

SHOE CARNIVAL INC
Form 10-K
April 17, 2008

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

Form 10-K

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended: **February 2, 2008**

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: 0-21360

Shoe Carnival, Inc.

(Exact name of registrant as specified in its charter)

Indiana

(State or other jurisdiction of incorporation or organization)

35-1736614

(IRS Employer Identification Number)

7500 East Columbia Street

Evansville, IN

(Address of principal executive offices)

47715

(Zip code)

(812) 867-6471

(Registrant's telephone number, including area code)

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

Common Stock, \$.01 par value

(Title of Each Class)

The NASDAQ Stock Market LLC

(Name of Each Exchange on Which Registered)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes No

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

Yes No

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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 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant based on the last sale price for such stock at August 4, 2007 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$372,271,000 (assuming solely for the purposes of this calculation that all Directors and executive officers of the registrant are "affiliates").

Number of Shares of Common Stock, \$.01 par value, outstanding at April 11, 2008 was 12,615,329.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information contained in the Definitive Proxy Statement for the Annual Meeting of Shareholders of the Registrant to be held on June 12, 2008 is incorporated by reference into PART III hereof.

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**Shoe Carnival, Inc.
Evansville, Indiana**

Annual Report to Securities and Exchange Commission
February 2, 2008

PART I

ITEM 1. BUSINESS

Forward-Looking Statements

This annual report contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve a number of risks and uncertainties. A number of factors could cause our actual results, performance, achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These factors include, but are not limited to: general economic conditions in the areas of the United States in which our stores are located; changes in the overall retail environment and more specifically in the apparel and footwear retail sectors; our ability to generate increased sales at our stores; the potential impact of national and international security concerns on the retail environment; changes in our relationships with key suppliers; the impact of competition and pricing; changes in weather patterns, consumer buying trends and our ability to identify and respond to emerging fashion trends; the impact of disruptions in our distribution or information technology operations; the effectiveness of our inventory management; the impact of hurricanes or other natural disasters on our stores, as well as on consumer confidence and purchasing in general; risks associated with the seasonality of the retail industry; our ability to successfully execute our growth strategy, including the availability of desirable store locations at acceptable lease terms, our ability to open new stores in a timely and profitable manner and the availability of sufficient funds to implement our growth plans; higher than anticipated costs associated with the closing of underperforming stores; the inability of manufacturers to deliver products in a timely manner; changes in the political and economic environments in the People's Republic of China, Brazil, Spain and East Asia, the primary manufacturers of footwear; and the continued favorable trade relations between the United States and China and the other countries which are the major manufacturers of footwear. See ITEM 1A. RISK FACTORS of this report.

General

Shoe Carnival, Inc. is one of the nation's largest family footwear retailers. We offer customers a broad assortment of moderately priced dress, casual and athletic footwear for men, women and children with emphasis on national and regional name brands. We differentiate ourselves from our competitors by our distinctive, highly promotional in-store marketing effort and large stores that average 11,300 square feet, generate an average of approximately \$2.4 million in annual sales and carry an average inventory of approximately 29,000 pairs of shoes per location. As of February 2, 2008, we operated 291 stores in 27 states primarily in the Midwest, South and Southeast regions of the United States.

We make available free of charge through the Investor Relations portion of our website at www.shoecarnival.com our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

Our annual report on Form 10-K as filed with the Securities and Exchange Commission is available without charge to shareholders, investment professionals and securities analysts upon written request. Requests should be directed to Investor Relations at the corporate address.

We are an Indiana corporation that was initially formed in Delaware in 1993 and reincorporated in Indiana in 1996.

Business Strategy

Our goal is to continue to grow our net sales and earnings by strengthening our position as the logical destination store for our customers' footwear needs. Key elements of our business strategy are as follows.

We offer a distinctive shopping experience. Our stores combine competitive pricing with a highly promotional, in-store marketing effort that encourages customer participation and creates a fun and exciting shopping experience. We promote a high-energy retail environment by decorating with bright lights and bold colors, and by featuring a stage and barker as the focal point in each store. With a microphone, this barker, or "mic-person", announces current specials, organizes contests and games, and assists and educates customers with the features and location of merchandise. Our mic-person offers limited-duration promotions throughout the day, encouraging the customers to take immediate advantage of our value pricing. We believe this highly promotional atmosphere results in various competitive advantages, including increased multiple unit sales; the building of a loyal, repeat customer base; the creation of word-of-mouth advertising; and enhanced sell through of in-season goods.

We offer a broad merchandise assortment. Our objective is to be the destination store-of-choice for a wide range of consumers seeking moderately priced, current season name brand and private label footwear. Our product assortment includes dress and casual shoes, sandals, boots and a wide assortment of athletic shoes for the entire family. The average store carries approximately 29,000 pairs of shoes in four general categories - men's, women's, children's and athletics. In addition to footwear, our stores carry selected accessory items complementary to the sale of footwear. We emphasize name brand merchandise to customers with creative signage and by prominently displaying selected brands on end caps, focal walls and within the aisles. These displays may highlight a product offering of a single vendor, highlight sales promotions, advertise promotional pricing to meet or beat competitors' sale prices or may make a seasonal or lifestyle statement by highlighting similar footwear from multiple vendors. These visual merchandising techniques make it easier for customers to shop and focus attention on key name brands. Expenses for signage and visual displays highlighting a particular brand will often be partially or fully reimbursed by the vendor.

We believe that by offering a wide selection of both athletic and non-athletic footwear, we are able to reduce our exposure to shifts in fashion preferences between those categories. Our ability to identify and react to fashion changes is a key factor in our sales and earnings performance.

We offer value to our customers. Our marketing effort targets moderate income, value conscious consumers seeking name brand footwear for all age groups. We believe that by offering a wide selection of popular styles of name brand merchandise at competitive prices, we generate broad customer appeal. Additionally, the time conscious customer appreciates the convenience of one stop shopping for the entire family. We also believe our highly promotional in-store shopping environment contributes to a reputation of value pricing throughout the store.

We maintain an efficient store level cost structure. Our cost efficient store operations and real estate strategy enable us to price products competitively. Low labor costs are achieved by housing merchandise directly on the selling floor in an open stock format, enabling customers to serve themselves, if they choose. This reduces the staffing required to assist customers and reduces store level labor costs as a percentage of sales. We prefer to locate stores predominantly in strip shopping centers in order to take advantage of lower occupancy costs and maximize our exposure to value oriented shoppers.

We rely heavily on information technology. We have invested significant resources in information technology. Our proprietary inventory management and state-of-the-art point-of-sale ("POS") systems provide corporate management, buyers and store managers with the timely information necessary to monitor and control all phases of operations. The POS provides, in addition to other features, full price management (including price look-up), promotion tracking capabilities (in support of the spontaneous nature of the in-store price promotions), real-time sales and gross margin analysis by product category at the store level and customer tracking. Using the POS, store managers are able to monitor sales and gross profit margins on a real-time basis throughout the day.

Reacting to sales trends, our mic-people use POS reports to choose from among a number of product promotions supplied by our centralized merchandising staff.

Our network connects our corporate office to our distribution center and retail stores via a wide area network, providing up-to-date sales and inventory information as required. Our data warehouse enables the merchandising staff to analyze sales, margin and inventory levels by store, by day, down to the size of shoe. Using this information, our merchandise managers meet regularly with vendors to compare their product sales, gross margins and return on inventory investment against previously stated objectives. We believe timely access to key business data has enabled us in the past to drive annual comparable store sales increases, manage our markdown activity and improve inventory turnover.

Growth Strategy and Store Location

We plan to continue to grow our store base in order to strengthen our position as a leading specialty branded footwear retailer. Aside from comparable store sales increases, the majority of our sales and earnings growth is expected to be generated by the opening of new stores. In fiscal 2008, we expect to open between 20 and 25 stores. These new stores will be located in large and small markets in both new and existing geographic areas. Our intention is to fill in certain under-penetrated markets with additional stores, thereby increasing the performance of the overall market. We also intend to enter smaller markets that we can fully penetrate with one or two stores. We generally can advertise more effectively in these markets, which helps to create immediate brand awareness. We have adjusted, and will continue to adjust, our annual store growth rate based on our view of internal and external opportunities and challenges. We intend to increase our store growth rate by 10% to 12% in the future, subject to the availability of sufficient real estate and the state of the U.S. economy.

Critical to the success of opening new stores in larger markets or geographic areas is our ability to cluster stores. In larger markets (populations greater than 400,000), clustering involves opening two or more stores at approximately the same time, and in smaller markets that can only support a single store, clustering involves seeking locations in reasonably close proximity to other existing markets. This strategy creates cost efficiencies by enabling us to leverage store expenses with respect to advertising, distribution and management costs. We believe the advantages of clustering stores in existing markets will lead to cost efficiencies and overall incremental sales gains that should more than offset any adverse effect on sales of existing stores.

The number of stores opened and closed during fiscal years 2007, 2006 and 2005 were as follows:

Fiscal Year	2007	2006	2005
Stores open at beginning of year	271	263	255
Opened during year	25	14	15
Closed during year	5	6	7
Stores open at end of year	291	271	263

On February 2, 2008, we had 291 stores located in 27 states, primarily in the Midwest, South and Southeast regions of the United States. We prefer strip shopping center locations where occupancy costs are typically lower and we enjoy greater operating freedom to implement our non-traditional retail methods. We feel that our target customers enjoy the convenience offered by strip shopping centers as opposed to enclosed malls. Our stores averaged approximately 11,300 square feet, ranging in size from 6,400 to 26,500 square feet. Our current store prototype utilizes between 8,000 and 12,000 square feet, depending upon, among other factors, the location of the store and the population base the store is expected to service. The sales area of most stores is approximately 85% of the gross store size.

All of our stores are leased rather than owned. We believe the flexibility afforded by leasing allows us to avoid the inherent risks of owning real estate, particularly with respect to under-performing stores. Before entering a new market, we perform a market, demographic and competition analysis to evaluate the suitability of the potential market. Potential store site selection criteria include, among other factors, market demographics, traffic counts, the tenant mix of a potential strip shopping center, visibility within the center and from major thoroughfares, overall retail activity of the area and proposed lease terms. The time required to open a store after signing a lease depends primarily upon the landlord's ability to deliver the premises. After we accept the premises from the

landlord in turnkey condition, we can generally open a store within 60 days.

Merchandising and Pricing

Our merchandising strategy is designed to provide a large selection of moderately priced footwear for the entire family. Our stores carry an average of approximately 29,000 pairs of shoes featuring a broad assortment of current-season name brand footwear, supplemented with private label merchandise and select name brand closeouts. Our stores also carry complementary accessories such as handbags, shoe care items and socks. The mix of merchandise and the brands offered in a particular store are based upon the demographics of each market, among other factors.

Our pricing strategy is designed to emphasize value. By combining current season name brand product with promotional pricing, we feel that we create a better value for customers. Initial pricing decisions are guided by gross profit margin targets, which vary by merchandise category and depend on whether the item is name brand or private label merchandise. Markdowns are centrally managed by the buying staff and communicated to the stores through information systems as needed.

The table below sets forth our percentage of sales by product category for fiscal years 2007, 2006 and 2005.

Fiscal Year	2007	2006	2005
Women's	27%	27%	25%
Men's	15	15	15
Children's(1)	17	17	16
Athletics (2)	37	37	40
Accessories and Miscellaneous Items	4	4	4
	100%	100%	100%

(1) Children's includes children's athletic shoes.

(2) Includes men's and women's sizes only.

Women's, men's and children's non-athletic footwear categories are further divided into dress, casual, sport, sandals and boots. Athletic shoes are classified by functionality, such as running, basketball or fitness shoes. In fiscal 2007, athletic styles, including children's sizes, represented approximately half of our footwear sales.

One of our major goals is to improve our operating margins. We are focused on improving our operating margins by increasing our gross margin and to a lesser extent leveraging general and administrative expenses against a higher sales base. An opportunity to increase our gross margin is to increase women's non-athletic sales as a percentage of our total business. Women's product has historically achieved the highest gross margin. Our women's non-athletic product represented 27 percent of our total sales in fiscal years 2007 and 2006, an increase of two percentage points from fiscal 2005. We expect to achieve our goal of 28 to 30 percent of our total sales being generated by women's dress and casual merchandise over the next two years.

Advertising and Promotion

We use various forms of media advertising to communicate the exceptional values offered on specific shoes or entire product categories. Approximately 58% of our total advertising budget was directed to television and radio in fiscal 2007. Print media (including newspaper ads, inserts and direct mail) and outdoor advertising accounted for the balance of the budget. A special effort is made to utilize the cooperative advertising dollars offered by vendors whenever possible. Major promotions during grand openings and peak selling periods allow customers to win prizes such as gift cards, merchandise or cash.

In-store promotions are a key element in our marketing effort. By utilizing both planned and impromptu contests and games, store managers create an environment that encourages customer interaction with store personnel. For example, a customer is enticed to purchase additional merchandise by winning an on-the-spot discount. Promotions of this type exemplify our emphasis on fun and excitement in order to enhance our customers' total shopping experience.

We strive to make each store opening a major retail event. Grand openings feature contests and giveaways of cash and prizes. We believe our grand openings help to establish the high-energy, promotional atmosphere that develops a loyal, repeat customer base and generates word-of-mouth advertising.

Distribution

During the fourth quarter of fiscal 2006 and the first quarter of fiscal 2007, we converted our distribution and warehousing functions to our new 410,000 square foot distribution center, located in Evansville, Indiana. This facility is leased from a third party and can support the processing and distribution needs of a minimum of 460 stores to facilitate future growth. We negotiated in our lease the right to expand into a designated expansion area as long as we provide 120 days written notice to the property owner. Expansion under this option would provide us the processing capacity to support a total of approximately 650 stores.

The new distribution center is equipped with state-of-the-art processing and product movement equipment. The facility utilizes cross docking/store replenishment and redistribution methods to fill store product requirements. These methods may include count verification, price and bar code labeling of each unit (when not performed by the manufacturer), redistribution of an order into size assortments (when not performed by the manufacturer) and allocation of shipments to individual stores. Throughout packing, allocating, storing and shipping, our distribution process is essentially paperless. Merchandise is typically shipped to each store one time per week. The majority of shipments are handled by a dedicated carrier, with occasional use of common carriers.

In February 2006, we sold our former 200,000 square foot distribution center, located in Evansville, Indiana, to a third party and entered into a leaseback arrangement with the landlord to continue operations of this facility. On March 1, 2007, we relinquished all of our rights to the facility to the landlord. See our Notes to Consolidated Financial Statements, Note 6 □ "Leases" included in PART II, ITEM 8 of this report for further details on the sale and leaseback of the facility.

Buying Operations

Maintaining fresh, fashionable merchandise is critical to our success. Our buyers stay in touch with evolving trends by shopping fashion-leading markets, attending national trade shows, gathering vendor input and monitoring the current styles shown in leading fashion and lifestyle magazines. Management of the purchasing function is the responsibility of our Executive Vice President - General Merchandise Manager. Store operations personnel are expected to provide input to our merchandising staff regarding market specific fashion trends.

We purchase merchandise from over 170 footwear vendors. In fiscal 2007, two suppliers, Nike USA, Inc. and Skechers USA, Inc., each accounted for over 10% of our net sales and together accounted for over 28% of our net sales. A loss of any of our key suppliers in certain product categories could have a material adverse effect on our business. As is common in the industry, we do not have any long-term contracts with suppliers.

Competition

The retail footwear business is highly competitive. We believe the principal competitive factors in our industry are merchandise selection, price, fashion, quality, location, store environment and service. We compete primarily with department stores, shoe stores, sporting goods stores and mass merchandisers.

We compete with most department stores and traditional shoe stores by offering lower prices. We compete with off-price retailers, mass merchandisers and discount stores by offering a wider and deeper selection of merchandise.

Many of our competitors are significantly larger and have substantially greater financial and other resources. However, we believe that our distinctive retail format, in combination with our wide merchandise selection, competitive prices and low operating costs, have in the past enabled us to compete effectively.

Store Operations

Management of store operations is the responsibility of our Executive Vice President - Store Operations, who is assisted by the Senior Vice President - Store Operations, divisional managers, regional managers and the individual store general managers. In general, each store has a general manager and up to three assistant managers, depending on sales volume. Store operations personnel are charged with making certain merchandising decisions necessary to maximize sales and profits primarily through merchandise placement, signage and timely clearance of slower selling items. Administrative functions are centrally controlled from the corporate headquarters. These functions include accounting, purchasing, store maintenance, information systems, advertising, human resources, distribution and pricing.

Employees

At February 2, 2008, we had approximately 4,300 employees, of which approximately 2,500 were employed on a part-time basis. The number of employees fluctuates during the year primarily due to seasonality. None of our employees are represented by a labor union.

We attribute a large portion of our success in various areas of cost control to our inclusion of virtually all management level employees in incentive compensation plans. We contribute all or a portion of the cost of medical, disability and life insurance coverage for those employees who are eligible to participate in company-sponsored plans. Additionally, we sponsor a 401(k) retirement plan that is open to all employees who have met the minimum age and workhour requirements. All employees are eligible to receive discounts on purchases from our stores. We consider our relationship with our employees to be satisfactory.

Seasonality

Our quarterly results of operations have fluctuated, and are expected to continue to fluctuate in the future, primarily as a result of seasonal variances and the timing of sales and costs associated with opening new stores. Non-capital expenditures, such as advertising and payroll, incurred prior to the opening of a new store are charged to expense as incurred. Therefore, our results of operations may be adversely affected in any quarter in which we incur pre-opening expenses related to the opening of new stores.

We have three distinct peak selling periods: Easter, back-to-school and Christmas.

Trademarks

We own the following federally registered trademarks and servicemarks: Shoe Carnival®, The Carnival®, Donna Lawrence®, Oak Meadow®, Victoria Spenser®, Via Nova®, Innocence®, Trade Dress®, Carnival Lites® and Color Block Design®. We believe these marks are valuable and, accordingly, we intend to maintain the marks and the related registrations. We are not aware of any pending claims of infringement or other challenges to our right to use these marks.

ITEM 1A. RISK FACTORS

You should carefully consider the following risk factors and all other information contained in this annual report before making an investment decision with respect to our common stock. Investing in our common stock involves a high degree of risk. If any of the following risks actually occur, we may not be able to conduct our business as currently planned and our financial condition and operating results could be seriously harmed. See ITEM 1. BUSINESS - "Forward-Looking Statements" of this report.

We may not be able to successfully execute our growth strategy, which could have a material adverse effect on our business, financial condition and results of operations. We intend to open new stores as a part of our growth strategy. We may not be able to open all of the new stores contemplated by our growth strategy and the new stores that we open may not be as profitable as existing stores.

The complexity of our operations and management responsibilities will increase as we grow. Our growth strategy requires that we continue to expand and improve our operating and financial systems and to expand, train and manage our employee base. In addition, as we open new stores, we may be unable to hire a sufficient number of qualified store personnel or successfully integrate the new stores into our business.

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The success of our growth strategy will depend on a number of other factors, many of which are out of our control, including, among other things:

- our ability to locate suitable store sites and negotiate store leases (for new stores and renewals) on favorable terms;
- the acceptance of the Shoe Carnival concept in new markets;
- the availability of financing for capital expenditures and working capital requirements;
- our ability to provide adequate distribution to support growth;
- our ability to source sufficient levels of inventory to meet the needs of new stores;
- particularly in new markets, our ability to open a sufficient number of new stores to provide the critical mass needed for efficient advertising and effective name recognition;
- our ability to improve costs and timing associated with opening new stores; and
- the impact of new stores on sales or profitability of existing stores in the same market.

Due to the risks involved, we may be unable to open new stores at the rates expected. If we fail to successfully implement our growth strategy, it could have a material adverse effect on our business, financial condition or results of operations.

A failure to increase sales at our existing stores may adversely affect our stock price and impact our results of operations. A number of factors have historically affected, and will continue to affect, our comparable store sales results, including:

- competition;
- timing of holidays including sales tax holidays;
- general regional and national economic conditions;
- inclement weather;
- consumer trends, such as less disposable income due to the impact of higher gasoline prices;
- fashion trends;
- changes in our merchandise mix;
- our ability to distribute merchandise efficiently to our stores;
- timing and type of, and customer response to, sales events, promotional activities or other advertising;
- the effectiveness of our inventory management;
- new merchandise introductions; and
- our ability to execute our business strategy effectively.

Our comparable store sales results have fluctuated in the past, and we believe such fluctuations may continue. The unpredictability of our comparable store sales may cause our revenue and results of operations to vary from quarter to quarter, and an unanticipated decline in revenues or operating income may cause our stock price to fluctuate significantly.

We depend on our key suppliers for merchandise and advertising support and the loss of key suppliers could adversely affect our business. Our business depends upon our ability to purchase fashionable, name brand and other merchandise at competitive prices from our suppliers. In fiscal 2007, two branded suppliers, Nike USA, Inc. and Skechers USA, Inc., collectively accounted for over 28% of our net sales. Name brand suppliers also provide us with cooperative advertising and visual merchandising funds. A loss of any of our key suppliers in certain product categories or our inability to obtain name brand or other merchandise from suppliers at competitive prices could have a material adverse effect on our business. As is common in the industry, we do not have any long-term contracts with our suppliers.

An increase in the cost or a disruption in the flow of our imported goods may decrease our sales and profits. We rely on imported goods to sell in our stores. Substantially all of the footwear product we sell is manufactured overseas, including the merchandise we import directly from overseas manufacturers and agents and the merchandise we purchase from domestic vendors. The primary footwear manufacturers are located in China, Brazil, Spain and East Asia. A disruption in the flow of imported merchandise or an increase in the cost of those goods may decrease our sales and profits. In addition, we do not control our vendors or their labor and business practices. The violation of labor or other laws by one of our vendors could have an adverse affect on our business.

If imported merchandise becomes more expensive or unavailable, the transition to alternative sources may not occur in time to meet our demands. Products from alternative sources may be of lesser quality and more expensive than those we currently import. Other risks associated with our use of imported goods include: disruptions in the flow of imported goods because of factors such as electricity or raw material shortages, work stoppages, strikes and political unrest; problems with oceanic shipping, including shipping container shortages; economic crises and international disputes; currency exchange rate fluctuations; increases in the cost of purchasing or shipping foreign merchandise resulting from the failure to maintain normal trade relations with source countries; import duties, import quotas and other trade sanctions; and increases in shipping rates imposed by the trans-Pacific shipping cartel.

Our failure to identify fashion trends could result in lower sales, higher markdowns and lower gross profits. Our success depends upon our ability to anticipate and react to the fashion tastes of our customers and provide merchandise that satisfies customer demand. Our failure to anticipate, identify or react appropriately to changes in consumer fashion preferences may result in lower sales, higher markdowns to reduce excess inventories and lower gross profits. Conversely, if we fail to anticipate or react to consumer demand for our products, we may experience inventory shortages, which would result in lost sales and could negatively impact our customer goodwill, our brand image and our profitability. Moreover, our business relies on continuous changes in fashion preferences. Stagnating consumer preferences could also result in lower sales and would require us to take higher markdowns to reduce excess inventories.

Our failure to retain our existing senior management team and to continue to attract qualified personnel could adversely affect our business. Our success depends to a large extent on the continued service of our executive management team. Departures by executive officers could have a negative impact on our business, as we may not be able to find suitable management personnel to replace departing executives on a timely basis. Furthermore, our strategy requires us to continue to train, motivate and manage our employees and to attract, motivate and retain additional qualified managerial and merchandising personnel. Competition for these types of personnel is intense, and we cannot assure you that we will be successful in attracting, assimilating and retaining the personnel required to grow and operate our business profitably.

We face significant competition in our markets and we may be unable to compete favorably. The retail footwear industry is highly competitive. We compete primarily with department stores, shoe stores, sporting goods stores and mass merchandisers. Many of our competitors are significantly larger and have substantially greater financial and other resources than we do. Economic pressures on or bankruptcies of our competition could result in increased pricing pressures. This competition could adversely affect our results of operations and financial condition in the future.

We will require significant funds to implement our growth strategy and meet our other liquidity needs. We cannot assure you that we will be able to generate sufficient cash flow from operations or obtain sufficient borrowings under our existing credit agreement to finance our growth strategy and meet our other liquidity needs. In fiscal 2008, capital expenditures are expected to range from \$12 million to \$14 million. Our actual costs

may be greater than anticipated. We also require working capital to support inventory for our existing stores. Failure to generate or raise sufficient funds may require us to modify, delay or abandon some of our future growth or expenditure plans. In addition, our results could be adversely affected if interest rates materially increase from present levels.

Poor economic conditions affect consumer spending and may significantly harm our business. The success of our business depends to a significant extent upon the level of consumer spending. A number of factors may affect the level of consumer spending on merchandise that we offer, including, among other things:

- general economic, industry and weather conditions;
- energy costs, which affect gasoline and home heating prices;
- the level of consumer debt;
- consumer credit availability;
- interest rates;
- tax rates and policies;
- unemployment trends;
- war, terrorism and other hostilities; and
- consumer confidence in future economic conditions.

Adverse economic conditions and any related decrease in consumer demand for discretionary items could have a material adverse effect on our business, results of operations and financial condition. The merchandise we sell generally consists of discretionary items. Reduced consumer confidence and spending may result in reduced demand for discretionary items and may force us to take inventory markdowns. Reduced demand may also require increased selling and promotional expenses.

We would be adversely affected if our distribution or information technology operations were disrupted. We currently operate a single, 410,000 square foot distribution center in Evansville, Indiana. Virtually all merchandise received by our stores, with the exception of a small amount of goods shipped directly to the stores, is and will be shipped through our distribution center. Our corporate computer network is essential to our distribution process. If our distribution center is shut down for any reason, such as a natural disaster, power outage or terrorist attack, or if our information technology systems do not operate effectively, or if we are the target of attacks or breaches, we could incur significantly higher costs and longer lead times associated with distributing our products to our stores. Our insurance only covers costs relating to specified, limited matters such as a shutdown due to fire and windstorms, but does not cover other events such as acts of war or terrorist attacks. Even in the event of a shutdown due to covered matters, we cannot assure you that our insurance will be sufficient, or that the insurance proceeds will be paid to us in a timely fashion. Shutdowns or information technology disruptions could have an adverse effect on our operating and financial performance.

In addition, our stores process debit and credit card transactions. We believe we have established appropriate controls to protect our customers' personal confidential information gathered when a debit or credit card is utilized. However, in the event that such confidential information is misused or obtained by an unauthorized third party, we could be subject to negative publicity that could harm our business, as well as have a material adverse effect on our financial conditions or results of operations.

Failure to maintain effective internal control over financial reporting could result in a loss of investor confidence in our financial reports and have a material adverse effect on our stock price. We must continue to document, test and evaluate our internal control over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, which requires annual reports by management regarding the effectiveness of our internal control over financial reporting and a report by our independent registered public accounting firm attesting to management's assessment and the effectiveness of our internal

controls. We have expended, and expect that we will continue to expend, significant management time and resources documenting and testing our internal control over financial reporting. If we conclude in future periods that our internal control over financial reporting is not effective, it could result in lost investor confidence in the accuracy, reliability and completeness of our financial reports. Any such events could have a material adverse effect on our stock price.

We are controlled by our principal shareholder. J. Wayne Weaver, our Chairman of the Board of Directors and principal shareholder, his spouse and an adult child together own approximately 28.4% of our outstanding common stock. Accordingly, Mr. Weaver is able to exert substantial influence over our management and operations. In addition, his interests may differ from or be opposed to the interests of our other shareholders, and his control may have the effect of delaying or preventing a change in control that may be favored by other shareholders.

Our stock price may be volatile and could decline substantially. The stock market has, from time to time, experienced extreme price and volume fluctuations. Many factors may cause the market price for our common stock to decline, including:

- operating results failing to meet the expectations of securities analysts or investors in any quarter;
- downward revisions in securities analysts' estimates;
- material announcements by us or our competitors; and
- the other risk factors cited in this annual report.

In the past, companies that have experienced volatility in the market price of their stock have been the subject of securities class action litigation. If we become involved in a securities class action litigation in the future, it could result in substantial costs and diversion of management attention and resources, thus harming our business.

Our quarterly operating results will fluctuate due to seasonality and other factors. Our quarterly results of operations have fluctuated in the past and can be expected to continue to fluctuate in the future. Our quarterly results of operations are affected by a variety of factors, including:

- fashion trends;
- calendar shifts of holiday or seasonal periods;
- the effectiveness of our inventory management;
- weather conditions;
- timing of opening of new stores;
- changes in general economic conditions and consumer spending patterns; and
- actions of competitors or co-tenants.

We have three distinct peak selling periods: Easter, back-to-school and Christmas. To prepare for our peak shopping seasons, we must order and keep in stock significantly more merchandise than we would carry during other parts of the year. Any unanticipated decrease in demand for our products during these peak shopping seasons could require us to sell excess inventory at a substantial markdown, which could reduce our net sales and gross margins and negatively impact our profitability. Our operating results depend significantly upon the sales generated during these periods. If our future quarterly results fail to meet the expectations of research analysts, then the market price of our common stock could decline substantially.

Provisions of our organizational documents and Indiana law might deter acquisition bids for us. Our Restated Articles of Incorporation and Indiana corporate laws contain provisions that may discourage other persons from attempting to acquire control of us, including, without limitation, a Board of Directors that has

staggered terms for its members, supermajority voting provisions, restrictions on the ability of shareholders to call a special meeting of shareholders and procedural requirements in connection with shareholder proposals or director nominations. The Board of Directors has the authority to issue preferred stock in one or more series without the approval of the holders of our common stock. Further, Indiana corporate law contains business combination provisions that, in general, prohibit for five years any business combination with a beneficial owner of more than 10% or more of our common stock unless the holder's acquisition of the stock was approved in advance by our Board of Directors. Indiana corporate law also contains control share acquisition provisions that limit the ability of certain shareholders to vote their shares unless their control share acquisition is approved. In certain circumstances, the fact that corporate devices are in place that inhibit or discourage takeover attempts could reduce the market value of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease all existing stores and intend to lease all future stores. All leases for existing stores provide for fixed minimum rentals and most provide for contingent rental payments based upon various specified percentages of sales above minimum levels. Certain leases also contain escalation clauses for increases in minimum rentals, operating costs and taxes.

The following table identifies the number of our stores in each state as of February 2, 2008:

State	#	State	#
Alabama	11	Missouri	18
Arkansas	8	Mississippi	6
Colorado	6	North Carolina	13
Florida	23	North Dakota	1
Georgia	13	Ohio	17
Idaho	2	Oklahoma	6
Iowa	6	Pennsylvania	2
Illinois	28	South Carolina	12
Indiana	20	South Dakota	1
Kansas	3	Tennessee	17
Kentucky	12	Texas	32
Louisiana	11	Virginia	10
Michigan	6	Wisconsin	3
		West Virginia	4
		Total Stores	291

In February 2006, we sold our combined distribution center and corporate headquarters for \$7.2 million and recorded a loss of approximately \$55,000 including legal fees and associated selling costs. We entered into a lease to continue operations in this combined facility on a month-to-month basis. In March and June 2007, we relinquished our rights to the distribution center and corporate headquarters, respectively.

In February 2006, we entered into an operating lease with an independent third-party to lease our new distribution center. The lease has an initial term of 15 years, commencing on December 1, 2006. We have the right to extend the initial lease term for up to three additional periods of five years each.

In June 2006, we entered into an operating lease with an independent third-party to lease our new corporate headquarters for an initial term of 15 years, commencing on June 1, 2007. We have the right to extend the initial lease term for up to three additional periods of five years each.

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For additional information with respect to our properties, see ITEM 1. BUSINESS □ "Growth Strategy and Store Location" and "Distribution" as well as PART II, ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS □ "Executive Summary" of this report.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various legal proceedings incidental to the conduct of our business. While the outcome of any legal proceeding is always uncertain, we do not currently expect that any such proceedings will have a material adverse effect on our financial position or results of operations.

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

We did not submit any matters to a vote of security holders during the fourth quarter of the 2007 fiscal year.

Executive Officers

Name	Age	Position
J. Wayne Weaver	73	Chairman of the Board and Director
Mark L. Lemond	53	President, Chief Executive Officer and Director
Timothy T. Baker	51	Executive Vice President - Store Operations
		Executive Vice President - Chief Financial Officer and
W. Kerry Jackson	46	Treasurer
Clifton E. Sifford	54	Executive Vice President - General Merchandise Manager

Mr. Weaver is Shoe Carnival's largest shareholder and has served as Chairman of the Board since March 1988. From 1978 until February 2, 1993, Mr. Weaver had served as president and chief executive officer of Nine West Group Inc., a designer, developer and marketer of women's footwear. He has over 40 years of experience in the footwear industry. Mr. Weaver is a former director of Nine West Group, Inc. Mr. Weaver serves as chairman and chief executive officer of Jacksonville Jaguars, LTD and chairman and chief executive officer of LC Footwear, LLC.

Mr. Lemond has been employed as President and Chief Executive Officer since September 1996. From March 1988 to September 1996, Mr. Lemond served as Executive Vice President, Chief Financial Officer, Treasurer and Assistant Secretary. On February 3, 1994, Mr. Lemond was promoted to the position of Chief Operating Officer. Mr. Lemond has served as a Director since March 1988. Prior to March 1988, he served in similar officer capacities with Russell's Shoe Biz, Inc. Prior to joining Russell's Shoe Biz, Inc. in 1987, Mr. Lemond was a partner with a public accounting firm. He is a Certified Public Accountant.

Mr. Baker has been employed as Executive Vice President - Store Operations since June 2001. From March 1994 to June 2001, Mr. Baker served as Senior Vice President - Store Operations. From May 1992 to March 1994, Mr. Baker served as Vice President - Store Operations. Prior to that time, he served as one of our regional managers. From 1983 to June 1989, Mr. Baker held various retail management positions with Payless ShoeSource.

Mr. Jackson has been employed as Executive Vice President - Chief Financial Officer and Treasurer since August 2004. From June 2001 to August 2004, Mr. Jackson served as Senior Vice President □ Chief Financial Officer and Treasurer. From September 1996 to June 2001, Mr. Jackson served as Vice President □ Chief Financial Officer and Treasurer. From January 1993 to September 1996, Mr. Jackson served as Vice President - Controller and Chief Accounting Officer. Prior to January 1993, Mr. Jackson held various accounting positions with us. Prior to joining us in 1988, Mr. Jackson was associated with a public accounting firm. He is a Certified Public Accountant.

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Mr. Sifford has been employed as Executive Vice President - General Merchandise Manager since June 2001. From April 13, 1997 to June 2001, Mr. Sifford served as Senior Vice President - General Merchandise Manager. Prior to joining us, Mr. Sifford served as merchandise manager-shoes for Belk Store Services, Inc.

Our executive officers serve at the discretion of the Board of Directors. There is no family relationship between any of our Directors or executive officers.

(Pursuant to General Instruction G (3) of Form 10-K, the foregoing information is included as an unnumbered Item in PART I of this annual report in lieu of being included in our Proxy Statement for our 2008 Annual Meeting of Shareholders.)

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information and Holders

Our common stock has been quoted on The NASDAQ Stock Market, LLC under the trading symbol "SCVL" since March 16, 1993.

The quarterly high and low trading prices for fiscal 2007 and fiscal 2006 were as follows:

Fiscal Year 2007	High	Low
First Quarter	\$ 35.26	\$ 29.09
Second Quarter	30.66	20.28
Third Quarter	23.18	14.26
Fourth Quarter	15.47	10.54
Fiscal Year 2006		
First Quarter	\$ 28.10	\$ 21.70
Second Quarter	29.12	20.39
Third Quarter	29.24	19.25
Fourth Quarter	33.28	25.45

As of March 26, 2008, there were approximately 213 holders of record of our common stock.

No unregistered equity securities were sold by us during fiscal 2007.

Dividends

We have not paid, and do not currently intend to pay, cash dividends on our common stock in the foreseeable future. The payment of any future dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, operations, capital requirements, our general financial condition and general business conditions. In addition, our credit agreement contains certain limitations on the payment of dividends.

Issuer Purchases of Equity Securities

Throughout fiscal 2007 we issued treasury shares to employees for the exercise of stock options and the issuance of restricted stock awards. This included the repurchase of approximately 10,500 shares of common stock as a result of our withholding shares or allowing our employees to deliver shares to us to cover the income taxes resulting from the vesting of certain restricted stock awards. It is our intention to continue to issue treasury shares to employees for the exercise of stock options and the issuance of restricted stock awards.

In fiscal 2006, our Board of Directors authorized a \$50.0 million share repurchase program, which will terminate upon the earlier of the repurchase of the maximum amount or December 31, 2008. As of February 2, 2008, approximately 1.2 million shares had been repurchased at an aggregate cost of \$28.1 million. The amount that remained available under the existing repurchase authorization at February 2, 2008 was \$21.9 million. The following table summarizes repurchase activity during the fourth quarter of fiscal 2007:

Period	Total Number	Average	Total Number	Approximate
	of Shares	Price	Of Shares	Dollar Value
	Purchased	Paid	Purchased as	of Shares
		per	Part of Publicly	that
		Share	Announced	May Yet Be
			Programs	Purchased
				Under the
				Programs
November 4, 2007 to December 1, 2007	0	\$ 0.00	0	\$ 0
December 2, 2007 to January 5, 2008	0	\$ 0.00	0	\$ 0
January 6, 2008 to February 2, 2008	216,307	\$ 11.68	216,307	\$ 21,852,000
	216,307		216,307	

Securities Authorized for Issuance Under Equity Compensation Plans

The information required by this Item concerning securities authorized for issuance under our equity plans has been incorporated by reference into PART III, ITEM 12 of this report.

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ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with our consolidated financial statements and notes to those statements included in PART II, ITEM 8 of this report.

(In thousands, except per share and operating data)

Fiscal years (1)	2007	2006	2005	2004	2003
Income Statement Data:					
Net Sales	\$ 658,680	\$ 681,662	\$ 655,638	\$ 590,186	\$ 557,923
Cost of sales (including buying, distribution and occupancy costs)	472,831	482,888	465,942	422,961	399,713
Gross Profit	185,849	198,774	189,696	167,225	158,210
Selling, general and administrative expenses	166,717	161,144	158,860	146,360	138,178
Operating income	19,132	37,630	30,836	20,865	20,032
Interest income	(690)	(1,235)	(170)	(73)	(15)