

SHOE CARNIVAL INC  
Form 10-Q  
September 10, 2009

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

**Form 10-Q**

- Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended **August 1, 2009**  
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)*

**NOT APPLICABLE**

*(Former name, former address and former fiscal year, if changed since last report)*

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

Yes       No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes       No

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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Number of Shares of Common Stock, \$.01 par value, outstanding at September 4, 2009 were 12,942,563.

**SHOE CARNIVAL, INC.  
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**SHOE CARNIVAL, INC.  
PART I - FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**SHOE CARNIVAL, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
Unaudited**

August 1,                      January 31,                      August 2,

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(In thousands, except per share data)	2009	2009	2008
<b>Assets</b>			
<b>Current Assets:</b>			
Cash and cash equivalents	\$ 17,673	\$ 24,817	\$ 16,659
Accounts receivable	1,948	1,607	1,961
Merchandise inventories	216,728	189,494	208,409
Deferred income tax benefit	2,424	2,305	2,481
Other	7,540	4,234	7,920
<b>Total Current Assets</b>	<b>246,313</b>	<b>222,457</b>	<b>237,430</b>
Property and equipment-net	66,054	70,217	71,014
Other	1,627	400	463
<b>Total Assets</b>	<b>\$ 313,994</b>	<b>\$ 293,074</b>	<b>\$ 308,907</b>
<b>Liabilities and Shareholders' Equity</b>			
<b>Current Liabilities:</b>			
Accounts payable	\$ 73,475	\$ 60,320	\$ 74,953
Accrued and other liabilities	13,712	11,600	14,546
<b>Total Current Liabilities</b>	<b>87,187</b>	<b>71,920</b>	<b>89,499</b>
Deferred lease incentives	5,791	5,844	4,735
Accrued rent	5,155	5,331	5,626
Deferred income taxes	905	1,144	917
Deferred compensation	3,187	2,678	3,395
Other	1,858	1,521	1,410
<b>Total Liabilities</b>	<b>104,083</b>	<b>88,438</b>	<b>105,582</b>
<b>Shareholders' Equity:</b>			
Common stock, \$.01 par value, 50,000 shares authorized, 13,655, 13,664 and 13,664 shares issued at August 1, 2009, January 31, 2009 and August 2, 2008, respectively	137	137	137
Additional paid-in capital	67,428	67,686	72,821
Retained earnings	158,980	153,866	154,308
Treasury stock, at cost, 726, 745 and 1,045 shares at August 1, 2009, January 31, 2009 and August 2, 2008, respectively	(16,634)	(17,053)	(23,941)
<b>Total Shareholders' Equity</b>	<b>209,911</b>	<b>204,636</b>	<b>203,325</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 313,994</b>	<b>\$ 293,074</b>	<b>\$ 308,907</b>

See notes to condensed consolidated financial statements.

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**SHOE CARNIVAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**Unaudited**

(In thousands, except per share data)	Thirteen Weeks Ended August 1, 2009	Thirteen Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 2, 2008
Net sales	\$ 152,840	\$ 158,480	\$ 320,109	\$ 320,599
Cost of sales (including buying, distribution and occupancy costs)	111,916	116,334	232,545	231,373
<b>Gross profit</b>	<b>40,924</b>	<b>42,146</b>	<b>87,564</b>	<b>89,226</b>

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Selling, general and administrative expenses		39,020	40,661	79,076	79,984
Operating income		1,904	1,485	8,488	9,242
Interest income		(1)	(39)	(4)	(76)
Interest expense		42	36	84	69
Income before income taxes		1,863	1,488	8,408	9,249
Income tax expense		881	511	3,294	3,488
Net income	\$	982	\$ 977	\$ 5,114	\$ 5,761
Net income per share:					
Basic	\$	.08	\$ .08	\$ .41	\$ .47
Diluted	\$	.08	\$ .08	\$ .41	\$ .46
Average shares outstanding:					
Basic		12,487	12,367	12,483	12,360
Diluted		12,569	12,463	12,543	12,455

See notes to condensed consolidated financial statements.

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**SHOE CARNIVAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**Unaudited**

(In thousands)	Issued	Common Stock Treasury	Amount	Additional Paid-In Capital	Retained Earnings	Treasur Stock
Balance at January 31, 2009	13,664	(745)	\$ 137	\$ 67,686	\$ 153,866	\$ (17,0
Stock option exercises		5		(93)		1
Stock-based compensation income tax benefit				57		
Employee stock purchase plan purchases		10		(122)		2
Restricted stock awards	(9)	4		(98)		
Stock-based compensation income				(2)		
Net income					5,114	
Balance at August 1, 2009	13,655	(726)	\$ 137	\$ 67,428	\$ 158,980	\$ (16,6

See notes to condensed consolidated financial statements.

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**SHOE CARNIVAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Unaudited**

(In thousands)	Twenty-six Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 2, 2008
Cash Flows From Operating Activities		

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Net income	\$	5,114	\$	5,761
Adjustments to reconcile net income to net cash (used in) provided by operating activities:				
Depreciation and amortization		7,590		8,286
Stock-based compensation		220		559
Loss on retirement and impairment of assets		57		109
Deferred income taxes		(358)		377
Lease incentives		715		174
Other		(320)		(1,135)
Changes in operating assets and liabilities:				
Accounts receivable		(241)		(1,550)
Merchandise inventories		(27,234)		(7,628)
Accounts payable and accrued liabilities		15,045		9,992
Other		(2,538)		(1,164)
Net cash (used in) provided by operating activities		(1,950)		13,781
<b>Cash Flows From Investing Activities</b>				
Purchases of property and equipment		(5,474)		(6,700)
Proceeds from sale of property and equipment		8		2
Proceeds from note receivable		100		0
Net cash used in investing activities		(5,366)		(6,698)
<b>Cash Flows From Financing Activities</b>				
Borrowings under line of credit		0		6,625
Payments on line of credit		0		(6,625)
Proceeds from issuance of stock		106		399
Excess tax benefits from stock-based compensation		66		0
Net cash provided by financing activities		172		399
Net (decrease) increase in cash and cash equivalents		(7,144)		7,482
Cash and cash equivalents at beginning of period		24,817		9,177
Cash and Cash Equivalents at End of Period	\$	17,673	\$	16,659
<b>Supplemental disclosures of cash flow information:</b>				
Cash paid during period for interest	\$	83	\$	66
Cash paid during period for income taxes	\$	180	\$	2,927
Capital expenditures incurred but not yet paid	\$	912	\$	3,092
<b>Supplemental disclosures of non-cash operating and investing activities:</b>				
Forgiveness of accounts payable from litigation settlement <sup>(1)</sup>	\$	1,160	\$	0
Recording of note receivable from litigation settlement <sup>(1)</sup>	\$	1,200	\$	0

<sup>(1)</sup> See Note 5 □ Litigation Matters for details of the settlement. Cumulative settlement served to reduce the value of originally acquired assets.

See notes to condensed consolidated financial statements.

**SHOE CARNIVAL, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Unaudited**

**Note 1 - Basis of Presentation**

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly our financial position and the results of our operations and our cash flows for the

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periods presented. Certain information and disclosures normally included in the notes to consolidated financial statements have been condensed or omitted according to the rules and regulations of the Securities and Exchange Commission (the "SEC"), although we believe that the disclosures are adequate to make the information presented not misleading. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended January 31, 2009.

We determined that certain deposits and pre-paid expenses totaling \$1.6 million as of August 1, 2009 would not be utilized within the next 12 months and should be classified as long-term. Therefore, we have presented these amounts as Other in the long-term section of our condensed consolidated balance sheet. Similar assets in the amount of \$400,000 and \$463,000 as of January 31, 2009 and August 2, 2008, respectively, that had previously been classified as Other within Current Assets have been presented as long-term in the accompanying comparative condensed consolidated balance sheets.

### Note 2 - Net Income Per Share

Net income per share of common stock is based on the weighted average number of shares and common share equivalents outstanding during the period. The following table presents a reconciliation of our basic and diluted weighted average common shares outstanding as required by Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share":

(In thousands)	Thirteen Weeks Ended August 1, 2009	Thirteen Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 2, 2008
Basic shares	12,487	12,367	12,483	12,360
Dilutive effect of stock-based awards	82	96	60	95
Diluted shares	12,569	12,463	12,543	12,455

Options to purchase 410,400 shares of common stock for the second quarter of fiscal 2009 and options to purchase 413,200 shares of common stock for the first six months of fiscal 2009 were not included in the computation of diluted shares because the options' exercise prices were greater than the average market price of our common stock for the period. Options to purchase 227,100 shares of common stock for the second quarter of fiscal 2008 and options to purchase 220,300 shares of common stock for the first six months of fiscal 2008 were not included in the computation of diluted shares because the options' exercise prices were greater than the average market price of our common stock for the period.

### Note 3 □ Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB deferred the implementation of SFAS No. 157 for certain non-financial assets and liabilities for fiscal years beginning after November 15, 2008. We adopted the provisions of SFAS No. 157 for financial assets and liabilities on February 3, 2008 and adopted the provisions of SFAS No. 157 for non-financial assets and liabilities on February 1, 2009. The adoption of SFAS No. 157 did not have a material impact on our condensed consolidated financial statements. See Note 6 □ "Fair Value Measurements" to our notes to condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" ("SFAS No. 141R"). SFAS No. 141R requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the acquired business at the acquisition date, measured at their full fair values as of that date. We adopted the provisions of SFAS No. 141R on February 1, 2009. The adoption of SFAS No. 141R did not have a material impact on our condensed consolidated financial statements.

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In April 2008, the FASB issued Financial Statement of Position ("FSP") No. FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP No. FAS 142-3"), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, "Goodwill and Other Intangible Assets". FSP No. FAS 142-3 allows an entity to use its own historical experience in renewing or extending similar arrangements, adjusted for specified entity-specific factors, in developing assumptions about renewal or extension used to determine the useful life of a recognized intangible asset. Additional disclosures are required to enable financial statement users to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement. The guidance for determining the useful life of a recognized intangible asset is to be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements are to be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. We adopted the provisions of FSP No. FAS 142-3 on February 1, 2009. The adoption of FSP No. FAS 142-3 did not have a material impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP No. FAS 157-4"). FSP No. FAS 157-4 indicates that when determining the fair value of an asset or liability that is not a Level 1 fair value measurement, an entity should assess whether the volume and level of activity for the asset or liability have significantly decreased when compared with normal market conditions. If the entity concludes that there has been a significant decrease in the volume and level of activity, a quoted price (e.g., observed transaction) may not be determinative of fair value and may require a significant adjustment. The adoption of FSP No. FAS 157-4 during the second quarter of fiscal 2009 did not have a material impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments" ("FSP No. FAS 115-2 and FAS 124-2"). FSP No. FAS 115-2 and FAS 124-2 modifies the requirements for recognizing other-than-temporarily impaired debt securities and changes the existing impairment model for such securities. It also modifies the presentation of other-than-temporary impairment losses and increases the frequency of and expands already required disclosures about other-than-temporary impairment for debt and equity securities. The adoption of FSP No. FAS 115-2 and FAS 124-2 during the second quarter of fiscal 2009 did not have a material impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" ("FSP No. FAS 107-1 and APB 28-1"). FSP No. FAS 107-1 and APB 28-1 requires publicly traded companies, as defined in Opinion No. 28, to disclose the fair value of financial instruments within the scope of FAS No. 107 in interim financial statements, adding to the current requirement to make those disclosures in annual financial statements. This staff position also requires that companies disclose the method or methods and significant assumptions used to estimate the fair value of financial instruments and a discussion of changes, if any, in the method or methods and significant assumptions during the period. The adoption of FSP No. FAS 107-1 and APB 28-1 during the second quarter of fiscal 2009 did not have a material impact on our condensed consolidated financial statements.

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In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS No. 165). SFAS No. 165 sets forth: 1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; 2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and 3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009. Subsequent events were evaluated through September 10, 2009, the date on which the financial statements were issued. This assessment of subsequent events did not reveal the occurrence of any material events or transactions.

### **Note 4 - Stock-Based Compensation**

#### Stock Options

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The following table summarizes the stock option transactions pursuant to the stock-based compensation plans for the twenty-six week period ended August 1, 2009:

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 31, 2009	526,168	\$ 12.77		
Grants	0	0.00		
Forfeited or expired	(8,000)	11.91		
Exercised	(5,000)	4.38		
Outstanding August 1, 2009	513,168	\$ 12.87	3.40	\$ 671
Options outstanding at August 1, 2009, net of estimated forfeitures	511,319	\$ 12.87	3.38	\$ 670
Exercisable at August 1, 2009	479,001	\$ 12.88	3.03	\$ 649

The total fair value at grant date of previously non-vested stock options that vested during the twenty-six week periods ended August 1, 2009 and August 2, 2008 were \$32,000 and \$6,000, respectively.

No stock options were granted during the first half of fiscal 2009. The weighted-average fair value of options granted was \$6.46 during the first half of fiscal 2008. The fair value of options granted during the first half of fiscal 2008 was estimated at grant date using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	2008
Risk free interest rate	3.1%
Expected dividend yield	0.0%
Expected volatility	45.39%
Expected term	5 Years

The risk free interest rate was based on the U.S. Treasury yield curve in effect at the time of the grant. We had not paid and did not anticipate paying cash dividends; therefore, the expected dividend yield was assumed to be zero. Expected volatility was based on the historical volatility of our stock. The expected term of the options was based on our historical option exercise data taking into consideration the exercise and forfeiture patterns of the class of option holders during the option's life.

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The following table summarizes information regarding options exercised:

	Thirteen Weeks Ended August 1, 2009	Thirteen Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 2, 2008
Total intrinsic value <sup>(1)</sup>	\$ 38,000	\$ 0	\$ 38,000	\$ 26,600
Total cash received	\$ 22,000	\$ 0	\$ 22,000	\$ 291,800
Associated excess income tax benefits recorded	\$ 66,000	\$ 0	\$ 66,000	\$ 6,000

(1) Defined as the difference between the market value at exercise and the grant price of stock options exercised.



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The following table summarizes information regarding outstanding and exercisable options at August 1, 2009:

Range of Exercise Price	Number of Options Outstanding	Options Outstanding		Weighted Average Exercise Price	Options Exercisable	
		Weighted Average Remaining Life	Weighted Average Exercise Price		Number of Options Exercisable	Weighted Average Exercise Price
\$ 4.38 - 5.75	56,162	1.33	\$ 4.46	56,162	\$ 4.46	
\$ 8.56 - 12.14	102,585	4.06	\$ 10.36	80,918	\$ 10.05	
\$ 12.67 - 16.30	196,801	4.23	\$ 13.16	184,301	\$ 13.07	
\$ 17.12	157,620	2.67	\$ 17.12	157,620	\$ 17.12	

The following table summarizes information regarding stock-based compensation expense recognized for non-vested options:

	Thirteen Weeks Ended August 1, 2009	Thirteen Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 2, 2008
Stock-based compensation expense before the recognized income tax benefit	\$ 19,000	\$ 22,000	\$ 40,000	\$ 37,000
Income tax benefit	\$ 9,000	\$ 8,000	\$ 16,000	\$ 14,000

As of August 1, 2009, there was approximately \$120,500 of unrecognized compensation expense, net of estimated forfeitures, remaining related to non-vested stock options. This expense is expected to be recognized over a weighted-average period of 1.8 years.

Restricted Stock Awards

The following table summarizes the restricted share transactions for the twenty-six week period ended August 1, 2009:

	Number of Shares	Weighted- Average Grant Date Fair Value
Non-vested at January 31, 2009	434,234	\$ 15.97
Granted	4,284	12.26
Released	(1,034)	12.49
Forfeited	(1,500)	21.64
Non-vested at August 1, 2009	435,984	\$ 15.92

The total fair value at grant date of previously non-vested stock awards that vested during the first half of fiscal 2009 was \$12,900. No previously non-vested stock awards vested during the first half of fiscal 2008. The weighted-average grant date fair values of stock awards granted during the twenty-six week periods ended August 1, 2009 and August 2, 2008 were \$12.26 and \$12.50, respectively.

The following table summarizes information regarding stock-based compensation expense (income) for restricted stock awards:

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	Thirteen Weeks Ended August 1, 2009	Thirteen Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 2, 2008
Stock-based compensation expense (income) before the recognized income tax benefit	\$ 305,000	\$ 296,100	\$ (57,000)	\$ 503,000
Income tax benefit (expense)	\$ 144,000	\$ 101,700	\$ (22,000)	\$ 189,700

The \$57,000 of income recorded during the first half of fiscal 2009 was comprised of compensation expense of \$596,000 offset by income of \$653,000. The income was attributable to the first quarter reversal of the cumulative prior period expense for performance-based awards which now have been deemed by management as not probable of vesting.

As of August 1, 2009, there was approximately \$3.5 million of unrecognized compensation expense remaining related to both the performance-based and service-based non-vested stock awards. The expense is expected to be recognized over a weighted average period of 2.8 years. This incorporates the current assumptions of the estimated requisite service period required to achieve the designated performance conditions for performance-based stock awards.

Cash-Settled Stock Appreciation Rights (SARs)

Cash-settled stock appreciation rights (SARs) were granted to non-executive employees in the fourth quarter of fiscal 2008 such that one-third of the shares underlying the SARs granted would vest and become fully exercisable on each of the first three anniversaries of the date of the grant and were assigned a five-year term from the date of grant. Each SAR entitles the holder, upon exercise, to receive cash in the amount equal to the closing price of our stock on the date of exercise less the exercise price. The maximum amount paid, however, cannot exceed 100% of the exercise price. In accordance with SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"), cash-settled SARs are classified as Accrued and other liabilities on the condensed consolidated balance sheet as of August 1, 2009 and January 31, 2009.

No previously non-vested SARs vested nor were any SARs granted during the first half of fiscal 2009. The total number of non-vested SARs and the weighted-average exercise price at both January 31, 2009 and August 1, 2009 was 157,000 and \$9.72, respectively. The weighted-average remaining contractual term for non-vested SARs at August 1, 2009 was 4.4 years.

SFAS No. 123R requires the fair value of these liability awards be remeasured at each reporting period until the date of settlement. Increases or decreases in compensation expense are recognized over the vesting period, or immediately for vested awards. The weighted-average fair value of outstanding, non-vested SARs awards was \$4.15 as of August 1, 2009. The fair value was estimated using a trinomial lattice model with the following assumptions:

	August 1, 2009
Risk free interest rate yield curve	0.14% - 2.53%
Expected dividend yield	0.0%
Expected volatility	59.34%
Maximum life	4.38 Years
Exercise multiple	1.7
Maximum payout	\$9.72
Employee exit rate	2.2% - 9.0%

The risk free interest rate was based on the U.S. Treasury yield curve in effect at the end of the reporting period. We had not paid and did not anticipate paying cash dividends; therefore, the expected dividend yield was assumed to be zero. Expected volatility was based on the historical volatility of our stock. The exercise multiple

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and employee exit rate are based on historical option data.

The following table summarizes information regarding stock-based compensation expense recognized for SARs:

	Thirteen Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 1, 2009
Stock-based compensation expense before the recognized income tax benefit	\$ 119,000	\$ 222,000
Income tax benefit	\$ 56,000	\$ 87,000

As of August 1, 2009, there was approximately \$390,000 in unrecognized compensation expense related to non-vested SARs. The expense is expected to be recognized over a weighted-average period of 1.38 years.

Employee Stock Purchase Plan

The following table summarizes information regarding stock-based compensation expense recognized for the employee stock purchase plan:

	Thirteen Weeks Ended August 1, 2009	Thirteen Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 2, 2008
Stock-based compensation expense before the recognized income tax benefit <sup>(1)</sup>	\$ 6,000	\$ 9,500	\$ 15,000	\$ 19,000
Income tax benefit	\$ 3,000	\$ 3,300	\$ 6,000	\$ 7,000

(1) Amounts are representative of the 15% discount employees are provided for purchases under the employee stock purchase plan.

**Note 5 - Litigation Matters**

On or about April 22, 2008, an arbitration claim was filed by SDI Industries, Inc. ("SDI") against us with the American Arbitration Association Western Case Management Center in Los Angeles, California, captioned *SDI Industries, Inc. (Claimant and Counter-Respondent) v. Shoe Carnival, Inc. (Respondent and Counterclaimant)*, in which SDI sought payment of \$1.2 million of unpaid retainage, \$700,000 for services not yet billed, plus additional interest and legal fees. The retainage was withheld from progress billings for work performed on our distribution center and was recorded in accrued and other liabilities and fixed assets in our consolidated financial statements. We filed a Counterclaim and Response in this matter, denying SDI's claim, and seeking monetary damages of more than \$3.0 million. We asserted that SDI breached our contract with SDI ("Contract") due to its failure to deliver our distribution center's material handling system pursuant to the specifications of the Contract.

On May 30, 2009, the parties entered into a settlement of the above matter. Under the terms of the settlement, SDI agreed to forego collection of the \$1.2 million in unpaid retainage and to pay us \$1.2 million towards the remediation of the distribution center's material handling system. The \$1.2 million will be paid in installments over seven years and is evidenced by a promissory note secured by a standby letter of credit, renewable annually, in an amount not less than \$200,000 and by a security interest in SDI's accounts receivable. In addition, both parties agreed to the dismissal of all pending claims currently under arbitration. The installment due on the promissory note within the next 12 months has been recorded in Accounts receivable in our consolidated financial statements. The remaining balance of the promissory note is recorded in Other as a non-current asset. SDI remitted the first scheduled payment prior to the due date of July 1, 2009.

Although the investment we made in the distribution center will satisfy our distribution needs throughout fiscal 2009, we have not achieved the productivity that we expect will be required based on our plan for long-term store

growth. We have contracted with another distribution logistics company to provide recommendations to improve throughput and will implement certain of these recommendations in the second half of fiscal 2009 and also possibly in fiscal 2010.

We are involved in various other 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.

**Note 6 - Fair Value Measurements**

As of February 1, 2009, SFAS No. 157 applies to both our financial and non-financial assets and liabilities. Although the adoption of SFAS No. 157 had no impact on our financial position or results of operations, it does result in additional disclosures regarding fair value measurements.

SFAS No. 157 provides guidance for using fair value to measure assets and liabilities and only applies when other standards require or permit the fair value measurement of assets and liabilities. It does not expand the use of fair value measurements. SFAS No. 157 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels.

- Level 1 □ Quoted prices in active markets that are unadjusted and accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 □ Quoted prices for identical assets and liabilities in markets that are not active, quoted prices for similar assets and liabilities in active markets or financial instruments for which significant inputs are observable, either directly or indirectly; and
- Level 3 □ Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

Our financial assets as of August 1, 2009, January 31, 2009, and August 2, 2008 included cash and cash equivalents. We did not have any financial liabilities measured at fair value for these periods. The carrying value of cash and cash equivalents approximates fair value due to its short-term nature and is considered a Level 1 fair value measurement.

The following table summarizes our cash and cash equivalents that are measured at fair value on a recurring basis as of August 1, 2009, January 31, 2009, and August 2, 2008:

(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
<b>As of August 1, 2009</b>				
Cash <sup>(1)</sup>	\$ 9,530	\$ 0	\$ 0	\$ 9,530
Credit and debit card receivables <sup>(2)</sup>	8,143	0	0	8,143
	\$ 17,673	\$ 0	\$ 0	\$ 17,673
<b>As of January 31, 2009</b>				
Cash and short-term investments <sup>(1)</sup>	\$ 20,920	\$ 0	\$ 0	\$ 20,920
Credit and debit card receivables <sup>(2)</sup>	3,897	0	0	3,897
	\$ 24,817	\$ 0	\$ 0	\$ 24,817
<b>As of August 2, 2008</b>				
Cash and short-term investments <sup>(1)</sup>	\$ 7,011	\$ 0	\$ 0	\$ 7,011
Credit and debit card receivables <sup>(2)</sup>	9,648	0	0	9,648
	\$ 16,659	\$ 0	\$ 0	\$ 16,659

(1)

Cash and short-term investments represents cash deposits and short-term investments held with financial institutions. The cash balances held in bank operating accounts are covered by the Federal Deposit Insurance Corporation Transaction Account Guarantee Program. Through the end of the period, non-interest bearing checking accounts and certain low interest transaction accounts are fully guaranteed for the entire amount in the account. To date, we have experienced no loss or lack of access to either invested cash or cash held in our operating accounts. Short-term investments consist of investments in a money market account and commercial paper that accrue interest on a periodic basis.

(2) Our credit and debit card receivables are highly liquid financial assets that typically settle in less than three days. We did not have any fair value measurements for our non-financial assets and liabilities during the quarter or first half of fiscal 2009.

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## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Factors That May Effect Future Results**

This Quarterly Report on Form 10-Q 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; the effects and duration of the current economic downturn and the ailing credit markets; 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. For a more detailed discussion of certain risk factors see the "Risk Factors" section of our Annual Report on Form 10-K for the fiscal year ended January 31, 2009.

### **General**

Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to provide information to assist the reader in better understanding and evaluating our financial condition and results of operations. We encourage you to read this in conjunction with our condensed consolidated financial statements and the notes to those statements included in PART I, ITEM 1. FINANCIAL STATEMENTS of this Quarterly Report on Form 10-Q, as well as our Annual Report on Form 10-K for the fiscal year ended January 31, 2009 as filed with the SEC.

### **Overview of Our Business**

Shoe Carnival, Inc. is one of the nation's largest family footwear retailers. As of August 1, 2009, we operated 314 stores in 29 states primarily in the Midwest, South and Southeast regions of the United States. We offer a distinctive shopping experience, a broad merchandise assortment and value to our customers while maintaining an efficient store level cost structure.

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 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. 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. 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.

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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. 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 locate stores predominantly in strip shopping centers in order to take advantage of lower occupancy costs and maximize our exposure to value-oriented shoppers.

### **Critical Accounting Policies**

It is necessary for us to include certain judgments in our reported financial results. These judgments involve estimates that are inherently uncertain and actual results could differ materially from these estimates. The accounting policies that require the more significant judgments are:

*Merchandise Inventories* - Merchandise inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) method. In determining market value, we estimate the future sales price of items of merchandise contained in the inventory as of the balance sheet date. Factors considered in this determination include, among others, current and recently recorded sales prices, the length of time product has been held in inventory and quantities of various product styles contained in inventory. The ultimate amount realized from the sale of certain product could differ materially from our estimates. We also estimate a shrinkage reserve for the period between the last physical count and the balance sheet date. The estimate for the shrinkage reserve can be affected by changes in merchandise mix and changes in actual shrinkage trends.

*Valuation of Long-Lived Assets* - We review long-lived assets whenever events or circumstances indicate the carrying value of an asset may not be recoverable and annually when no such event has occurred. We evaluate the ongoing value of assets associated with retail stores that have been open longer than one year. When events such as these occur, the assets subject to impairment are adjusted to estimated fair value and, if applicable, an impairment loss is recorded in selling, general and administrative expenses. Our assumptions and estimates used in the evaluation of impairment, including current and future economic trends for stores, are subject to a high degree of judgment and if actual results or market conditions differ from those anticipated, additional losses may be recorded.

*Income Taxes* - We calculate income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109") and account for uncertain tax positions in accordance with Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" an interpretation of Financial Accounting Standards Board ("FASB") Statement No. 109 ("FIN 48"). Under SFAS No. 109, deferred tax assets and liabilities are recognized based on the difference between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the estimated tax rates in effect in the years when those temporary differences are expected to reverse. Under FIN 48, we are required to make many subjective assumptions and judgments regarding our income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations are often complex, ambiguous and change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in the consolidated financial statements.

*Insurance Reserves* - We use a combination of self-insurance and third-party insurance for workers' compensation, employee medical and general liability insurance. These plans have stop-loss provisions that protect us from individual and aggregate losses over specified dollar values. When estimating our self-insured liabilities, we consider a number of factors, including historical claims experience, severity factors, statistical trends and, in certain instances, valuation assistance provided by independent third-parties. We will continue to evaluate our self-insured liabilities and the underlying assumptions on a quarterly basis and make adjustments as needed. The ultimate cost of these claims may be greater than or less than the established accruals. While we

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believe that the recorded amounts are adequate, there can be no assurance that changes to management's estimates will not occur due to limitations inherent in the estimating process. In the event we determine an accrual should be increased or reduced, we will record such adjustments in the period in which such determination is made.

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**Results of Operations Summary Information**

Quarter Ended	Number of Stores			End of Period	Store Square Footage		Comparable Store Sales
	Beginning Of Period	Opened	Closed		Net Change	End of Period	
May 2, 2009	304	10	1	313	78,000	3,413,000	(0.3)%
August 1, 2009	313	2	1	314	6,000	3,419,000	(6.4)%
Year-to-date 2009	304	12	2	314	84,000	3,419,000	(3.3)%
May 3, 2008	291	2	0	293	16,000	3,254,000	(4.9)%
August 2, 2008	293	12	2	303	87,000	3,341,000	(1.0)%
Year-to-date 2008	291	14	2	303	103,000	3,341,000	(3.0)%

Comparable store sales for the periods indicated include stores that have been open for 13 full months prior to the beginning of the period, including those stores that have been relocated or remodeled. Therefore, stores opened or closed during the periods indicated are not included in comparable store sales.

The following table sets forth our results of operations expressed as a percentage of net sales for the periods indicated:

	Thirteen Weeks Ended August 1, 2009	Thirteen Weeks Ended August 2, 2008	Twenty-six Weeks Ended August 1, 2009	Twenty-six Weeks Ended August 2, 2008
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales (including buying, distribution and occupancy costs)	73.2	73.4	72.6	72.2
Gross profit	26.8	26.6	27.4	27.8
Selling, general and administrative expenses	25.6	25.7	24.7	24.9
Operating income	1.2	0.9	2.7	2.9
Interest income	0.0	0.0	0.0	0.0
Interest expense	0.0	0.0	0.1	0.0
Income before income taxes	1.2	0.9	2.6	2.9
Income tax expense	0.6	0.3	1.0	1.1
Net income	0.6%	0.6%	1.6%	1.8%

**Operational Summary**

While consumer spending and the overall economic environment remained challenging in the second quarter of fiscal 2009, we were able to improve our year-over-year gross and operating margins for the second quarter and, therefore, record earnings per share equal to last year. We believe these results demonstrate the strength of our business model and our ability to effectively manage the controllable aspects of our business, particularly operating expenses, inventory, and our marketing and merchandising strategies.

Our net sales declined in the second quarter of fiscal 2009, compared to the prior year, primarily due to a decline in customer traffic. Comparable store sales fell 6.4%. We believe the absence of government stimulus checks,

which were provided to consumers during the second quarter last year, was one of the contributing factors for the decline in traffic. In addition, sales-tax-free holidays in nine of our states shifted from the second quarter, where they were reported in fiscal 2008, into the third quarter this year. The shift in these sales-tax-free holidays, which have historically created a significant incentive for the consumer to shop, accounted for approximately 2% of our comparable store sales decline for the second quarter of fiscal 2009.

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During the first quarter of fiscal 2009, we undertook an aggressive liquidation within our non-athletic categories which positioned us with a fresher product assortment for the second quarter. As a result, we were able to achieve an increase in the average net price and gross margin of our footwear during the second quarter of fiscal 2009 as compared to the prior year. Our per-store inventories at the end of the second quarter were approximately flat as compared to the end of the second quarter of fiscal 2008.

We tightly controlled selling, general and administrative expenses during the second quarter of fiscal 2009. This resulted in year-over-year savings of \$1.7 million, despite opening two new stores during the quarter and operating 11 more stores than the same period last year. Approximately 30% of this savings was due to shifting a portion of our advertising into the third quarter to coincide with the shift in sales-tax-free holidays.

We experienced a favorable start to the third quarter of fiscal 2009, as the consumer responded well to both our athletic and non-athletic product assortments to satisfy their back-to-school needs. While considerable uncertainty remains regarding discretionary spending by consumers after the back-to-school period, we remain optimistic about our sales trend for the third quarter of fiscal 2009. Our management team has been through many economic cycles and we will continue to conservatively manage the controllable aspects of our business until we have better clarity with respect to a sustained economic recovery.

### **Results of Operations for the Second Quarter Ended August 1, 2009**

#### *Net Sales*

Net sales decreased \$5.7 million to \$152.8 million during the second quarter ended August 1, 2009, a 3.6% decrease from the prior year's second quarter net sales of \$158.5 million. The decrease in net sales was due to a comparable store sales decline of 6.4% in addition to the loss of sales from the 13 stores closed since the beginning of the second quarter of last year. Approximately 2% of the comparable store sales decline was attributable to the sales-tax-free holiday shift that occurred in nine of our states. These sales-tax-free holidays shifted from the second quarter, where they were reported in fiscal 2008, into the third quarter this year. This combined decrease was partially offset by an \$8.1 million increase in sales generated by the new stores opened since the beginning of the second quarter of fiscal 2008.

#### *Gross Profit*

Gross profit decreased \$1.2 million to \$40.9 million in the second quarter of fiscal 2009 from gross profit of \$42.1 million in the comparable prior year period. The gross margin in the second quarter of fiscal 2009 increased 0.2% from the same period last year to 26.8%. The merchandise margin increased 0.4%, largely as a result of efforts during the first quarter to liquidate seasonal product and enter the second quarter of fiscal 2009 with a fresher product assortment requiring less promotional pricing. While occupancy costs increased as a result of operating an additional 11 stores at the end of the second quarter of fiscal 2009 compared to the prior year, we were able to more than offset this increase through cost savings initiatives within our buying and distribution functions. However, as a percentage of sales, these costs increased 0.2% relative to the second quarter of fiscal 2008 due to the decrease in net sales.

#### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses decreased \$1.7 million in the second quarter of fiscal 2009 to \$39.0 million, or 25.6% of sales, from \$40.7 million, or 25.7% of sales, in the comparable prior year period. Even though we operated an additional 11 stores at the end of the second quarter of fiscal 2009 compared to the prior year period, we were able to achieve expense savings in a number of store-level categories including supplies, depreciation and advertising. Advertising decreased \$468,000, primarily due to the shift in the sales-tax-free holidays.



Pre-opening costs included in selling, general and administrative expenses were \$153,000, or 0.1% of sales, for the second quarter of fiscal 2009 as compared to \$406,000, or 0.3% of sales, for the second quarter of fiscal 2008. We opened two stores in the second quarter of fiscal 2009 as compared to 12 stores in the second quarter of fiscal 2008.

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Pre-opening costs, such as advertising, payroll and supplies, incurred prior to the opening of a new store are charged to expense in the period they are incurred. The total amount of pre-opening expense incurred will vary by store depending on the specific market and the promotional activities involved.

*Interest (Income) Expense, Net*

We recorded net interest expense of \$41,000 in the second quarter of fiscal 2009 as compared to net interest income of \$3,000 in the second quarter of the prior year. As returns available on short-term investments fell to record lows, we held our excess funds in non-interest bearing deposit accounts to offset bank service fees.

*Income Taxes*

The effective income tax rate for the second quarter of fiscal 2009 increased to 47.3% from 34.3% for the second quarter of fiscal 2008. During the second quarter of both fiscal years, our rate was primarily impacted by the true up of the prior year estimated annual income tax rate.

**Results of Operations for the Six Months Ended August 1, 2009**

*Net Sales*

Net sales decreased \$490,000 to \$320.1 million during the six months ended August 1, 2009, from net sales of \$320.6 million in the comparable prior year period. The decrease in net sales was due to a comparable store sales decline of 3.3% in addition to the loss of sales from the 13 stores closed since the beginning of fiscal 2008. Approximately 1% of the comparable store sales decline was attributable to the sales-tax-free holiday shift that occurred in nine of our states. These sales-tax-free holidays shifted from the second quarter, where they were reported in fiscal 2008, into the third quarter this year. This decrease was offset by a \$17.3 million increase in sales generated by the new stores opened since the beginning of fiscal 2008.

*Gross Profit*

Gross profit decreased \$1.6 million to \$87.6 million in the first six months of fiscal 2009 from gross profit of \$89.2 million in the comparable prior year period. The gross margin in the first half of fiscal 2009 decreased 0.4% from the same period last year to 27.4%. The merchandise margin decreased 0.4%, largely as a result of aggressive liquidation of non-athletic footwear in the first quarter of fiscal 2009. Both as a percentage of sales and in dollars, buying, distribution and occupancy costs remained flat with prior year. While occupancy costs increased on a year-over-year basis as a result of operating additional stores, we were able to offset this increase through cost savings initiatives within our buying and distribution functions.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses decreased \$908,000 to \$79.1 million, or 24.7% of sales, in the first half of fiscal 2009 from \$80.0 million, or 24.9% of sales, in the comparable prior year period. Even though we operated additional stores during the first half of fiscal 2009 compared to the prior year period, we were able to achieve expense savings in a number of store-level categories, including depreciation and advertising. These savings were partially offset by an increase of \$583,000 in employee health care, incentives and benefits.

Pre-opening costs included in selling, general and administrative expenses were \$634,000, or 0.2% of sales, for the first half of fiscal 2009 as compared to \$440,000, or 0.1% of sales, for the first half of fiscal 2008. We opened 12 stores in the first six months of fiscal 2009 as compared to 14 stores in the first six months of fiscal 2008. Pre-opening costs, such as advertising, payroll and supplies, incurred prior to the opening of a new store are charged to expense in the period they are incurred. The total amount of pre-opening expense incurred will vary by store depending on the specific market and the promotional activities involved.

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*Interest (Income) Expense, Net*

We recorded net interest expense of \$80,000 in the first half of fiscal 2009 as compared to net interest income of \$7,000 in the first half of the prior year. As returns available on short-term investments fell to record lows, we held our excess funds for the majority of the first half of fiscal 2009 in non-interest bearing deposit accounts to offset bank service fees.

*Income Taxes*

The effective income tax rate for the first six months of fiscal 2009 increased to 39.2% from 37.7% compared to the same time period in 2008. The annual effective income tax rate is expected to be approximately 39.0%.

**Liquidity and Capital Resources**

Our primary sources of funds are cash flows from operations and borrowings under our revolving credit facility. Our net cash used in operations was \$2.0 million in the first six months of fiscal 2009 as compared to net cash provided by operations of \$13.8 million in the first six months of 2008. The change in operating cash flow, when comparing the two periods of each year, was primarily due to an increase in merchandise inventories, partially offset by related accounts payable. During the second quarter of fiscal 2008, given the adverse economic conditions, we lessened our historical back-to-school build up of inventory levels and as a result reduced our per-store inventories compared to the prior year period thus generating cash flow. We continued to reduce our per-store inventories in the second half of fiscal 2008. For the fiscal 2009 back-to-school season, we followed a more normalized inventory build cycle and did not reduce per-store inventories further on a year-over-year basis. Together with operating an additional 11 stores as compared to the second quarter of fiscal 2008, this increase in per-store inventories resulted in a use of cash in fiscal 2009.

Working capital increased to \$159.1 million at August 1, 2009 from \$147.9 million at August 2, 2008. Approximately \$7.6 million of this increase was attributable to the merchandise inventories required to operate the additional 11 stores open on August 1, 2009 as compared to August 2, 2008. The current ratio at August 1, 2009 was 2.8 as compared to 2.7 at August 2, 2008. We had no interest bearing long-term debt as of the end of either period.

During the first half of fiscal 2009, we expended \$5.5 million in cash for the purchase of property and equipment. Of this expenditure, \$4.3 million was used for new stores, store remodeling and store relocation projects. An additional \$685,000 was used to begin the remediation of our distribution center's material handling system. The remaining capital expenditures were used primarily for information technology and miscellaneous equipment purchases.

We opened 12 new stores during the first half of fiscal 2009 and we anticipate opening an additional four stores during the second half of the year. Capital expenditures of approximately \$4.4 million to \$6.2 million will be made during the second half of fiscal 2009. Our projected capital expenditures include a range of \$300,000 to \$2.3 million for further remediation of our distribution center's material handling system. The actual amount expended at the distribution center will be dictated by the level of remediation effort that can reasonably be undertaken during the second half of fiscal 2009. The remaining capital expenditures will be incurred for the opening of new stores, store remodels and various other store improvements, along with continued investments in technology and normal asset replacement activities. We currently anticipate receiving an additional \$1.1 million in landlord incentives through the end of fiscal 2009. The actual amount of cash required for capital expenditures for store operations depends in part on the number of new stores opened, the amount of lease incentives, if any, received from landlords and the number of stores remodeled. The opening of new stores will be dependent upon, among other things, the availability of desirable locations, the negotiation of acceptable lease terms and general economic and business conditions affecting consumer spending in areas we target for expansion.

Our current store prototype uses 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. For fiscal 2009, our new stores will average proximately 9,700 square feet. Capital expenditures for a new store in fiscal 2009 are expected to average approximately \$341,000 and tenant improvement allowances are expected to average \$94,000. The average inventory investment in a new store is expected to range from \$350,000 to \$500,000 depending on the size and sales expectation of the store and the timing of the new store opening. Pre-opening expenses, such as

advertising, salaries and supplies, are expected to average approximately \$68,000 per store in fiscal 2009.

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We closed two stores during the first half of both fiscal years. We expect to close six stores during the second half of fiscal 2009 as compared to closing nine stores in the second half of fiscal 2008. We will continue to evaluate underperforming stores for possible closing on a routine basis, which may result in the identification of additional store closings for the current or future fiscal years. The timing and actual amount of expense recorded in closing a store can vary significantly depending, in part, on the period in which management commits to a closing plan, the remaining basis in the fixed assets to be disposed of at closing and the amount of any lease buyout.

As of August 1, 2009, our unsecured credit agreement provided for up to \$95.0 million in cash advances and commercial and standby letters of credit. Borrowings under the revolving credit line are based on eligible inventory. The credit agreement contains the following covenants: (1) Total Shareholders' Equity, adjusted for the effect of any share repurchases, will not fall below that of the prior fiscal year-end; (2) the ratio of funded debt plus rent to EBITDA plus rent will not exceed 2.5 to 1.0; (3) total distributions for stock repurchases will not exceed \$50.0 million; and (4) cash dividends will not reduce our Total Shareholders' Equity, adjusted for the effect of any share repurchases, below that of the prior fiscal year-end. We were in compliance with these covenants as of August 1, 2009. Should a default condition be reported, the lenders may preclude additional borrowings and call all loans and accrued interest at their discretion. As of August 1, 2009, there were no cash advances outstanding and letters of credit outstanding were \$12.0 million. The amount available to us for additional borrowings was \$83.0 million as of August 1, 2009.

Our \$50.0 million share repurchase program will terminate on December 31, 2009, unless extended by our Board of Directors. Share repurchases under this authorization may be made in the open market or in privately negotiated transactions. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements and other market conditions. As of August 1, 2009, 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 August 1, 2009 was \$21.9 million. No shares have been repurchased since the fourth quarter of fiscal 2007.

On or about April 22, 2008, an arbitration claim was filed by SDI Industries, Inc. ("SDI") against us with the American Arbitration Association Western Case Management Center in Los Angeles, California, captioned *SDI Industries, Inc. (Claimant and Counter-Respondent) v. Shoe Carnival, Inc. (Respondent and Counterclaimant)*, in which SDI sought payment of \$1.2 million of unpaid retainage, \$700,000 for services not yet billed, plus additional interest and legal fees. The retainage was withheld from progress billings for work performed on our distribution center and was recorded in accrued and other liabilities and fixed assets in our consolidated financial statements. We filed a Counterclaim and Response in this matter, denying SDI's claim, and seeking monetary damages of more than \$3.0 million. We asserted that SDI breached our contract with SDI ("Contract") due to its failure to deliver our distribution center's material handling system pursuant to the specifications of the Contract.

On May 30, 2009, the parties entered into a settlement of the above matter. Under the terms of the settlement, SDI agreed to forego collection of the \$1.2 million in unpaid retainage and to pay us \$1.2 million towards the remediation of the distribution center's material handling system. The \$1.2 million will be paid in installments over seven years and is evidenced by a promissory note secured by a standby letter of credit, renewable annually, in an amount not less than \$200,000 and by a security interest in SDI's accounts receivable. In addition, both parties agreed to the dismissal of all pending claims currently under arbitration. The installment due on the promissory note within the next 12 months has been recorded in Accounts receivable in our consolidated financial statements. The remaining balance of the promissory note is recorded in Other as a non-current asset. SDI remitted the first scheduled payment prior to the due date of July 1, 2009.

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Although the investment we made in the distribution center will satisfy our distribution needs throughout fiscal 2009, we have not achieved the productivity that we expect will be required based on our plan for long-term store growth. We have contracted with another distribution logistics company to provide recommendations as to system upgrades to improve throughput and will implement certain of these recommendations in the second half of fiscal 2009 and also possibly in fiscal 2010.

We anticipate that our existing cash and cash flow from operations, supplemented by borrowings under our revolving credit line, will be sufficient to fund our planned store expansion along with other capital expenditures, any future repurchase of our common stock under our current repurchase plan and working capital requirements for at least the next 12 months.

### **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 opening 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.

### **New Accounting Pronouncements**

Recent accounting pronouncements applicable to our operations are contained in Note 3 □ "Recently Issued Accounting Pronouncements" contained in the Notes to Condensed Consolidated Financial Statements included in PART I, ITEM 1. FINANCIAL STATEMENTS of this Quarterly Report on Form 10-Q.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk in that the interest payable under our credit facility is based on variable interest rates and therefore is affected by changes in market rates. We do not use interest rate derivative instruments to manage exposure to changes in market interest rates. We had no borrowings during the first half of fiscal 2009.

### **ITEM 4. CONTROLS AND PROCEDURES**

Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of August 1, 2009, that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management is continuously seeking to improve the efficiency and effectiveness of our operations and internal controls. This results in refinements to processes throughout the company. As part of our continued strategy to grow our store base and increase capacity, we are in the process of redesigning certain elements of the material handling system in our distribution center. The internal controls impacted by this project are mainly automated and operational in nature. See our Notes to Condensed Consolidated Financial Statements, Note 5 □ "Litigation Matters" included in PART I, ITEM 1. FINANCIAL STATEMENTS of this Quarterly Report on Form 10-Q for further details on this matter. There have been no other changes in our internal control over financial reporting that occurred during the quarter ended August 1, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**SHOE CARNIVAL, INC.**  
**PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The information set forth in Note 5 □ "Litigation Matters" contained in the Notes to Condensed Consolidated Financial Statement included in PART I, ITEM 1. FINANCIAL STATEMENTS of this Quarterly Report on Form 10-Q is incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

You should carefully consider the risks and uncertainties we describe both in this Quarterly Report on Form 10-Q and in the "Risk Factors" section of our Annual Report on Form 10-K for the fiscal year ended January 31, 2009 before deciding to invest in, or retain, shares of our common stock. These are not the only risks and uncertainties that we face. Additional risks and uncertainties that we do not currently know about, we currently believe are immaterial or we have not predicted may also harm our business operations or adversely affect us. If any of these risks or uncertainties actually occur, our business, financial condition, results of operations or cash flows could be materially adversely affected. There have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the fiscal year ended January 31, 2009.

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

The annual meeting of our common shareholders was held June 9, 2009.

**Election of Directors**

William E. Bindley and Kent A. Kleeberger were elected at the annual meeting to serve as our Directors for three-year terms. Mr. Bindley received 10,164,556 votes in favor of his election and 2,226,489 votes were withheld. Mr. Kleeberger received 10,174,047 votes in favor of his election and 2,216,998 votes were withheld.

In addition, the following Directors continue in office until the annual meeting of shareholders in the year indicated:

Mark L. Lemond	2010
J. Wayne Weaver	2011
Gerald W. Schoor	2011

**Other Matters Voted Upon at the Meeting**

The appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2009 was ratified. Votes of 12,371,091 were cast in favor, 18,919 votes were cast against, 1,035 abstentions were recorded, and no broker non-votes were recorded with respect to such ratification.

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**ITEM 6. EXHIBITS**

Exhibit No.	Description	Incorporated by Reference To			Filed Herewith
		Form	Exhibit	Filing Date	
3-A	Restated Articles of Incorporation of Registrant	10-K	3-A	4/25/2002	
3-B	By-laws of Registrant, as amended to date	8-K	3-B	6/12/2009	
4	(i) Amended and Restated Credit Agreement and Promissory Notes dated April 16, 1999, between Registrant and Mercantile Bank National Association, First Union National Bank and Old National Bank	10-K	4(I)	4/29/1999	
	(ii) Amendment to Amended and Restated Credit Agreement and Promissory Notes dated March 24, 2000, between Registrant and Mercantile Bank National Association, First Union National Bank and Old National Bank	10-K	4(II)	4/28/2000	
		10-Q	4(III)	12/12/2000	

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(iii) Second Amendment to Amended and Restated Credit Agreement and Promissory Notes dated November 8, 2000, between Registrant and Firststar Bank N.A., First Union National Bank, Old National Bank and LaSalle Bank National Association			
(iv) Third Amendment to Amended and Restated Credit Agreement and Promissory Notes dated March 18, 2002, between Registrant and U.S. Bank National Association, First Union National Bank, Old National Bank and LaSalle Bank National Association	10-K	4(IV)	4/25/2002
(v) Fourth Amendment to Amended and Restated Credit Agreement and Promissory Notes dated March 12, 2003, between Registrant and U.S. Bank National Association, Wachovia Bank National Association, Old National Bank and LaSalle Bank National Association	10-K	4(V)	5/1/2003
(vi) Fifth Amendment to Amended and Restated Credit Agreement and Promissory Notes dated April 5, 2004, between Registrant and U.S. Bank National Association, Wachovia Bank National Association, Old National Bank and LaSalle Bank National Association	10-K	4(VI)	4/14/2004
(vii) Assignment Agreement dated June 1, 2004 among LaSalle Bank National Association as Assignor, Fifth Third Bank (Southern Indiana) as Assignee, Registrant as Borrower and U.S. Bank National Association as Agent relating to the Amended and Restated Credit Agreement as further amended	10-Q	4(VII)	6/8/2004

**EXHIBITS - Continued**

Exhibit No.	Description	Incorporated by Reference To			Filed Herewith
		Form	Exhibit	Filing Date	
	(viii) Sixth Amendment to Amended and Restated Credit Agreement and Notes dated April 5, 2005, between Registrant and U.S. Bank National Association, Wachovia Bank National Association, Fifth Third Bank (Southern Indiana) and Old National Bank	8-K	4(VIII)	4/11/2005	
	(ix) Seventh Amendment to Amended and Restated Credit Agreement and Notes dated March 31, 2006, between Registrant and U.S. Bank National Association, Wachovia Bank, National Association and Fifth Third Bank	8-K	4(IX)	4/4/2006	
	(x) Eighth Amendment to Amended and Restated Credit Agreement and Notes dated December 15, 2006, between Registrant and U.S. Bank National	8-K	4(X)	12/15/2006	

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	Association, Wachovia Bank, National Association and Fifth Third Bank				
	(xi) Ninth Amendment to Amended and Restated Credit Agreement and Notes dated June 10, 2008, between Registrant and U.S. Bank National Association, Wachovia Bank, National Association and Fifth Third Bank	10-Q	4(XI)	6/11/2008	
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X

**SHOE CARNIVAL, INC.  
SIGNATURE**

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

Date: September 10, 2009

SHOE CARNIVAL, INC.  
(Registrant)

By: /s/ W. Kerry Jackson  
W. Kerry Jackson  
Executive Vice President and  
Chief Financial Officer