CHARMING SHOPPES INC
Form 10-K
April 14, 2005

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

FORM 10-K

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

For the fiscal year ended January 29, 2005

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: 000-07258

CHARMING SHOPPES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	23-1721355
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
450 Winks Lane, Bensalem, Pennsylvania	19020
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code (215) 245-9100

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock (par value $.10 per share)
(Title of Class)

Stock Purchase Rights
(Title of Class)

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. [X] YES [ ] NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item

405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). [X] YES [ ] NO

The aggregate market value of the outstanding common stock of the registrant held by non-affiliates as of July 31, 2004 (the last day of the registrant's most recently completed second fiscal quarter), based on the closing price on July 30, 2004, was approximately $857,971,000.

As of March 24, 2005, 119,815,703 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Part III of Form 10-K is incorporated by reference herein from the registrant's definitive proxy statement for its 2005 annual shareholders meeting, which is expected to be filed within 120 days after the end of the fiscal year covered by this Annual Report.

CHARMING SHOPPES, INC.
2005 FORM 10-K ANNUAL REPORT

TABLE OF CONTENTS

		Page
PART I		
Item 1	Business	
	General	1
	Stores	1
	Merchandising and Buying	3
	Marketing and Promotions	4
	Proprietary Credit Card Program	5
	Sourcing	5
	Distribution and Logistics	6
	Competition	6
	Employees	6
	Trademarks and Servicemarks	7
	Executive Offices	7
	Available Information	7
Item 2	Properties	7
Item 3	Legal Proceedings	8
Item 4	Submission of Matters to a Vote of Security Holders	9
Additional Part I Information - Our Executive Officers		9
PART II		
Item 5	Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities	10
Item 6	Selected Financial Data	12
Item 7	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
	Forward-Looking Statements	14
	Restatement of Financial Statements	16
	Overview	17

	Critical Accounting Policies	18
	Results of Operations	25
	Financial Condition	33
	Market Risk	40
	Impact of Recent Accounting Pronouncements	41
Item 7A	Quantitative and Qualitative Disclosures About Market Risk	41
Item 8	Financial Statements and Supplementary Data	42
Item 9	Changes In and Disagreements With Accountants on Accounting and Financial Disclosure	89
Item 9A	Controls and Procedures	89
Item 9B	Other Information	89
PART III		
Item 10	Directors and Executive Officers of the Registrant	90
Item 11	Executive Compensation	90
Item 12	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	90
Item 13	Certain Relationships and Related Transactions	91
Item 14	Principal Accountant Fees and Services	91
PART IV		
Item 15	Exhibits and Financial Statement Schedules	92
SIGNATURES		102
EXHIBIT INDEX		103

PART I

Item 1. Business

General

We are a leading specialty apparel retailer primarily focused on plus-size women's apparel through our three distinct brands: LANE BRYANT(R), FASHION BUG(R), and CATHERINES PLUS SIZES(R). During the year ended January 29, 2005 ("Fiscal 2005"), the sale of plus-size apparel represented approximately 77% of our total net sales. Through our fashion content, store layouts, and broad merchandise assortments, we seek to appeal to customers from a broad range of socioeconomic, demographic, and cultural groups. As of January 29, 2005, we operated 2,221 stores in 48 states. Each of our brands is designed to attract a distinct customer.

LANE BRYANT is a widely recognized name in plus-size fashion. Through private labels, such as VENEZIA(R), CACIQUE(R), and LANE BRYANT(R), we offer fashionable and sophisticated apparel in plus-sizes 14 - 28, including intimate apparel, wear-to-work, and casual sportswear, as well as accessories. LANE BRYANT has a loyal customer base, generally ranging in age from 25 to 45 years old, that shops for fashionable merchandise in the moderate price range. Primarily a mall-based destination store for the plus-size woman, LANE BRYANT operates 722 stores in 46 states that average approximately 5,900 square feet. In March 2003, we began E-commerce operations on our lanebryant.com website.

FASHION BUG stores specialize in selling a wide variety of plus-size, misses and junior apparel, accessories, intimate apparel, and footwear. FASHION BUG customers generally range in age from 20 to 49 years old and shop in the

low-to-moderate price range. Our 1,028 FASHION BUG stores are located in 45 states, primarily in strip shopping centers, and average approximately 8,900 square feet. In July 2004, we began E-commerce operations on our fashionbug.com website.

CATHERINES PLUS SIZES is particularly known for extended sizes (over size 28) and petite plus-sizes. CATHERINES offers classic apparel and accessories for wear-to-work and casual lifestyles. CATHERINES customers generally range in age from 40 to 65 years old, shop in the moderate price range, and are concerned with fit and value when purchasing clothes. Our 471 CATHERINES stores are located in 44 states, primarily in strip shopping centers in the Southeast, Mid-Atlantic, and Eastern Central regions of the United States, and average approximately 4,100 square feet. In March 2002, we began E-commerce operations on our catherines.com website.

Stores

Our 2,221 stores (as of January 29, 2005) are primarily located in suburban areas and small towns. Approximately 70% of these stores are located in strip shopping centers, with the remainder located in community and regional malls. The majority of our FASHION BUG and CATHERINES stores are strip-center based. Most of our LANE BRYANT stores are in malls. Over the past few years, LANE BRYANT has expanded into strip and lifestyle centers, and has demonstrated success in such locations. Approximately 25% of our LANE BRYANT stores are currently located in strip and lifestyle shopping centers.

We believe that our customers visit strip shopping centers frequently as a result of the tenant mix and convenience of strip shopping centers. Our long-term store growth plans are to expand both LANE BRYANT and CATHERINES into additional strip and lifestyle center locations. Availability of strip and lifestyle center retail space continues to significantly outpace mall expansion. In addition, we benefit in strip and lifestyle centers from substantially lower occupancy costs as compared to occupancy costs in malls.

Our merchandise displays enable our customers to assemble coordinated and complete outfits that satisfy many of their lifestyle needs. We relocate or remodel our stores as appropriate to convey a fresh and contemporary shopping environment. We frequently test and implement new store designs and fixture packages that are aimed at providing an effective merchandise presentation. We emphasize customer service, including the presence of helpful salespeople in the stores, layaway plans, and acceptance of merchandise returns for cash or credit within a reasonable time period. Typically, our stores are open seven days per week, eleven hours per day Monday through Saturday, and seven hours on Sunday.

We continue to seek additional locations that meet our financial and operational objectives. We plan to open approximately 70-80 stores and close approximately 50 stores during Fiscal 2006. Planned store openings by brand are approximately 50-60 LANE BRYANT stores, 5 CATHERINES stores, and 15 FASHION BUG stores. Planned store closings by brand are approximately 15 LANE BRYANT stores, 15 CATHERINES stores, and 20 FASHION BUG stores. Additionally, we currently plan to relocate approximately 40 LANE BRYANT stores, 15 CATHERINES stores, and 25 FASHION BUG stores during Fiscal 2006.

Our store openings, closings, and number of locations over the past five fiscal years are as follows:

	Year Ended				
	Jan. 29, 2005	Jan. 31, 2004	Feb. 1, 2003	Feb. 2, 2002	Feb. 3, 2001
Store Activity:					
Number of stores open at beginning of period	2,227	2,248	2,446	1,755	1,740
Opened during period	51	50	57	125	106
Acquired during period	0	0	0	651	0
Closed during period	(57)	(71)	(255)(1)	(85)	(91)(
Number of stores open at end of period	2,221	2,227	2,248	2,446	1,755
Number of Stores by Brand:					
FASHION BUG	1,028	1,051	1,083	1,252	1,230
LANE BRYANT	722	710	689	647	0
CATHERINES	471	466	467	461	414
Discontinued brands(3)	0	0	9	86	111
Number of stores open at end of period	2,221	2,227	2,248	2,446	1,755

All stores are operated under our direct management. Each store has a manager and an assistant manager or supervisor who is in daily operational control of the location. We also employ district managers, who travel to all stores in their district on a frequent basis, to supervise store operations. Each district manager has responsibility for

an average of 12 stores. Regional managers, who report to a Director of Stores, supervise the district managers. Generally, we appoint store managers from the group of assistant managers and district managers from the group of store managers. We seek to motivate our store personnel through internal advancement and promotion, competitive wages, and various incentive, medical, and retirement plans. We centrally develop store operations, merchandising, and buying policies, and assign to individual store management the principal duties of display, selling, and reporting through point-of-sale terminals.

Merchandising and Buying

We employ a merchandising and buying strategy that is focused on providing an attractive selection of apparel and accessories that reflect the fashion preferences of the target customer for each of our brands. Separate merchandise groups for each of our brands conduct merchandise purchasing, using buyers supervised by one or more merchandise managers. We believe that specialization of buyers within our brands enhances the distinctiveness of the brands and their offerings. In addition, we use domestic and international fashion market guidance, fashion advisory services, proprietary design, and in-store testing to determine the optimal product assortments for each of our brands. We believe

that this approach results in greater success in predicting customer preferences while reducing our inventory investment and risk. We also seek to maintain high quality standards with respect to merchandise fabrication, construction, and fit.

We continually refine our merchandise assortments to reflect the needs and demands of our diverse customer groups and the demographics of each store location. At LANE BRYANT, we offer a combination of fashion basics, seasonal fashions, and high fashion in casual and wear-to-work merchandise, intimate apparel, and accessories. We strive to translate current trends into plus-sizes and to be first to market with our styles. At FASHION BUG, we offer a broad assortment of both casual and wear-to-work apparel, in plus, misses, and junior sizes as well as girls and maternity, at low-to-moderate prices. FASHION BUG's plus- and misses-size merchandise typically reflects established fashion trends and includes a broad offering of ready-to-wear apparel as well as footwear, accessories, intimate apparel, and seasonal items, such as outerwear. FASHION BUG's junior merchandise reflects the latest fashion trends and includes a significant amount of well-recognized third-party national brands. At CATHERINES, we offer a broad assortment of plus-size merchandise in classic styles designed to provide "head-to-toe" dressing for our customers. CATHERINES features casual and career sportswear, dresses, intimate apparel, suits, and accessories in a variety of plus-sizes, including petites and extended sizes. CATHERINES has developed a unique expertise in the fit, design, and manufacturing of extended sizes, making it one of the few retailers to emphasize these sizes.

For stores that are identified as having certain attributes, we use our distribution capabilities to stock the stores with products specifically targeted to such attributes. Our merchandising staffs obtain store and brand-wide inventory information generated by merchandise information systems that use point-of-sale terminals. Through these terminals, merchandise can be followed from the placement of our initial order for the merchandise to the actual sale to our customer. Based upon this data, our merchandise managers compare budgeted-to-actual sales and make merchandising decisions as needed, including re-order, markdowns, and changes in the buying plans for upcoming seasons. In addition, we continue to work to improve inventory turnover by better managing the flow of seasonal merchandise to our stores across all geographic regions.

Our merchandising and buying philosophy, coupled with enhancements in inventory management, helps facilitate the timely and orderly purchase and flow of merchandise. This enables our stores to offer fresh product assortments on a regular basis.

We employ a realistic pricing strategy that is aimed at setting the initial price markup of fashion merchandise in order to increase the percentage of sales at the original ticketed price. We believe this strategy has resulted in a greater degree of credibility with the customer, reducing the need for aggressive price promotions. However, our pricing strategy typically does allow sufficient margin to permit merchandise discounts in order to stimulate customer purchases when necessary.

Our stores experience a normal seasonal sales pattern for the retail apparel industry, with peak sales occurring during the spring and Christmas seasons. We generally build inventory levels before these peak sales periods. To maintain current and fashionable inventory, we reduce the price of slow-moving

merchandise throughout the year. Much of our merchandise is developed for one or more of our six seasons: spring, summer, summer-fall transitional, fall, holiday, and holiday-spring transitional. End-of-season sales are conducted with the objective of carrying a minimal amount of seasonal merchandise over from one season to another. Sales for the four quarters of Fiscal 2005, as a percent of total sales, were 25.4%, 26.2%, 23.2%, and 25.2%, respectively.

Marketing and Promotions

We use several types of advertising to stimulate customer traffic. We use targeted direct-mail advertising to preferred customers selected from a database of approximately 27.5 million proprietary credit card, third-party credit card, and cash customers. We may also use radio, television, and newspaper advertising and fashion shows to stimulate traffic at certain strategic times of the year. We also use pricing policies, displays, store promotions, and convenient store hours to attract customers. We believe that, with the planning and guidance of our specialized home-office personnel, each brand provides such displays and advertising as may be necessary to feature certain merchandise or certain promotional selling prices from time to time.

We maintain websites for our LANE BRYANT, FASHION BUG, and CATHERINES brands that provide information regarding current fashions and promotions. We began E-commerce operations on our CATHERINES website in March 2002, on our LANE BRYANT website in March 2003, and on our FASHION BUG website in July 2004. Our CATHERINES website averaged more than 300,000 unique visitors per month during Fiscal 2005, our LANE BRYANT website enjoys more than 1.2 million unique visitors per month and an established on-line community, and our FASHION BUG website has averaged more than 500,000 unique visitors per month since we commenced E-commerce operations.

In August 2003, we launched FIGURE(R) magazine, a periodic fashion and lifestyle magazine for women. The magazine features clothing and fashions from our LANE BRYANT, FASHION BUG, and CATHERINES brands, and also covers topics such as: beauty; health and fitness; home, food and entertaining; relationships; and social and community issues. FIGURE magazine is available by subscription, and is also sold in all of our stores and at selected newsstands and supermarkets, including certain national booksellers. Since its inception in August 2003, the magazine has grown to a per-issue circulation of more than 400,000 copies.

We offer our customers various loyalty card programs. Customers who join these programs are entitled to various benefits, including discounts and rebates on purchases during the membership period. Customers generally join these programs by paying an annual membership fee. Additional information on our loyalty card programs is included in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations; CRITICAL ACCOUNTING POLICIES; Revenue Recognition" below.

Proprietary Credit Card Program

We seek to encourage sales through the promotion of our proprietary credit cards. We believe that our credit cards act as promotional vehicles by engendering customer loyalty, creating a substantial base for targeted direct-mail promotion, and encouraging incremental sales.

Our FASHION BUG credit card program accounted for approximately 28% of

FASHION BUG retail sales in Fiscal 2005, and has approximately 1.9 million active accounts. We control credit policies and service the FASHION BUG proprietary credit card file, and, through various agreements, we securitize and sell the credit card receivables generated by this facility.

Our LANE BRYANT and CATHERINES brands also offer customers the convenience of proprietary credit card programs. The LANE BRYANT credit card program accounted for approximately 29% of LANE BRYANT retail sales during Fiscal 2005, and has approximately 1.6 million active accounts. The CATHERINES credit card program accounted for approximately 29% of CATHERINES retail sales during Fiscal 2005, and has approximately 537,000 active accounts. During Fiscal 2005, we used third-party banks to finance and service the LANE BRYANT and CATHERINES credit card programs. These third-party banks provide new account approval, credit authorization, billing, and account collection services. Under non-recourse agreements with the third-party banks, we are reimbursed with respect to sales generated by the credit cards. In January 2004, in accordance with the terms of the Merchant Services Agreement pursuant to which the CATHERINES proprietary credit cards were issued, we provided one year's notice to the third party bank in order to exercise our option to terminate the agreement and to purchase the portfolio. Spirit of America National Bank (our wholly-owned credit card bank) purchased the CATHERINES credit card portfolio in March 2005 for approximately $56.6 million (subject to adjustment). The purchase was funded through our securitization facilities, including a portion of the proceeds from the sale of Series 2004-1 certificates under that securitization facility.

A more comprehensive description of our asset securitization process and our commitments under the third-party bank agreements is included in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations; FINANCIAL CONDITION; Off-Balance-Sheet Arrangements" and "Item 8. Financial Statements and Supplementary Data: Notes to Consolidated Financial Statements; NOTE 16. ASSET SECURITIZATION" below.

Sourcing

To meet the demands of our customers, we access both the domestic wholesale and overseas apparel markets for our merchandise purchases. This allows us to maintain flexible lead times, respond quickly to current fashion trends, and quickly replenish merchandise inventory as necessary. During Fiscal 2005, we purchased merchandise from approximately 1,000 suppliers and factories located throughout the world. We use our overseas sourcing operations, which generally require longer lead times, primarily to purchase fashion-basic merchandise. In Fiscal 2005, overseas sourcing accounted for approximately 21% of consolidated merchandise purchases. Overseas sourcing as a percent of merchandise purchases by brand, was approximately 26% for FASHION BUG, 19% for LANE BRYANT, and 11% for CATHERINES. During Fiscal 2005, we purchased a portion of LANE BRYANT merchandise from Mast Industries, Inc. ("Mast"). Mast, a contract manufacturer and apparel importer, is a wholly-owned subsidiary of Limited Brands, Inc. ("Limited Brands"). These purchases from Mast accounted for approximately 15% of our total consolidated merchandise purchases and approximately 42% of merchandise purchases for LANE BRYANT during Fiscal 2005. No other vendor accounted for more than 3% of total consolidated merchandise purchases during Fiscal 2005.

We pay for merchandise purchases outside the United States using letters of credit with third-party vendors where we are the importer of record. To date, we

have not experienced difficulties in purchasing merchandise overseas or importing such merchandise into the United States. Should events such as political instability or a natural disaster result in a disruption of normal activities in any single country with which we do business, we believe that we would have adequate alternative sources of supply.

Distribution and Logistics

We currently operate two distribution centers. For our FASHION BUG stores, we operate a distribution center in Greencastle, Indiana. Located on a 150-acre tract of land, this facility contains a building of approximately 1,000,000 square feet. We estimate that this facility has the capacity to service up to approximately 1,800 stores. For our LANE BRYANT stores and CATHERINES stores, we operate a distribution center in White Marsh, Maryland. Located on 29 acres of land, the White Marsh facility contains a building of approximately 393,000 square feet, which is currently designed to service up to approximately 1,400 stores.

We acquired the White Marsh distribution center during Fiscal 2003 to replace a leased distribution center in Reynoldsburg, Ohio that serviced our LANE BRYANT stores. We completed the relocation of the Reynoldsburg distribution center to our White Marsh distribution center in February 2004 and terminated the lease for the Reynoldsburg distribution center and a related logistics and transportation services agreement in accordance with early cancellation provisions of the lease and agreement. We also consolidated a 213,000 square foot Memphis, Tennessee distribution center that serviced our CATHERINES stores into the White Marsh facility during Fiscal 2004.

Substantially all of our merchandise purchases are received at our distribution facilities, where they are prepared for distribution to our stores. Automated sorting systems in the distribution centers enhance the flow of merchandise from receipt to quality control inspection, receiving, ticketing, packing, and final shipment. Merchandise is shipped to each store principally by common carriers. We use computerized automated distribution attributes to combine shipments when possible and improve the efficiency of the distribution operations.

Competition

The retail sale of women's apparel is a highly competitive business with numerous competitors, including department stores, specialty apparel stores, discount stores, and mail-order and E-commerce companies. We cannot reasonably estimate the number of our competitors due to the large number of companies selling women's apparel. The primary elements of competition are merchandise style, size, selection, fit, quality, display, and price, as well as store location, design, advertising, and promotion and personalized service to the customers.

Employees

As of the end of Fiscal 2005, we employed approximately 27,000 associates, which included approximately 17,800 part-time employees. In addition, we hire a number of temporary employees during the Christmas season. Approximately 106 of our employees are represented by unions. We believe that overall our relationship with these unions, and our employees in general, is satisfactory.

Trademarks and Servicemarks

We own, or are in the process of obtaining, all rights to the trademarks and trade names we believe are necessary to conduct our business as presently operated. "FASHION BUG(R)", "FASHION BUG PLUS(R)", "BUNDLE OF JOY(TM)", "FIGURE(R)", "L.A. BLUES(R)", "CATHERINES(R)", "CATHERINES PLUS SIZES(R)", "C.S.T. STUDIO(R)", "C.S.T. SPORT(R)", "MAGGIE BARNES(R)", "ANNA MAXWELL(R)", "LIZ & ME(R)", "SERENADA(R)", "CAPISTRANO(R)", "LANE BRYANT(R)", "VENEZIA(R)", "CACIQUE(R)", "ELEMENTAL STRETCH(R)", "MODERN WOMAN(TM)", and several other trademarks and servicemarks of lesser importance to us have been registered or are in the process of being registered with the United States Patent and Trademark Office and in other countries.

We also own the following internet domain name registrations: catherines.com, charming.com, charmingshoppes.com, fashionbug.com, fashionbugcard.com, fashionbugplus.com, figuremagazine.com, lanebryant.com, modernwoman.com, and others of lesser importance.

Executive Offices

Charming Shoppes, Inc., was incorporated in Pennsylvania in 1969. Our principal offices are located at 450 Winks Lane, Bensalem, Pennsylvania 19020. Our telephone number is (215) 245-9100.

Available Information

We maintain an Internet website at charmingshoppes.com. As of March 25, 2003, copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on or through this website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). Our historical filings can also be accessed directly from the SEC's website at sec.gov. See "PART III; Item 10. Directors and Executive Officers of the Registrant" below for additional information that is available on our Internet website.

Item 2. Properties

We lease all our stores, with the exception of four stores that we own. Typically, store leases have initial terms of 5 to 20 years and generally contain provisions for co-tenancies, renewal options, additional rents based on a percentage of sales, and payment of real estate taxes and common area charges.

With respect to leased stores open as of January 29, 2005, the following table shows the number of store leases expiring during the calendar periods indicated, assuming the exercise of our renewal options:

Period	Number of Leases Expiring
2005	117(1)
2006 - 2010	726
2011 - 2015	401

2016 - 2020	369
2021 - 2025	486
2026 - 2030	93
Thereafter	29

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(1) Includes 46 stores on month-to-month leases

We own a 1,000,000 square foot distribution center in Greencastle, Indiana that services our FASHION BUG stores and a 393,000 square foot distribution center in White Marsh, Maryland that services our LANE BRYANT and CATHERINES stores. We acquired the White Marsh distribution center during Fiscal 2003 to replace a leased distribution center in Reynoldsburg, Ohio that serviced our LANE BRYANT stores. We relocated the Reynoldsburg distribution center in February 2004 and terminated the lease for the Reynoldsburg distribution center and a related logistics and transportation services agreement in accordance with early cancellation provisions of the lease and agreement. We also consolidated a 213,000 square foot Memphis, Tennessee distribution center that serviced our CATHERINES stores into the White Marsh facility in June 2003. During the fourth quarter of Fiscal 2005, we entered into an agreement to lease the Memphis, Tennessee distribution center to a third party for a three-year period.

We lease 105,000 square feet of office space in Bensalem, Pennsylvania that houses our corporate headquarters and certain FASHION BUG operations. We also own approximately 22 acres in Bensalem with a 145,000 square foot office building that houses our primary data processing facility and additional administrative offices. We own a 63,000 square foot facility in Memphis, Tennessee that houses our CATHERINES home office. We also lease 130,000 square feet of office space near Reynoldsburg, Ohio that houses our LANE BRYANT home office. In January 2005, we entered into an amendment to the lease on the Reynoldsburg facility to extend the term of the lease from December 2005 to February 2006. We also entered into an agreement with a separate third party that provides for the leasing of a 135,000 square foot facility in Columbus, Ohio, which will serve as a new LANE BRYANT home office. We expect to occupy the Columbus facility by the first quarter of Fiscal 2007. Our credit operations, including Spirit of America National Bank, our wholly-owned credit card bank subsidiary, occupy 30,000 square feet of leased office space in Miami Township, Ohio. We also maintain offices in New York City that occupy 13,000 square feet of leased space, and we own or lease a total of 40,000 square feet of office and warehouse space in Asia.

Item 3. Legal Proceedings

Other than ordinary routine litigation incidental to our business, there are no other pending material legal proceedings that we or any of our subsidiaries are a party to, or of which any of their property is the subject. There are no proceedings that are expected to have a material adverse effect on our financial condition or results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

Additional Part I Information - Our Executive Officers

The following list contains certain information relative to our executive

officers. There are no family relationships among any of our executive officers.

Dorrit J. Bern, 54, has served as Chairman of the Board of Directors since January 1997. She has also served as President and Chief Executive Officer since September 1995. Ms. Bern's term as a Director expires in 2005.

Joseph M. Baron, 57, has served as Executive Vice President and Chief Operating Officer since March 2002. Before that, he served as President and Chief Executive Officer of Homelife Corporation from February 1999 to October 2001. Homelife Corporation filed a bankruptcy petition under Chapter 11 of the U. S. Bankruptcy Code during July 2001.

Michel Bourlon, 45, has served as Executive Vice President - Sourcing since March 2004. Before that, he served as Managing Director of Eddie Bauer International (Hong Kong) Ltd., from September 1997 to February 2004.

Anthony A. DeSabato, 56, has served as Executive Vice President - Corporate and Labor Relations, Business Ethics, and Loss Prevention since July 2003. Before that, he served as Executive Vice President and Corporate Director of Human Resources since 1990, and he has been employed by us since 1987.

Eric M. Specter, 47, has served as Executive Vice President - Chief Financial Officer since January 1997, and he has been employed by us since 1983. He also served as Treasurer from February 1998 to March 2000.

Colin D. Stern, 56, has served as Executive Vice President and General Counsel since 1990, and he has been employed by us since 1989. He has also served as Secretary since February 1998.

Gale H. Varma, 54, has served as Executive Vice President - Human Resources since July 2003. Before that, she served as Division Vice President - Human Resources and Ethics Officer for the Prudential Institutional Employee Benefits division of Prudential Financial Services, a division of Prudential Insurance Company of America, from September 1997 to April 2003.

Erna Zint, 61, served as Executive Vice President - Sourcing from January 1996 to March 2004.

Jonathon Graub, 46, has served as Senior Vice President - Real Estate, since December 1999, and he has been employed by us since 1981.

John J. Sullivan, 58, has served as Vice President - Corporate Controller since October 1998.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Our common stock is traded on the over-the-counter market and quoted on the NASDAQ National Market ("NASDAQ") under the symbol "CHRS," and is listed and traded on the Chicago Board Options Exchange ("CBOE") and Pacific Stock Exchange ("PCX") under the symbol "QSR." The following table sets forth the high and low sale prices for our common stock during the indicated periods, as reported by NASDAQ.

	Fiscal 2005 High	Fiscal 2005 Low	Fiscal 2004 High	Fiscal 2004 Low
1st Quarter	$8.22	$5.70	$4.75	$2.70
2nd Quarter	9.19	6.48	5.72	3.94
3rd Quarter	7.73	6.23	6.80	4.89
4th Quarter	9.64	7.55	6.85	5.09

The approximate number of holders of record of our common stock as of March 24, 2005 was 2,059. This number excludes individual stockholders holding stock under nominee security position listings.

We have not paid any dividends since 1995, and we do not expect to declare or pay any dividends on our common stock in the near future. In addition, our existing credit facility prohibits the payment of dividends on our common stock. (See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations; FINANCIAL CONDITION; Financing; Long-term Debt and Equity Financing" and "Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; NOTE 7. DEBT" below).

Purchases of Equity Securities by the Issuer and Affiliated Purchasers:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(2)	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs(2)
October 31, 2004 through November 27, 2004...........	-	-	-	
November 28, 2004 through January 1, 2005.............	-	-	-	
January 2, 2005 through January 29, 2005............	635(1)	$8.01(1)	-	

Total..........................	635	$8.01	-

Item 6. Selected Financial Data

The following table presents selected financial data for each of our five fiscal years ended as of February 3, 2001 through January 29, 2005. Certain amounts for fiscal years 2001 through 2004 have been restated (see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations; RESTATEMENT OF FINANCIAL STATEMENTS" and "Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; NOTE 2. RESTATEMENT OF FINANCIAL STATEMENTS" below). The selected financial data is taken from our audited financial statements and should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and accompanying notes included under "Item 8. Financial Statements and Supplementary Data."

CHARMING SHOPPES, INC. AND SUBSIDIARIES
FIVE-YEAR COMPARATIVE SUMMARY

	Year Ended			
(Dollars in thousands, except per share amounts)	Jan. 29, 2005	Jan. 31, 2004	Feb. 1, 2003	Feb. 2, 2002(1)
Operating Statement Data:				
Net sales..............................	$2,332,334	$2,285,680	$2,412,409	$1,993,843
Cost of goods sold, buying, and occupancy expenses................	1,640,248	1,642,816(3)	1,726,306	1,460,256
Selling, general, and administrative expenses...........	577,301	558,248(3)	603,502	486,204
Amortization of goodwill...............	0	0	0	4,885
Expenses related to cost reduction plan....................	605(4)	11,534(4)	0	0
Restructuring charge (credit)..........	0	0	(4,813)(5)	37,708(5
Total operating expenses...............	2,218,154	2,212,598	2,324,995	1,989,053
Income from operations.................	114,180	73,082	87,414	4,790

Other income, principally interest	3,098	2,050	2,328	4,730
Interest expense	(15,610)	(15,609)	(20,292)	(18,701)
Income (loss) before income taxes, minority interest, and cumulative effect of accounting changes	101,668	59,523	69,450	(9,181)
Income tax provision (benefit)	37,142	21,623	27,117	(1,838)
Income (loss) before minority interest and cumulative effect of accounting changes	64,526	37,900	42,333	(7,343)
Minority interest in net loss of consolidated subsidiary	0	142	679	0
Cumulative effect of accounting changes, net of tax	0	0	(49,098)(6)	0
Net income (loss)	$ 64,526	$ 38,042	$ (6,086)	$ (7,343)
Basic net income (loss) per share:				
Before cumulative effect of accounting changes	$ .56	$ .34	$ .38	$(.07)
Net income (loss)	.56	.34	(.05)	(.07)
Basic weighted average common shares outstanding	116,196	112,491	113,810	105,842
Net income (loss) per share, assuming dilution:				
Before cumulative effect of accounting changes	$ .52	$ .33	$ .36	$(.07)
Net income (loss)	.52	.33	(.01)	(.07)
Diluted weighted average common shares and equivalents outstanding	133,174	128,558	130,937	105,842

(Table continued on next page)

CHARMING SHOPPES, INC. AND SUBSIDIARIES
FIVE-YEAR COMPARATIVE SUMMARY
(Continued)

	Year Ended			
(Dollars in thousands)	Jan. 29, 2005	Jan. 31, 2004	Feb. 1, 2003	Feb. 2, 2002(1)
Balance Sheet Data:				
Total assets	$1,303,771	$1,173,070	$1,139,564	$1,147,911
Current portion - long-term debt	16,419	17,278	12,595	9,379
Long-term debt	208,645	202,819	203,045	208,491

Working capital........................	413,989	266,178	190,797	119,873
Stockholders' equity...................	694,464	587,409	546,555	538,039
Performance Data:				
Including cumulative effect of accounting changes:				
Net return on average stockholders' equity..........	10.1%	6.7%	(1.1)%	(1.4)%
Net return on average total assets.................	5.2	3.3	(0.5)	(0.7)
Before cumulative effect of accounting changes:				
Net return on average stockholders' equity..........	10.1%	6.7%	7.6%	(1.4)%
Net return on average total assets.................	5.2	3.3	3.7	(0.7)

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the financial statements and accompanying notes appearing elsewhere in this report. As used in this report, the terms "Fiscal 2005," "Fiscal 2004," and "Fiscal 2003" refer to our fiscal years ended January 29, 2005, January 31, 2004, and February 1, 2003, respectively. The term "Fiscal 2006" refers to our fiscal year which will end on January 28, 2006. The terms "the Company," "we," "us," and "our" refer to Charming Shoppes, Inc. and, where applicable, its consolidated subsidiaries.

FORWARD-LOOKING STATEMENTS

With the exception of historical information, the matters contained in the following analysis and elsewhere in this report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements may include, but are not limited to, projections of revenues, income or loss, cost reductions, capital expenditures, liquidity, financing needs or plans, and plans for future operations, as well as assumptions relating to the foregoing. The words "expect," "should," "project," "estimate," "predict," "anticipate," "plan," "believes," and similar expressions are also intended to identify forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties, some of which we cannot predict or quantify. Future events and actual results, performance, and achievements could differ materially from those set forth in, contemplated by, or underlying the forward-looking statements. We assume no obligation to update any forward-looking statement to reflect actual results or changes in, or additions to, the factors affecting such forward-looking statements.

Factors that could cause our actual results of operations or financial condition to differ from those described in this report include, but are not necessarily limited to, the following:

- Our business is dependent upon our being able to accurately predict rapidly changing fashion trends, customer preferences, and other fashion-related

factors, which we may not be able to successfully accomplish in the future.

- A slowdown in the United States economy, an uncertain economic outlook, and escalating energy costs could lead to reduced consumer demand for our apparel and accessories in the future.

- Our business could be negatively affected by a deflationary pricing environment in the apparel industry.

- The women's specialty retail apparel industry is highly competitive and we may be unable to compete successfully against existing or future competitors.

- We cannot assure the successful implementation of our business plan for increased profitability and growth in our plus-size women's apparel business.

- Our business plan is largely dependent upon continued growth in the plus-size women's apparel market, which may not occur.

- We depend on key personnel, particularly our Chief Executive Officer, Dorrit J. Bern, and we may not be able to retain or replace these employees or recruit additional qualified personnel.

- We depend on our distribution centers and could incur significantly higher costs and longer lead times associated with distributing our products to our stores if operations at any of these distribution centers were to be disrupted for any reason.

- We depend on the availability of credit for our working capital needs, including credit we receive from our suppliers and their agents, and on our credit card securitization facility. If we were unable to obtain sufficient financing at an affordable cost, our ability to merchandise our stores would be adversely affected.

- We rely significantly on foreign sources of production and face a variety of risks generally associated with doing business in foreign markets and importing merchandise from abroad. Such risks include (but are not necessarily limited to) political instability, imposition of, or changes in, duties or quotas, trade restrictions, increased security requirements applicable to imports, delays in shipping, increased costs of transportation, and issues relating to compliance with domestic or international labor standards.

- Our stores experience seasonal fluctuations in net sales and operating income. Any decrease in sales or margins during our peak sales periods, or in the availability of working capital during the months preceding such periods, could have a material adverse effect on our business. In addition, extreme or unseasonable weather conditions may have a negative impact on our sales.

- Natural disasters, as well as war, acts of terrorism, or the threat of either may negatively impact availability of merchandise and customer traffic to our stores, or otherwise adversely affect our business.

- We may be unable to obtain adequate insurance for our operations at a reasonable cost.

- We may be unable to protect our trademarks and other intellectual property rights, which are important to our success and our competitive position.

- We may be unable to hire and retain a sufficient number of suitable sales associates at our stores.

- Our manufacturers may be unable to manufacture and deliver merchandise to us in a timely manner or to meet our quality standards.

- Our sales are dependent upon a high volume of traffic in the strip centers and malls in which our stores are located, and our future growth is dependent upon the availability of suitable locations for new stores.

- We may be unable to successfully implement our plan to improve merchandise assortments in our brands.

- The carrying amount and/or useful life of intangible assets related to acquisitions are subject to periodic valuation tests. An adverse change in interest rates or other factors could have a significant impact on the results of the valuation tests, resulting in a write-down of the carrying value or acceleration of amortization of acquired intangible assets.

- Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include our assessment of the effectiveness of our internal control over financial reporting in our annual reports. Our independent registered public accounting firm is also required to attest to whether or not our assessment is fairly stated in all material respects and to separately report on whether or not they believe that we maintained, in all material respects, effective internal control over financial reporting. If we are unable to maintain effective internal control over financial reporting, or if our independent registered public accounting firm is unable to timely attest to our assessment, we could be subject to regulatory sanctions and a possible loss of public confidence in the reliability of our financial reporting. Such a failure could result in our inability to provide timely and/or reliable financial information and could adversely affect our business.

RESTATEMENT OF FINANCIAL STATEMENTS

Our system of internal controls over financial reporting includes the monitoring of emerging accounting issues and the reviewing of industry and peer group filings and news releases. As a result of the publicity on the restaurant industry financial statement restatements related to leases, we commenced a review of certain of our accounting policies related to leases during January 2005. Subsequently, on February 7, 2005, the Office of the Chief Accountant of the Securities and Exchange Commission ("SEC") issued a letter to the American Institute of Certified Public Accountants expressing its views regarding certain operating-lease-related accounting issues and their application under generally accepted accounting principles in the United States of America ("GAAP"). Based on our internal review, and after consultation with the Audit Committee of our Board of Directors and our independent registered public accounting firm, we

restated our financial statements for years prior to Fiscal 2005 to correct our accounting for landlord allowances, calculation of straight-line rent expense, recognition of rent holiday periods, and depreciation of leasehold improvements for our retail stores.

We lease substantially all of our stores under non-cancelable operating lease agreements. These lease agreements generally include standard language on landlord allowances for costs relating to the design, construction, fixturing, and opening of stores. Construction allowances vary by store, and represent a reimbursement from the landlord for a portion of the leasehold improvement costs we incur. Historically, we classified construction allowances as a reduction of property, equipment, and leasehold improvements on our consolidated balance sheets and as a reduction of capital expenditures on our consolidated statements of cash flows. In addition, when accounting for leases with renewal options, we historically recorded rent expense on a straight-line basis over the initial non-cancelable lease term, beginning with the lease commencement date. However, we depreciated leasehold improvements over their estimated useful life of ten years, which, in many cases, may have included both the initial non-cancelable lease term and option renewal periods provided for in the lease. Also, we historically recognized rent holiday periods on a straight-line basis over the lease term commencing with the initial occupancy date, or the opening date of the stores. Management re-evaluated FASB Technical Bulletin No. 85-3, "Accounting for Operating leases with Scheduled Rent Increases," and determined that the lease term should commence on the date we take possession of the leased space for construction purposes, which is generally two months prior to a store opening date.

As a result of the restatement, construction allowances have been recorded as a deferred rent liability on our consolidated balance sheets instead of being recorded as a reduction of the cost of leasehold improvements. In our consolidated statements of cash flows, we have recognized construction allowances as an operating activity instead of recognizing them as a reduction of our investment in capital assets. In addition, the construction allowances will be amortized over the related lease term as a reduction of rent expense rather than as a reduction of depreciation expense commencing on the date we take possession of the leased space for construction purposes.

We also corrected the lease term used to determine straight-line rent expense and depreciation of leasehold improvements to include lease option renewal periods only in instances in which the exercise of the option period is reasonably assured and the failure to exercise such an option would result in an economic penalty. Depreciation of leasehold improvements has been recognized over the shorter of the corrected lease term or the assets' estimated useful lives. Lease terms used to determine straight-line rent expense include pre-opening store build-out periods (commonly referred to as "rent holidays"), where applicable. These corrections resulted in the accelerated recognition of certain annual rent expense and depreciation expense on leasehold improvements.

As a result of the above corrections, we recorded additional deferred rent in "accrued expenses" and "deferred taxes and other non-current liabilities" and we adjusted "retained earnings" on the consolidated balance sheet. We also corrected amortization in "cost of goods sold, buying, and occupancy expenses" on the consolidated statements of operations and comprehensive income (loss) for each of our three fiscal years in the period ended

January 29, 2005. These accounting changes resulted in a decrease in retained earnings of $11.8 million for the cumulative effect as of the beginning of Fiscal 2003, and decreases in retained earnings of $3.3 million and $2.6 million

for Fiscal 2003 and Fiscal 2004, respectively. These corrections did not have any impact on our previously reported comparable store sales, net sales, cash flow, and actual lease payments, or on the economic value of our leasehold improvements.

See "Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; NOTE 2. RESTATEMENT OF FINANCIAL STATEMENTS" below for further details of the restatement.

OVERVIEW

We are a specialty apparel retailer primarily focused on serving the plus-size woman through three distinct brands: LANE BRYANT, FASHION BUG, and CATHERINES PLUS SIZES. We currently represent approximately 40% of the women's plus-size specialty retail apparel market, and we are the third largest specialty apparel retailer in the United States. Through our varied plus-size fashion concepts, we cater to customers from a broad range of socioeconomic, demographic, and cultural groups. As of January 29, 2005, we operated 2,221 stores in 48 states.

The apparel industry is highly competitive and is continuously faced with new and existing competitors seeking areas of growth to expand their businesses. Our strategy focuses on increasing our market share in the growing plus-size women's apparel market through our three brands. Americans continue to gain weight in all age groups, with an estimated 65% of American adults being overweight and half of American women wearing size 14 or larger. Through our three brands, we offer plus-size women's apparel to a broad range of age groups, with varied fashion tastes and income levels, in multiple shopping venues. By focusing on the plus-size market, we believe that we are well-positioned to meet the demands of this growing demographic.

Our long-term plans are to continue to expand our market position in the women's plus-size specialty apparel market. These plans include the addition of new stores (primarily at our LANE BRYANT brand), continued growth in E-commerce, entry into the catalog business, international expansion, and increasing our relevance to our customer. In Fiscal 2005, we more than doubled our sales volume in our E-commerce channel and expanded E-commerce into Canada. We view the direct-to-consumer channels, including catalogs, to be disproportionately important to the plus-size customer and a significant growth opportunity. In October 2007, the Lane Bryant catalog trademark, which is currently licensed by a third party, will revert back to Lane Bryant. We are currently building our direct-to-consumer business organization for entry into catalog sales. We view the growth in our store base and the extension into other direct-to-consumer channels as an opportunity for us to maintain and increase our market share. We continue to pursue ways to increase our relevance to our customer, and believe that through factors such as our expertise in plus-size fit and our FIGURE magazine (America's leading plus-size fashion and lifestyle magazine) we are differentiating ourselves from our competitors.

With the addition of E-commerce at our FASHION BUG website in Fiscal 2005, we now offer E-commerce at each of our three brands. Our Fiscal 2006 plan is to increase our E-commerce sales volume more than 50% by continuing to broaden category offerings at our websites. Our E-commerce sales in Fiscal 2004 and Fiscal 2005 were less than one percent and two percent, respectively, of our consolidated net sales, and we expect our E-commerce sales in Fiscal 2006 to increase to more than two percent of consolidated net sales. Although our websites primarily offer basic merchandise assortments, we see opportunities to expand our product offerings into additional categories, such as hard-to-find sizes. This will allow us to offer a greater variety of merchandise categories than those currently offered in our stores.

Over the last three years, the retail apparel industry has been negatively affected by the general slowdown in the U.S. economy, reduced levels of consumer confidence, and the unstable geopolitical climate. We expect the deflationary pricing environment to continue to impact the apparel industry. In addition, the elimination of quota on imports in 2005 may create further downward pressure on retail prices.

In Fiscal 2004 we initiated a cost reduction plan that decreased expenses by a total of approximately $45 million on an annualized basis. In Fiscal 2005, we completed the cost reduction initiative with the consolidation of our CATHERINES and LANE BRYANT distribution centers into our new White Marsh distribution center. In addition to our continuing focus on maintaining control over expenses and inventories, another area of focus in Fiscal 2006 is the continued improvement of gross margins at our three brands through improved product mix and reduced markdowns.

We made significant progress in Fiscal 2005, particularly at our LANE BRYANT brand. An improvement of 160 basis points in our consolidated gross margin in Fiscal 2005 contributed to a 70% increase in our net income over the prior year. The positive results achieved in Fiscal 2005 are primarily attributable to plans implemented in Fiscal 2004 to improve merchandise assortments at our LANE BRYANT brand. In Fiscal 2005, LANE BRYANT experienced a 3% increase in comparable store sales. However, our FASHION BUG brand experienced only a modest 1% increase in comparable store sales, while our CATHERINES brand experienced a 6% decrease in comparable store sales. Our Fiscal 2005 results were negatively impacted by disappointing sales performances at each of our brands during the fourth quarter, mainly as a result of our lack of a timely response to the competitive promotional environment that developed during the 2004 Christmas holiday season. Our challenge in Fiscal 2006 will be to improve the performance of our FASHION BUG and CATHERINES brands while continuing to enhance our LANE BRYANT brand's performance.

Another area we focused on in Fiscal 2005 was inventory management. Improved management of inventory during Fiscal 2005 resulted in a decrease in inventory of $25 million, which allowed us to utilize our working capital more effectively, while concurrently increasing comparable store sales. As a result, we strengthened our balance sheet and increased our cash flows.

CRITICAL ACCOUNTING POLICIES

We have prepared the financial statements and accompanying notes included elsewhere in this report in conformity with accounting principles generally accepted in the United States. This requires us to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. These estimates and assumptions are based on historical experience, analysis of current trends, and various other factors that we believe to be reasonable under the circumstances. Actual results could differ from those estimates under different assumptions or conditions.

We periodically reevaluate our accounting policies, assumptions, and estimates and make adjustments when facts and circumstances warrant. Historically, actual results have not differed materially from those determined using required estimates. Our significant accounting policies are described in the notes accompanying the financial statements included elsewhere in this report. However, we consider the following accounting policies and related

assumptions to be more critical to, and involve the most significant management judgments and estimates in, the preparation of our financial statements and accompanying notes.

Revenue Recognition

We recognize revenue in accordance with SEC Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in the Financial Statements" (as amended by SAB 104). Our revenues from merchandise sales are net of returns and allowances and exclude sales tax. We record a reserve for estimated future sales returns based on an analysis of actual returns and we defer recognition of layaway sales to the date of delivery. A change in our actual rates of sales returns and layaway sales experience would affect the level of revenue recognized.

Revenues from our E-commerce business include shipping and handling fees billed to customers. E-commerce revenues are recognized after the following have occurred: execution of the customer's order, authorization of the customer's credit card has been received, and the product has been shipped and received by the customer. We record a reserve for estimated future E-commerce sales returns based on an analysis of actual returns.

We offer our customers various loyalty card programs. Customers that join these programs are entitled to various benefits, including discounts and rebates on purchases during the membership period. Customers generally join these programs by paying an annual membership fee. We recognize revenue from these loyalty programs as sales over the life of the membership period based on when the customer earns the benefits and when the fee is no longer refundable. Costs we incur in connection with administering these programs are recognized in cost of goods sold as incurred.

During Fiscal 2004, we introduced a FASHION BUG customer loyalty card program that we operate under our FASHION BUG proprietary credit card program. This program provides customers with the option to cancel their membership within 90 days, entitling them to a full refund of their annual fee. Additionally, after 90 days, customers that cancel their membership are entitled to a pro rata fee refund based on the number of months remaining on the annual membership. Accordingly, we recognize 25% of the annual membership fee as revenue after 90 days, with the remaining fee recognized on a pro rata basis over nine months.

Under a previous FASHION BUG customer loyalty card program, we recognized revenues from annual membership fees as sales over the life of the membership based on discounts earned by the customer. For customers who did not earn discounts during the membership period that exceeded the card fee, the difference between the membership fee and discounts earned was recognized as revenue upon the expiration of the annual membership period. Upon early cancellation of the loyalty card, refunds of membership fees were reduced by the amount of any discounts granted to the member under the program. We discontinued the issuance of new cards under this program in December 2002, and we terminated the program during the second quarter of Fiscal 2004.

Inventories

We value our merchandise inventories at the lower of cost or market under the retail inventory method (average cost basis), which is an averaging method

that is widely used in the retail industry. Under the retail inventory method ("RIM"), the valuation of inventories at cost, and the resulting gross margins, are adjusted in proportion to markdowns and shrinkage on our retail inventories. The use of the RIM will result in valuing inventories at the lower of cost or market if markdowns are currently taken as a reduction of the retail value of inventories. The RIM calculation involves certain significant management judgments and estimates including, among others, merchandise markon, markups, markdowns, and shrinkage, which significantly affect the ending inventory valuation at cost, as well as the resulting gross margins. Events such as store closings, liquidations, and a weak general economic environment for retail apparel sales could result in an increase in the level of markdowns. Such an increase in the level of markdowns could result in lower inventory values and increases to cost of goods sold as a percentage of net sales in future periods under the RIM. Also, failure to properly estimate markdowns currently can result in an overstatement or understatement of inventory cost under the lower of cost or market

principle. At the end of Fiscal 2005 and Fiscal 2004, in addition to markdowns that had been recorded in inventory, an additional $9.5 million and $10.1 million, respectively, of markdowns, representing markdowns not yet taken on aged inventory, was recorded in order to properly reflect inventory at the lower of cost or market.

We elected to adopt the provisions of Financial Accounting Standards Board ("FASB") Emerging Issues Task Force ("EITF") Issue No. 02-16 (see "Accounting for Cash Consideration Received From a Vendor" below) as of the beginning of Fiscal 2003. As of January 29, 2005 and January 31, 2004, $6.5 million and $9.5 million, respectively, of cash received from vendors was deferred into inventory to be recognized as inventory is sold.

Impairment of Long-Lived Assets

We evaluate the recoverability of our long-lived assets in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Under SFAS No. 144, we are required to assess our long-lived assets for recoverability whenever events or changes in circumstances indicate that the carrying amounts of long-lived assets may not be recoverable. We consider historical performance and estimated future results in our evaluation of potential impairment, and compare the carrying amount of the asset to the estimated future undiscounted cash flows expected to result from the use of the asset. If the estimated future undiscounted cash flows are less than the carrying amount of the asset, we write down the asset to its estimated fair value and recognize an impairment loss. Our estimate of fair value is generally based on either appraised value or the present value of future cash flows, based on a number of assumptions and estimates.

In accordance with the provisions of SFAS No. 144, we recorded a $2.7 million write-down of under-performing assets related to our consolidated MONSOON joint venture during Fiscal 2003. The write-down is included in occupancy expenses in our consolidated statement of operations.

We adopted SFAS No. 142, "Goodwill and Other Intangible Assets" as of the beginning of Fiscal 2003. In accordance with the transition provisions of SFAS No. 142, we performed a review of our goodwill and other intangible assets for possible impairment. As a result, we determined that the carrying value of goodwill related to our CATHERINES acquisition (which included the value of intangible assets we did not separately account for at the date of the CATHERINES acquisition) exceeded the estimated fair value of the goodwill under

SFAS No. 142. We determined the estimated fair value of the CATHERINES goodwill using the present value of expected future cash flows associated with the CATHERINES assets. We recorded a write-down, which was not deductible for income tax purposes, of $44.0 million to reduce the carrying value of the goodwill to its estimated fair value. The majority of the write-down was attributable to the value of unrecorded trademarks. We also evaluated our goodwill, trademarks, tradenames, and internet domain names related to our LANE BRYANT acquisition as of February 3, 2002 in accordance with the provisions of SFAS No. 142, and determined that there was no impairment of those assets. We have included the write-down of the CATHERINES goodwill as the cumulative effect of an accounting change as of February 3, 2002 in our Consolidated Statement of Operations and Comprehensive Income (Loss) for Fiscal 2003. Our calculation of the estimated fair value of the goodwill and other intangible assets required estimates, assumptions, and judgments, and results might have been materially different if other estimates, assumptions, and judgments had been used. We believe that the estimates and assumptions we used were reasonable and appropriate.

In accordance with the provisions of SFAS No. 142, we re-evaluate goodwill and other intangible assets for impairment at least annually or more frequently if there is an indication of possible impairment. We performed this annual review during the fourth quarters of Fiscal 2005, Fiscal 2004, and Fiscal 2003 and determined that there has been no additional impairment of these assets.

Acquisitions - Purchase Price Allocation

We account for acquisitions in accordance with the provisions of SFAS No. 141, "Business Combinations." We assign to all identifiable assets acquired (including intangible assets), and to all identifiable liabilities assumed, a portion of the cost of the acquired company equal to the estimated fair value of such assets and liabilities at the date of acquisition. We record the excess of the cost of the acquired company over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed, if any, as goodwill. We make the initial purchase price allocation based on the evaluation of information and estimates available at the date of the financial statements. As final information regarding the fair value of assets acquired and liabilities assumed is evaluated and estimates are refined, we make appropriate adjustments to the amounts allocated to those assets and liabilities and make corresponding changes to the amount allocated to goodwill. We use all available information to make these fair value determinations and, for major business acquisitions, typically engage an outside appraisal firm to assist in the fair value determination of the acquired long-lived assets. We have, if necessary, up to one year after the closing date of an acquisition to finish these fair value determinations and finalize the purchase price allocation.

Asset Securitization

Asset securitization is a practice commonly used in the retail industry that allows companies with proprietary credit card programs to finance credit card receivables at attractive rates. Asset securitization primarily involves the sale of proprietary credit card receivables to a special purpose entity, which in turn transfers the receivables to a trust (the "Trust") that is a qualified special purpose entity ("QSPE") and is administered by an independent trustee. We use asset securitization to fund the credit card receivables generated by our FASHION BUG credit card program. The FASHION BUG credit cards are issued by Spirit of America National Bank, one of our subsidiaries. Subsequent to the end of Fiscal 2005, Spirit of America National Bank acquired

the CATHERINES proprietary credit card portfolio and the right to operate the program, and added the CATHERINES credit card receivables to the Trust. Because the Trust qualifies as a QSPE, its assets and liabilities are not consolidated in our balance sheet.

Investors purchase various forms of certificates or credit card receivable interests (the "Certificates") issued by the Trust that represent undivided interests in the Trust's underlying assets. The Trust pays to the Certificate holders a portion of future scheduled cash flows from the credit card receivables under preset terms and conditions. Payments to Certificate holders are dependent upon actual cash flows generated by the underlying Trust assets.

We retain subordinated interests in certain securitization transactions that effectively serve as a form of credit enhancement to the Certificates sold to outside investors. To the extent that cash flows to the Trust from the credit card receivables remain available after repayment of the outside investors' interests, such amounts are paid to us. Neither the investors nor the Trust have recourse against us beyond the combination of Trust assets and our subordinated interests, other than for breaches of certain customary representations, warranties, and covenants. These representations, warranties, covenants, and related indemnities do not protect the Trust or the outside investors against credit-related losses on the receivables.

In accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," we record an interest in the estimated present value of cash flows we expect to receive over the period the receivables are outstanding. These cash flows essentially represent finance charges and late fees in excess of amounts paid to Certificate holders, credit losses, and service fees, and are referred to as the interest-only strip ("I/O strip"). In addition to the I/O strip, we recognize a servicing liability, since the servicing fees we expect to receive from the securitizations do not provide adequate compensation for servicing the receivables. The servicing liability represents the present value of the excess of the costs of servicing over the servicing fees we expect to receive, and is recorded at estimated fair value. Since quoted market prices are generally not available, we

determine the fair value of the costs of servicing by calculating all costs associated with billing, collecting, maintaining, and providing customer service during the expected life of the securitized credit card receivable balances. We discount the costs in excess of the servicing fees we expect to collect over the estimated life of the receivables sold. The discount rate and estimated life assumptions used in valuing the servicing liability are equivalent to those used in valuing the I/O strip. We amortize the I/O strip and the servicing liability on a straight-line basis over the expected life of the credit card receivables.

We use certain key valuation assumptions related to the average life of the receivables sold and anticipated credit losses, as well as the appropriate market discount rate in determining the estimated value of the I/O strip and the servicing liability. We estimate the values for these assumptions using historical data, the impact of the current economic environment on the performance of the receivables sold, and the impact of the potential volatility of the current market for similar instruments in assessing the fair value of the retained interests. Changes in the average life of the receivables sold, discount rate, and credit-loss percentage could cause actual results to differ materially from the estimates, and changes in circumstances could result in significant future changes to the assumptions currently being used.

The following table presents the decrease in our I/O strip receivable that

would result from hypothetical adverse changes of 10% and 20% in the assumptions used to determine the fair value of the I/O strip:

(In millions)	10% Change	20% Change
Assumption:		
Payment rate................................	$0.9	$1.7
Residual cash flows discount rate............	0.0	0.1
Credit loss percentage......................	0.9	1.7

Costs Associated With Exit or Disposal Activities

We have traditionally recognized certain costs associated with restructuring plans as of the date of commitment to the plan, in accordance with EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)." In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which nullified EITF Issue No. 94-3. Under SFAS No. 146, we are required to recognize liabilities for costs associated with an exit or disposal activity initiated after December 31, 2002 when the liabilities are incurred. Commitment to a plan, by itself, does not create an obligation that meets the definition of a liability. Under SFAS No. 146, we are required to recognize severance pay over time rather than "up front" if the benefit arrangement requires employees to render future service beyond a "minimum retention period." The liability for severance pay is recognized as employees render service over the future service period, even if the benefit formula used to calculate an employee's termination benefit is based on length of service. Fair value should be used for initial measurement of liabilities under SFAS No. 146. Adoption of SFAS No. 146 results in the deferral of recognition of certain costs for restructuring plans initiated subsequent to December 31, 2002, from the date of commitment to such a plan to the date that costs are incurred under the plan.

On March 18, 2003, we announced the implementation of a cost reduction plan (see "RESULTS OF OPERATIONS; Comparison of Fiscal 2004 to Fiscal 2003; Expenses Related to Cost Reduction Plan" below). Costs incurred in connection with the implementation of this plan have been accounted for in accordance with the provisions of SFAS No. 146.

Accounting for Cash Consideration Received From a Vendor

EITF Issue 02-16, "Accounting by a Customer (Including a Reseller) for Cash Consideration Received from a Vendor," addresses the accounting for cash consideration received from a vendor, including both a reseller of the vendor's products and an entity that purchases the vendor's products from a reseller. We adopted the provisions of EITF Issue No. 02-16 as of the beginning of Fiscal 2003. We recognized a charge of $5.1 million, net of income taxes of $2.8 million, for the cumulative effect of the deferral of cash received from vendors as of the beginning of Fiscal 2003. As of January 29, 2005 and January 31, 2004, $6.5 million and $9.5 million, respectively, of cash received from vendors has been deferred into inventory and will be recognized as a reduction of cost of

goods sold as inventory is sold.

Stock-Based Compensation

SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," allows two alternatives for accounting for stock-based compensation: the "intrinsic value method" in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," or the "fair value" method in accordance with SFAS No. 123. Companies electing to adopt the intrinsic value method are required to provide pro forma disclosures of the effect of adopting the fair value method.

We currently account for stock-based compensation using the intrinsic value method. We recognize compensation expense for stock options and stock awards that have an exercise price less than the market price of our common stock at the date of grant of the option or award. We measure compensation expense based on the difference between the market price and the exercise price of an option or award at the date of grant. This compensation expense is recognized on a straight-line basis over the vesting period of each option or award. We do not recognize compensation expense for options having an exercise price equal to the market price on the date of grant or for shares purchased under our Employee Stock Purchase Plan.

Under the fair value method, we would be required to recognize compensation expense for all stock options and stock awards. Compensation would be measured based on an estimated fair value of the option or award, using an option pricing model, such as the Black-Scholes or binomial pricing model. These models require estimates or assumptions as to the dividend yield and price volatility of the underlying stock, the expected life of the option or award, and a relevant risk-free interest rate. For purposes of determining our pro forma disclosures of the effect of adopting the fair value method, we use the Black-Scholes option-pricing model and various assumptions that are detailed in "Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES; Common Stock Plans" below. The use of different option-pricing models and different estimates or assumptions could result in materially different estimates of compensation expense under the fair value method.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"), a revision of SFAS No. 123. SFAS No. 123R supersedes APB Opinion No. 25, and amends SFAS No. 95, "Statement of Cash Flows." We will be required to adopt the provisions of SFAS No. 123R as of the beginning of the third quarter of Fiscal 2006. See "Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES; Impact of Recent Accounting Pronouncements" for a further discussion of SFAS No. 123R.

Insurance Liabilities

We use a combination of third-party insurance and/or self-insurance for certain risks, including workers' compensation, medical, dental, automobile, and general liability claims. Our insurance liabilities are a component of "Accrued expenses" on our consolidated balance sheet, and represent our estimate of the ultimate cost of uninsured claims incurred as of the balance sheet date. In

estimating our self-insurance liabilities, we use independent actuarial estimates of expected losses, which are based on statistical analyses of historical data. Loss estimates are adjusted based upon actual claim settlements and reported claims. Although we do not expect the amounts ultimately paid to differ significantly from our estimates, self-insurance liabilities could be affected if future claim experience differs significantly from the historical trends and the actuarial assumptions. We evaluate the adequacy of these liabilities on a regular basis, modifying our assumptions as necessary, updating our records of historical experience, and adjusting our liabilities as appropriate.

Operating Leases

We lease substantially all of our store properties and account for our store leases in accordance with SFAS No. 13, "Accounting for Leases." A majority of our store leases contain lease options that we can unilaterally exercise. The lease term we use for such operating leases includes lease option renewal periods only in instances in which the failure to exercise such options would result in an economic penalty for us and exercise of the renewal option is therefore reasonably assured at the lease inception date.

Store leasehold improvement assets are depreciated over the shorter of their useful life or the lease term, as determined above.

For leases that contain rent escalations, the lease term for recognition of straight-line rent expense commences on the date we take possession of the leased property for construction purposes, which is generally two months prior to a store opening date. Similarly, landlord incentives or allowances under operating leases (tenant improvement allowances) are recorded as a deferred rent liability and recognized as a reduction of rent expense on a straight-line basis over the lease term commencing on the date we take possession of the leased property for construction purposes.

RESULTS OF OPERATIONS

Financial Summary

The following table shows our results of operations expressed as a percentage of net sales and on a comparative basis:

	Percentage of Net Sales			Percentage Incr (Decrease) From Prior Ye	
	Fiscal 2005	Fiscal 2004	Fiscal 2003	Fiscal 2005-2004	F 20
Net sales....................................	100.0%	100.0%	100.0%	2.0%	
Cost of goods sold, buying, and occupancy....	70.3	71.9	71.6	(0.2)	
Selling, general, and administrative.........	24.8	24.4	25.0	3.4	
Expenses related to cost reduction plan......	0.0	0.5	--	(94.8)	
Restructuring charge (credit)................	--	--	(0.2)	--	
Income from operations.......................	4.9	3.2	3.6	56.2	(
Other income, principally interest...........	0.1	0.1	0.1	51.1	(
Interest expense.............................	0.7	0.7	0.8	0.0	(
Income tax provision (benefit)...............	1.6	0.9	1.1	71.8	(
Minority interest in net loss of subsidiary..	--	0.0	0.0	(100.0)	(
Cumulative effect of accounting changes......	--	--	(2.0)	--	
Net income (loss)............................	2.8	1.7	(0.3)	69.6	

The following table shows our net sales by store brand:

(In millions)	Year Ended January 29, 2005 Fiscal Year	Fourth Quarter	Year Ended January 31, 2004 Fiscal Year	Fourth Quarter	Year Ended February 1, 2003 Fiscal Year	Fourth Quarter
FASHION BUG ...	$1,045.4	$255.5	$1,057.1	$259.2	$1,156.0	$288.9
LANE BRYANT ...	974.2	259.4	903.6	251.0	906.9	236.1
CATHERINES	312.7	71.2	323.3	75.4	345.2	74.6
Other(1)	0.0	0.0	1.7	0.0	4.3	1.5
Total net sales	$2,332.3	$586.1	$2,285.7	$585.6	$2,412.4	$601.1

The following table shows additional information related to changes in our net sales:

	Year Ended January 29, 2005 Fiscal	Fourth	Year Ended January 31, 2004 Fiscal	Fourth

	Year	Quarter	Year	Quarter
Increase (decrease) in comparable store sales(1):				
Consolidated Company	1%	(2)%	(2)%	(1)%
FASHION BUG	1	(1)	0	(4)
LANE BRYANT	3	(1)	(6)	1
CATHERINES	(6)	(9)	(1)	0
Sales from new stores as a percentage of total consolidated prior-period sales:				
FASHION BUG	1	1	1	1
LANE BRYANT	3	3	3	2
CATHERINES	1	1	1	1
Prior-period sales from closed stores as a percentage of total consolidated prior-period sales:				
FASHION BUG	(2)	(2)	(4)	(3)
LANE BRYANT	(1)	(1)	(1)	(1)
CATHERINES	(1)	0	(2)	0
Increase (decrease) in total sales	2%	0%	(5)%	(3)%

The following table sets forth information with respect to store activity for Fiscal 2005 and planned store activity for Fiscal 2006:

	FASHION BUG	LANE BRYANT	CATHERINES	Total
Fiscal 2005:				
Stores at January 31, 2004	1,051	710	466	2,227
Stores opened	5	31	15	51
Stores closed	(28)	(19)	(10)	(57)
Net changes in stores	(23)	12	5	(6)
Stores at January 29, 2005	1,028	722	471	2,221
Stores relocated during period	23	15	9	47
Stores remodeled during period	4	9	0	13
Fiscal 2006:				
Planned store openings	15	50-60	5	70-80
Planned store relocations	25	40	15	80
Planned store closings	20	15	15	50

Comparison of Fiscal 2005 to Fiscal 2004

Net Sales

Net sales increased from Fiscal 2004 to Fiscal 2005 primarily as a result of sales from new stores, positive comparable store sales at our LANE BRYANT and FASHION BUG brands, and increased E-commerce sales. These increases were partially offset by negative comparable store sales results at our CATHERINES brand.

LANE BRYANT stores experienced an increase in the average dollar sale per transaction, which was partially offset by a decrease in the average number of transactions per store. The average dollar sale per transaction benefited from increases in both the average retail value per unit sold, reflecting reduced levels of promotional pricing for the brand as compared to the prior-year period, and the average number of units sold per customer ("UPC"). Except for casual wear, LANE BRYANT experienced comparable store sales increases in all major merchandise categories, especially wear-to-work and intimate apparel. During Fiscal 2004, LANE BRYANT experienced poor customer acceptance of, and fit and quality issues with, its product offering and had to maintain higher levels of promotional pricing. Improvements in the merchandise assortments offered at LANE BRYANT during Fiscal 2005 resulted in the brand's improved sales performance during Fiscal 2005.

For FASHION BUG stores, an increase in the average number of transactions per store during Fiscal 2005 was partially offset by a slightly lower average dollar sale per transaction. For Fiscal 2005, an increase in the average UPC was offset by a decrease in the average retail value per unit sold. FASHION BUG stores experienced comparable store sales increases in plus-size sportswear and accessories, which were offset by sales decreases in other categories. FASHION BUG store sales for Fiscal 2005 also benefited from sales of maternity and girls, two new categories added to the brand at the end of Fiscal 2004.

CATHERINES stores experienced a decrease in the average number of transactions per store and a lower average dollar sale per transaction during Fiscal 2005. An increase in the average UPC was more than offset by a decrease in the average retail value per unit sold, reflecting higher levels of promotional pricing during Fiscal 2005. The decrease in sales at CATHERINES was primarily a result of disappointing performance in the dress and wear-to-work categories.

During Fiscal 2005, we recognized revenues of $7.6 million in connection with our FASHION BUG customer loyalty card program that we introduced during Fiscal 2004, as compared to revenues of $7.8 million for Fiscal 2004. During Fiscal 2005 and Fiscal 2004, we also recognized revenues of $7.5 million and $7.5 million, respectively, in connection with our CATHERINES loyalty card program. In addition, during Fiscal 2004, we recognized revenues of $6.4 million in connection with a previous FASHION BUG loyalty card program that we terminated during Fiscal 2004.

Cost of Goods Sold, Buying, and Occupancy

Cost of goods sold, buying, and occupancy expenses for Fiscal 2005 were approximately equal to Fiscal 2004, and were 1.6% lower as a percentage of sales in the current year as compared to the prior year. Cost of goods sold as a percentage of net sales was 1.0% lower in Fiscal 2005 as compared to Fiscal 2004. Improved merchandise margins, primarily at our LANE BRYANT brand and, to a lesser extent, at our FASHION BUG brand, were partially offset by a decrease in merchandise margins at our CATHERINES brand. Margins at the CATHERINES brand for Fiscal 2005 were negatively affected by increased promotional activity that resulted from reduced traffic levels and poor customer acceptance of CATHERINES

product offerings during the current year. As discussed above, Fiscal 2004 margins at our LANE BRYANT brand were negatively affected by higher levels of promotional activity. Cost of goods sold includes merchandise costs net of discounts and allowances, freight, inventory

shrinkage, and shipping and handling costs associated with our E-commerce business. Net merchandise costs and freight are capitalized as inventory costs.

Buying and occupancy expenses as a percentage of net sales were 0.6% lower in Fiscal 2005 as compared to Fiscal 2004, primarily a result of leverage on increased sales at LANE BRYANT and cost savings from the consolidation of our LANE BRYANT and CATHERINES distribution operations into our White Marsh, Maryland facility. Buying expenses include payroll, payroll-related costs, and operating expenses for our buying departments and warehouses. Occupancy expenses include rent, real estate taxes, insurance, common area maintenance, utilities, maintenance, and depreciation for our stores and warehouse facilities and equipment. Buying and occupancy costs are treated as period costs and are not capitalized as part of inventory.

Selling, General, and Administrative

Selling, general, and administrative expenses increased in Fiscal 2005 as compared to Fiscal 2004, and were 0.3% higher as a percentage of net sales. Selling expenses for Fiscal 2005 were 0.3 % lower as a percentage of net sales, while general and administrative expenses were 0.6% higher as a percentage of net sales. The increase in selling, general, and administrative expenses was primarily a result of higher expenses related to incentive-based employee compensation programs and the purchase during the Fiscal 2005 Third Quarter of life insurance policies for certain executives to replace split-dollar life insurance policies that were terminated as a result of the Sarbanes-Oxley Act of 2002, which prohibits loans to executive officers. As a result of terminating the split-dollar program, the Company will receive the cash surrender value of the policies. In return, we agreed to provide each of the affected executives with an unconditional bonus to enable them to purchase a replacement life insurance policy. This bonus will be payable in five equal annual installments in an amount equal to the annual insurance premiums paid by the executive for the new policy, plus a tax gross-up amount. These increases in selling, general, and administrative expenses were partially offset by improved performance of our FASHION BUG credit card operations, including favorable trends in delinquencies during the current-year period. General and administrative expenses for Fiscal 2004 benefited from reduced medical benefits costs as a result of reduced medical claims by employees covered by our self-insured employee benefit program.

Expenses Related to Cost Reduction Plan

In March 2003, we announced a cost reduction plan designed to take advantage of the centralization of all corporate administrative services throughout the Company and to realize certain efficiencies, in order to improve profitability (see "Comparison of Fiscal 2004 to Fiscal 2003" below). The cost reduction plan was substantially completed during Fiscal 2004. We did not experience a material after-tax cash impact from execution of this plan. At the time we announced the plan, we expected this cost reduction plan to improve our annualized pre-tax earnings by a total of approximately $45 million. During Fiscal 2004, we realized cost reductions of more than $30 million as a result of this plan. During Fiscal 2005, we realized the remaining benefits of the plan.

As of January 31, 2004, there was $2.6 million of accrued lease termination costs related to the closing of our Hollywood, Florida credit facility. In October 2004, in accordance with SFAS No. 146, we revised our estimated sublease income on the remaining lease obligation for the Hollywood facility and recognized an additional expense of $0.6 million. During the fourth quarter of Fiscal 2005, we settled our remaining lease obligation for the Hollywood facility for approximately $3.2 million. Also, during the fourth quarter of Fiscal 2005, we entered into an agreement to lease the Memphis, Tennessee distribution center to a third party for a three-year period.

Income Tax Provision

The effective income tax rate was 36.5% in Fiscal 2005, as compared to 36.3% in Fiscal 2004. On October 22, 2004, the President of the United States of America signed into law H.R. 4250, "The American Jobs Creation Act of 2004" (the "Act"), which includes among its provisions certain tax benefits related to the repatriation to the United States of profits from a company's international operations. The Act provides for the repatriation of profits from international operations at a tax rate not to exceed 5.25% for approximately a one-year period. These tax benefits are subject to various limitations, and, as of January 29, 2005, the U.S. Treasury Department has not issued final guidelines for applying the repatriation provisions of the Act. We are currently evaluating the effects of the Act, and have not determined the effect, if any, that it will have on our financial condition and results of operations. As of January 29, 2005, our consolidated cash balance of $273.0 million included approximately $39.5 million of cash held by our international operations. We will finalize our analysis before the end of Fiscal 2006.

Comparison of Fiscal 2004 to Fiscal 2003

Net Sales

The decrease in net sales from Fiscal 2003 to Fiscal 2004 resulted primarily from a decrease in the number of operating stores at our FASHION BUG brand and the closing of our THE ANSWER/ADDED DIMENSIONS stores following our Fiscal 2003 store restructuring initiative, and negative comparable store sales results at our LANE BRYANT brand. We operated 2,227 retail stores at the end of Fiscal 2004, as compared to 2,248 stores at the end of Fiscal 2003.

FASHION BUG stores experienced mixed results in comparable store sales during Fiscal 2004, with flat comparable store sales for the year. The average number of transactions and average number of units sold per customer ("UPC") increased 1% and 3%, respectively, in our FASHION BUG stores, while the average dollar sale and average retail value per unit sold decreased 1% and 3%, respectively. FASHION BUG stores experienced comparable store sales increases in plus sportswear, accessories, intimate apparel, and footwear, which were partially offset by decreases in sales of junior sportswear and dresses.

CATHERINES stores also experienced mixed results in comparable store sales during Fiscal 2004, with a 1% decrease in comparable store sales for the year. The average dollar sale and average UPC each increased 3% in our CATHERINES stores, while the average number of transactions and average retail value per unit sold decreased 2% and 1%, respectively. Comparable store sales increases in

denim, which performed strongly as a result of the brand's fit initiative, and intimate apparel were offset by decreases in sales of dresses, career sportswear, suits, sweaters, and hosiery.

Although LANE BRYANT stores experienced quarter-over-quarter improvements in comparable store sales results during Fiscal 2004, they experienced an overall decrease of 6% in comparable store sales for the year. The average UPC increased 11% for LANE BRYANT stores, while the average dollar sale and average retail value per unit sold decreased 4% and 14% respectively, reflecting the brand's higher level of promotional pricing. The average number of transactions at LANE BRYANT stores decreased 3%. LANE BRYANT experienced comparable store sales decreases primarily in sweaters, casual woven tops, and denim separates, which were partially offset by comparable store sales increases in other merchandise categories. During the second half of Fiscal 2003 and the first half of Fiscal 2004, LANE BRYANT experienced poor customer acceptance of, and fit and quality issues with, its product offering, resulting in higher levels of promotional pricing. In addition, certain basic products were under-stocked during the second half of Fiscal 2003, resulting in missed sales opportunities. Improved merchandise

assortments resulted in increased unit sales and improved sales performance for the LANE BRYANT brand during the second half of Fiscal 2004.

During Fiscal 2004, we recognized revenues of $7.8 million in connection with the FASHION BUG customer loyalty card program that we introduced in Fiscal 2004. During Fiscal 2004 and Fiscal 2003, we also recognized revenues of $6.4 million and $21.8 million, respectively, in connection with a previous Fashion Bug loyalty card program that we terminated during Fiscal 2004. In addition, during Fiscal 2004 and Fiscal 2003, we recognized revenues of $7.5 million and $7.3 million, respectively, in connection with our CATHERINES loyalty card program.

Cost of Goods Sold, Buying, and Occupancy

The decrease in cost of goods sold, buying, and occupancy expenses from Fiscal 2003 to Fiscal 2004 principally reflects the decrease in net sales. Cost of goods sold as a percentage of net sales was unchanged from Fiscal 2003 to Fiscal 2004. Improvements in merchandise margins in our FASHION BUG brand were offset by lower merchandise margins in our LANE BRYANT and CATHERINES brands. Higher levels of promotional activity and poor customer acceptance of certain LANE BRYANT products, as discussed above, also negatively affected merchandise margins in both years. Cost of goods sold for Fiscal 2003 included $5.1 million of costs related to the valuation of LANE BRYANT inventories. The $5.1 million related to markdowns for inventory on hand as a result of the poor customer acceptance of, and fit and quality issues with, certain of LANE BRYANT's products, which resulted in higher levels of promotional pricing to liquidate the product. Cost of goods sold includes merchandise costs net of discounts and allowances, freight, inventory shrinkage, and shipping and handling costs associated with our E-commerce business. Net merchandise costs and freight are capitalized as inventory costs.

Buying and occupancy expenses as a percentage of net sales increased 0.3% in Fiscal 2004 as compared to Fiscal 2003. The increase in buying and occupancy expenses as a percentage of net sales was primarily attributable to the lack of leverage on relatively fixed occupancy costs as a result of negative comparable store sales, particularly in our LANE BRYANT brand. Occupancy expenses for Fiscal 2003 included a $2.7 million write-down of under-performing assets

related to our MONSOON/ACCESSORIZE stores. Buying expenses include payroll, payroll-related costs, and operating expenses for our buying departments and warehouses. Occupancy expenses include rent, real estate taxes, insurance, common area maintenance, utilities, maintenance, and depreciation for our stores and warehouse facilities and equipment. Buying and occupancy costs are treated as period costs and are not capitalized as part of inventory.

Selling, General, and Administrative

The decrease in selling, general, and administrative expenses from Fiscal 2003 to Fiscal 2004 was primarily a result of reductions in store payroll and the realization of cost reduction initiatives, including improved management of controllable expenses (see "Expenses Related to Cost Reduction Plan" below). Selling expenses were unchanged as a percentage of net sales, while general and administrative expenses decreased 0.6% as a percentage of net sales. General and administrative expenses for Fiscal 2004 benefited from reduced medical benefits costs as a result of reduced medical claims by employees covered by our self-insured employee benefit program. General and administrative expenses for Fiscal 2003 were negatively affected by costs associated with transitional service agreements related to the LANE BRYANT acquisition. We completed the integration of LANE BRYANT's information systems during Fiscal 2003.

Expenses Related to Cost Reduction Plan

On March 18, 2003, we announced a cost reduction plan designed to take advantage of the centralization of all corporate administrative services throughout the Company and to realize certain efficiencies, in order to improve profitability. Costs incurred in connection with this plan during Fiscal 2004 included $3.0 million of workforce reduction costs, $3.7 million of lease termination and related costs, $4.2 million of accelerated depreciation (a non-cash charge), and $0.6 million of other facility closure costs. During Fiscal 2004, we paid or settled $8.9 million of these costs and had $2.6 million of accrued costs at January 31, 2004.

Workforce reduction costs represent involuntary termination benefits and retention bonuses. Employees affected by the plan were notified during the first quarter of Fiscal 2004. During Fiscal 2004, we terminated 349 employees in connection with workforce reductions at our corporate and brand home offices and the closing of our Memphis, Tennessee distribution center, our Hollywood, Florida credit operations, and our remaining MONSOON stores. We accrued the severance benefit in accordance with SFAS No. 146 and recognized retention bonuses ratably over the employees' remaining service period. Lease termination and related costs mainly represent the estimated fair value of the remaining lease obligations at the Hollywood, Florida facility, reduced by estimated sublease income. In accordance with SFAS No. 146, we recognized the present value of the remaining lease obligation less estimated sublease income related to the Hollywood, Florida facility in June 2003 when we closed the facility.

Accelerated depreciation costs represent the acceleration of depreciation of the net book value of the assets at our Memphis distribution center and our Hollywood credit operations, which were closed in June 2003, to their estimated net realizable values. During the first quarter of Fiscal 2004, we made the decision to sell the Memphis, Tennessee distribution center, and began accelerating the depreciation of the asset to its estimated net realizable value as of its then-expected cease-use date of June 2003. During the third quarter of

Fiscal 2004, we began to evaluate alternative uses for the facility, and began to depreciate the then-current carrying amount of the asset over its estimated useful life.

Other Income/Interest Expense

The decrease in other income from Fiscal 2003 to Fiscal 2004 resulted from a $0.8 million decrease in interest income. Interest income decreased as a result of a decrease in the average yield on investments during Fiscal 2004 as compared to Fiscal 2003. The decrease in interest expense from Fiscal 2003 to Fiscal 2004 resulted primarily from lower interest rates on borrowings during Fiscal 2004 as compared to Fiscal 2003. Interest expense for Fiscal 2003 also included a write-off of $1.0 million of unamortized deferred financing costs related to a $67.5 million term loan that was repaid during Fiscal 2003. During Fiscal 2003, we replaced a $67.5 million 11.5% term loan and $96.0 million of 7.5% Convertible Subordinated Notes with $150.0 million of 4.75% Senior Convertible Notes.

Income Tax Provision

The effective income tax rate was 36.3% in Fiscal 2004 as compared to 39.0% in Fiscal 2003. The lower effective tax rate in Fiscal 2004 was due primarily to changes in previously estimated full-year amounts, including our tax liability related to insurance programs.

Comparison of Fourth Quarter 2005 to Fourth Quarter 2004

Net Sales

Net sales in the Fiscal 2005 fourth quarter were $586.1 million, an increase of 0.1% from net sales of $585.6 million in the Fiscal 2004 fourth quarter. Overall, comparable store sales decreased 2% in the Fiscal 2005 fourth quarter. The decrease in comparable store sales was primarily attributable to our lack of a timely response to the com