ended May 1, 2004**	**Thirty-Nine Weeks Ended May 3, 2003**
CASH FLOWS - OPERATING ACTIVITIES		
Net earnings	$ 184,245	$ 102,131
Change in accounting non-cash writedown of intangible assets, net of taxes		14,801
Earnings before change in accounting principle	184,245	116,932
Adjustments to reconcile net earnings to net cash (used for) provided by operating activities:		
Depreciation	69,163	57,924
Minority interest	3,249	1,946
Other primarily costs related to defined benefit pension and other long-term benefit plans	24,367	14,168
	281,024	190,970
Changes in operating assets and liabilities:		
Increase in accounts receivable	(576,986)	(5,354)
Increase merchandise inventories	(28,477)	(62,274)
Decrease in other current assets	27,803	4,125
Increase in accounts payable and accrued liabilities	35,347	21,156
Funding of defined benefit pension plan	(30,000)	(30,760)
NET CASH (USED FOR) PROVIDED BY OPERATING ACTIVITIES	(291,289)	117,863
CASH FLOWS - INVESTING ACTIVITIES		
Capital expenditures	(80,906)	(80,817)
Transactions related to undivided interests in NMG Credit Card Master Trust:		
Purchases of held-to-maturity securities	(240,808)	(747,396)
Maturities of held-to-maturity securities	483,373	678,003
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	161,659	(150,210)
CASH FLOWS - FINANCING ACTIVITIES		
Proceeds from borrowings	2,000	81,051
Repayment of debt	(1,500)	(80,000)
Borrowings under Credit Card Facility	225,000	
Acquisitions of treasury stock	(7,026)	(15,020)

Proceeds from exercises of stock options and restricted stock grants		23,235		1,642
Cash dividends paid		(6,312)		
Distributions paid		(732)		(294)
NET CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES		234,665		(12,621)
CASH AND CASH EQUIVALENTS				
Increase (decrease) during the period		105,035		(44,968)
Beginning balance		206,950		178,638
Ending balance	$	311,985	$	133,670
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION				
Cash paid during the period for:				
Interest	$	9,050	$	9,329
Income taxes	$	70,657	$	42,489

See Notes to Condensed Consolidated Financial Statements.

THE NEIMAN MARCUS GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation

The Condensed Consolidated Financial Statements of The Neiman Marcus Group, Inc. and subsidiaries (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted for complete financial statements. Therefore, the financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the fiscal year ended August 2, 2003.

The Company s fiscal year ends on the Saturday closest to July 31. All references to the third quarter of 2004 relate to the thirteen weeks ended May 1, 2004 and all references to the third quarter of 2003 relate to the thirteen weeks ended May 3, 2003. All references to 2004 relate to the thirty-nine weeks ended May 1, 2004 and all references to 2003 relate to the thirty-nine weeks ended May 3, 2003.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments (as well as a change in accounting principle made in the first quarter of 2003 as more fully described in Note 9) necessary to present fairly the financial position, results of operations and cash flows of the Company for the applicable interim periods. The results of operations for these periods are not necessarily comparable to, or indicative of, results of any other interim period or for the fiscal year as a whole.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events. These estimates and assumptions affect the amounts of assets, liabilities, revenues and expenses and the disclosure of gain and loss contingencies at the date of the condensed consolidated financial statements.

The Company evaluates its estimates and judgments on an ongoing basis and predicates those estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Management makes adjustments to its assumptions and judgments when facts and circumstances dictate. Since future events and their effects cannot be determined with absolute certainty, actual results may differ from the estimates used by the Company in preparing the accompanying condensed consolidated financial statements.

Management of the Company believes the following critical accounting policies, among others, encompass the more significant judgments and estimates used in the preparation of its financial statements:

Revenue recognition;

Valuation of merchandise inventories, including determination of original retail values, recognition of markdowns and vendor allowances, estimation of inventory shrinkage, and determination of cost of goods sold;

Recognition of income and expenses related to the Company s securitization program;

Determination of impairment of long-lived assets;

Recognition of advertising and catalog costs;

Recognition of costs related to the Company s loyalty programs;

Recognition of income taxes; and

Measurement of accruals for litigation, general liability, workers compensation and health insurance as well as short-term disability, pension and postretirement health care benefits.

A description of the Company s critical accounting policies is included in the Company s Annual Report on Form 10-K for the fiscal year ended August 2, 2003.

Stock-Based Compensation. The Company accounts for stock-based compensation awards to employees in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, no compensation expense has been recognized for stock options since all options granted had an exercise price equal to the market value of the Company s common stock on the grant date.

The following table illustrates the effect on net earnings and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation using the Black-Scholes option-pricing model for the thirteen weeks and thirty-nine weeks ended May 1, 2004 and May 3, 2003:

(in thousands, except per share data)	**Thirteen Weeks Ended May 1, 2004**	**Thirteen Weeks Ended May 3, 2003**	**Thirty-Nine Weeks Ended May 1, 2004**	**Thirty-Nine Weeks Ended May 3, 2003**
Net earnings:				
As reported	$ 68,849	$ 41,130	$ 184,245	$ 102,131
Less: stock-based employee compensation expense determined under fair value based method, net of related taxes	(2,210)	(2,095)	(6,411)	(6,333)
Pro forma	$ 66,639	$ 39,035	$ 177,834	$ 95,798
Basic earnings per share:				
As reported	$ 1.43	$ 0.87	$ 3.84	$ 2.15
Pro forma	$ 1.38	$ 0.83	$ 3.71	$ 2.02
Diluted earnings per share:				
As reported	$ 1.40	$ 0.87	$ 3.78	$ 2.14
Pro forma	$ 1.36	$ 0.82	$ 3.64	$ 2.01

The effects on pro forma net earnings and earnings per share of expensing the estimated fair value of stock options are not necessarily representative of the effects on reported net earnings for future periods due to such factors as the vesting periods of stock options and the potential issuance of additional stock options in future years. In addition, the Black-Scholes option-pricing model has inherent limitations in calculating the fair value of stock options for which no active market exists since the model does not consider the inability to sell or transfer options, vesting requirements and a reduced exercise period upon termination of employment - all of which would reduce the fair value of the options.

2. Operating Segments

The Company has identified two reportable segments: Specialty Retail Stores and Direct Marketing. The Specialty Retail Stores segment includes all Neiman Marcus and Bergdorf Goodman retail stores, including Neiman Marcus clearance stores. The Direct Marketing segment conducts both print catalog and online operations under the Neiman Marcus, Horchow and Chef s Catalog brand names. Other includes the operations of Kate Spade LLC and Gurwitch Products, LLC (the Brand Development Companies) and corporate expenses.

The following table sets forth the information for the Company s reportable segments:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
(in thousands)	**May 1, 2004**	**May 3, 2003**	**May 1, 2004**	**May 3, 2003**
REVENUES:				
Specialty Retail Stores	$ 721,971	$ 591,268	$ 2,230,071	$ 1,948,486
Direct Marketing	126,204	112,767	445,694	388,401
Other	29,401	18,882	80,798	58,580
Total	$ 877,576	$ 722,917	$ 2,756,563	$ 2,395,467
OPERATING EARNINGS:				
Specialty Retail Stores	$ 115,176	$ 68,337	$ 279,084	$ 186,008
Direct Marketing	9,842	10,386	45,226	35,787
Other	(5,423)	(6,891)	(17,426)	(16,315)
Total	$ 119,595	$ 71,832	$ 306,884	$ 205,480

3. Cash Dividend Program

In the second quarter of 2004, the Company s Board of Directors initiated a quarterly cash dividend of $0.13 per share. The Company declared dividends on January 30, 2004 and on April 30, 2004. As of May 1, 2004, the Company had dividends payable in the amount of $6.3 million (included in accrued liabilities in the accompanying condensed consolidated balance sheet), which were paid in May 2004.

4. Stock Repurchase Program

In prior years, the Company s Board of Directors authorized various stock repurchase programs and increases in the number of shares subject to repurchase. During the first quarter of 2004, the Company repurchased 175,600 shares at an average purchase price of $40.01. As of May 1, 2004, approximately 1.2 million shares remain authorized for repurchase under the Company s stock repurchase programs.

5. Earnings per Share

The weighted average shares used in computing basic and diluted earnings per share (EPS) are presented in the table below. No adjustments were made to net earnings for the computations of basic and diluted EPS during the periods presented.

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
(in thousands of shares)	**May 1, 2004**	**May 3, 2003**	**May 1, 2004**	**May 3, 2003**
Weighted average shares outstanding	48,557	47,530	48,313	47,789
Less: shares of non-vested restricted stock	(349)	(290)	(384)	(291)
Shares for computation of basic EPS	48,208	47,240	47,929	47,498
Effect of dilutive stock options and restricted stock	916	257	877	274
Shares for computation of diluted EPS	49,124	47,497	48,806	47,772
Shares represented by antidilutive stock options		1,937	9	1,950

Antidilutive stock options are not included in the computation of diluted EPS when the exercise price of those options is greater than the average market price of the common shares.

6. Undivided Interests in NMG Credit Card Master Trust

Pursuant to a revolving credit card securitization program (the Credit Card Facility), the Company transfers substantially all of its credit card receivables to a wholly-owned subsidiary, Neiman Marcus Funding Corporation, which in turn sells such receivables to the Neiman Marcus Credit Card Master Trust (Trust). At the inception of the Credit Card Facility in September 2000, the Trust issued certificates representing undivided interests in the credit card receivables to third-party investors in the face amount of $225 million (Sold Interests) and to the Company in an aggregate amount equal to the excess of the balance of the credit card portfolio over $225 million (Retained Interests). In order to maintain the committed level of securitized assets, cash collections on the securitized receivables are used by the Trust to purchase new credit card balances from the Company in accordance with the terms of the Credit Card Facility.

From its inception until December 2003, the Company s transfers and sales of credit card receivables pursuant to the terms of the Credit Card Facility were accounted for as sales in accordance with generally accepted accounting principles (Off-Balance Sheet Accounting). As a result, $225 million of credit card receivables were removed from the Company s balance sheet at the inception of the Credit Card Facility and the Company s $225 million repayment obligation to the holders of the certificates representing the Sold Interests was not required to be shown as a liability on the Company s balance sheet. During the period the transfers and sales qualified for Off-Balance Sheet Accounting, the Retained Interests were shown as Undivided interests in NMG Credit Card Master Trust on the Company s condensed consolidated balance sheets.

Beginning in April 2005, cash collections will be used by the Trust to repay the $225 million principal balance of the Class A Certificates in six monthly installments of $37.5 million (Amortization Period). As a result of certain provisions in the securitization agreement, the Company holds certain rights to repurchase the Class A Certificates (Repurchase Option) subsequent to the commencement of the Amortization Period and, therefore, has the ability to regain effective control over the credit card receivables held by the Trust at the time the Repurchase Option becomes exercisable. The Company believes that the Repurchase Option will become exercisable in September 2005.

Transfers to the Trust ceased to qualify for Off-Balance Sheet Accounting beginning in December 2003 since the contractual life of the receivables transferred after November 2003 is estimated to extend to September 2005 when the Repurchase Option becomes exercisable. Rather, these transfers are recorded as secured borrowings by the Company (Financing Accounting). As a consequence, the credit card receivables generated after November 2003 remained on the Company s balance sheet and the Company recorded a liability for its repayment obligation to the holders of the $225 million of certificates representing the Sold Interests. The transition period from Off-Balance Sheet Accounting to Financing Accounting (Transition Period) lasted approximately four months (December 2003 to March 2004). During the Transition Period, cash collections of receivables were allocated to the previous Sold Interests and Retained Interests until such time as those balances were reduced to zero.

A reconciliation of the outstanding balance of the Company s accounts receivables to the balances recorded by the Company at May 1, 2004, August 2, 2003 and May 3, 2003 is as follows:

(in millions)		**May 1, 2004**		**August 2, 2003**		**May 3, 2003**
Credit card receivables	$	569.5	$	468.1	$	504.6
Other receivables		30.1		22.6		25.1
		599.6		490.7		529.7
Less: Sold Interests originally qualifying for Off-Balance Sheet Accounting				(225.0)		(225.0)
Net balance	$	599.6	$	265.7	$	304.7
Amounts reflected in the Company s balance sheet:						
Undivided interests in NMG Credit Card Master Trust	$		$	243.1	$	279.6
Accounts receivable		599.6		22.6		25.1
	$	599.6	$	265.7	$	304.7
Current portion of borrowings under Credit Card Facility	$	37.5	$		$	
Borrowings under Credit Card Facility		187.5				
	$	225.0	$		$	

Upon completion of the Transition Period, the Company s entire credit card portfolio was included in accounts receivable in its condensed consolidated balance sheet and the $225 million repayment obligation was shown as a liability.

As of the start of the Transition Period in December 2003, the carrying value of the Retained Interests exceeded face value by approximately $7.6 million as a result of the application of the provisions of current accounting rules related to the calculation of the gains on sale of the previously Sold Interests and the valuation of both Sold and Retained Interests. During the Transition Period, the $7.6 million premium was amortized as a reduction of the Company s net earnings from its credit card portfolio (recorded as a reduction of selling, general and administrative expenses in the condensed consolidated statements of earnings). Of the $7.6 million premium, $5.3 million was amortized in the second quarter of 2004 and the remaining $2.3 million was amortized in the third quarter of 2004.

7. Employee Benefit Plans

The Company sponsors a defined benefit pension plan (Pension Plan) covering substantially all full-time employees. The Company also sponsors an unfunded supplemental executive retirement plan (SERP Plan) that provides certain employees additional pension benefits. Benefits under both plans are based on the employees years of service and compensation over defined periods of employment. Pension Plan assets consist primarily of equity and fixed income securities.

Retirees and active employees hired prior to March 1, 1989 are eligible for certain limited postretirement health care benefits (Postretirement Plan) if they have met certain service and minimum age requirements.

The components of pension expense for the Pension Plan are as follows:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
(in thousands)	**May 1, 2004**	**May 3, 2003**	**May 1, 2004**	**May 3, 2003**
Service cost	$ 2,366	$ 2,701	$ 8,469	$ 6,563
Interest cost	3,603	4,505	12,894	10,948
Expected return on plan assets	(3,612)	(4,326)	(12,928)	(10,512)
Net amortization of losses (gains) on prior service costs	698	121	2,498	293
Pension Plan expense	$ 3,055	$ 3,001	$ 10,933	$ 7,292

The components of SERP Plan expense are as follows:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
(in thousands)	**May 1, 2004**	**May 3, 2003**	**May 1, 2004**	**May 3, 2003**
Service cost	$ 342	$ 357	$ 1,024	$ 755
Interest cost	977	1,138	2,930	2,409
Net amortization of losses and prior service costs	367	363	1,099	769
SERP Plan expense	$ 1,686	$ 1,858	$ 5,053	$ 3,933

The components of Postretirement Plan expense are as follows:

		Thirty-Nine Weeks Ended
	Thirteen Weeks Ended	
	May 1,	
(in thousands)	**2004**	