

Citi Trends Inc  
Form 10-Q  
May 29, 2009  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

For the quarterly period ended May 2, 2009

OR

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

Commission File Number 000-51315

**CITI TRENDS, INC.**

(Exact name of registrant as specified in its charter)

**DELAWARE**

(State or other jurisdiction of  
incorporation or organization)

**104 Coleman Boulevard  
Savannah, Georgia**

(Address of principal executive offices)

**52-2150697**

(I.R.S. Employer  
Identification No.)

**31408**

(Zip Code)

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Registrant's telephone number, including area code **(912) 236-1561**

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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 the definitions 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

(Do not check if a 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

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

Class	Outstanding at May 15, 2009
Common Stock, \$.01 par value	14,679,929 shares

Table of Contents

**CITI TRENDS, INC.**

**FORM 10-Q**

**TABLE OF CONTENTS**

	<b>PAGE NUMBER</b>	
<b>PART I</b>	<b>FINANCIAL INFORMATION</b>	
<b>Item 1</b>	<b><u>Financial Statements</u></b>	
	<u>Condensed Balance Sheets (unaudited) May 2, 2009 and January 31, 2009</u>	3
	<u>Condensed Statements of Income (unaudited) Thirteen weeks ended May 2, 2009 and May 3, 2008</u>	4
	<u>Condensed Statements of Cash Flows (unaudited) Thirteen weeks ended May 2, 2009 and May 3, 2008</u>	5
	<u>Notes to the Condensed Financial Statements (unaudited)</u>	6
<b>Item 2</b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	10
<b>Item 3</b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	13
<b>Item 4</b>	<b><u>Controls and Procedures</u></b>	13
<b>PART II</b>	<b><u>OTHER INFORMATION</u></b>	
<b>Item 1</b>	<b><u>Legal Proceedings</u></b>	14
<b>Item 1A</b>	<b><u>Risk Factors</u></b>	14
<b>Item 2</b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	14
<b>Item 3</b>	<b><u>Defaults Upon Senior Securities</u></b>	14
<b>Item 4</b>	<b><u>Submission of Matters to a Vote of Security Holders</u></b>	14
<b>Item 5</b>	<b><u>Other Information</u></b>	14
<b>Item 6</b>	<b><u>Exhibits</u></b>	15
	<b><u>SIGNATURES</u></b>	16

Table of Contents**Item 1. Financial Statements.****Citi Trends, Inc.****Condensed Balance Sheets****May 2, 2009 and January 31, 2009****(Unaudited)****(in thousands, except share data)**

	<b>May 2, 2009</b>	<b>January 31, 2009</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 44,672	\$ 33,516
Inventory	84,613	86,259
Prepaid and other current assets	8,598	10,625
Deferred tax asset	3,629	3,447
<b>Total current assets</b>	<b>141,512</b>	<b>133,847</b>
Property and equipment, net	58,413	58,861
Investment securities	43,097	43,825
Goodwill	1,371	1,371
Deferred tax asset	2,947	2,480
Other assets	450	405
<b>Total assets</b>	<b>\$ 247,790</b>	<b>\$ 240,789</b>
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 47,899	\$ 52,295
Accrued expenses	12,012	11,478
Accrued compensation	5,327	7,514
Current portion of capital lease obligations	988	1,403
Income tax payable	3,977	682
Layaway deposits	1,603	564
<b>Total current liabilities</b>	<b>71,806</b>	<b>73,936</b>
Other long-term liabilities	9,049	8,646
<b>Total liabilities</b>	<b>80,855</b>	<b>82,582</b>
Stockholders equity:		
Common stock, \$0.01 par value. Authorized 32,000,000 shares; 14,845,679 shares issued as of May 2, 2009 and 14,698,852 shares issued as of January 31, 2009; 14,679,929 shares outstanding as of May 2, 2009 and 14,533,102 outstanding as of January 31, 2009	145	145
Paid-in-capital	71,749	70,950
Retained earnings	95,206	87,277
Treasury stock, at cost; 165,750 shares as of May 2, 2009 and January 31, 2009	(165)	(165)
<b>Total stockholders equity</b>	<b>166,935</b>	<b>158,207</b>

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Commitments and contingencies (note 8)

Total liabilities and stockholders' equity	\$	247,790	\$	240,789
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See accompanying notes to the condensed financial statements (unaudited).

Table of Contents**Citi Trends, Inc.****Condensed Statements of Income****Thirteen Weeks Ended May 2, 2009 and May 3, 2008****(Unaudited)****(in thousands, except per share data)**

	<b>May 2, 2009</b>	<b>May 3, 2008</b>
Net sales	\$ 143,097	\$ 120,996
Cost of sales	85,909	74,233
Gross profit	57,188	46,763
Selling, general and administrative expenses	40,133	36,241
Depreciation and amortization	4,373	3,703
Income from operations	12,682	6,819
Interest income	139	868
Interest expense	(41)	(87)
Unrealized loss on auction rate securities	(728)	
Income before income tax expense	12,052	7,600
Income tax expense	4,123	2,432
Net income	\$ 7,929	\$ 5,168
Basic net income per common share	\$ 0.54	\$ 0.36
Diluted net income per common share	\$ 0.54	\$ 0.36
Net income attributable to common shares		
Basic	\$ 7,780	\$ 5,127
Diluted	\$ 7,780	\$ 5,127
Weighted average number of shares outstanding		
Basic	14,318	14,048
Diluted	14,339	14,217

See accompanying notes to the condensed financial statements (unaudited).

Table of Contents

## Citi Trends, Inc.

## Condensed Statements of Cash Flows

Thirteen Weeks Ended May 2, 2009 and May 3, 2008

(Unaudited)

(in thousands)

	May 2, 2009	May 3, 2008
Operating activities:		
Net income	\$ 7,929	\$ 5,168
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,373	3,703
Loss on disposal of property and equipment		7
Deferred income taxes	(649)	(917)
Noncash stock-based compensation expense	355	445
Excess tax benefits from stock-based payment arrangements	(622)	(209)
Unrealized loss on auction rate securities	728	
Changes in assets and liabilities:		
Inventory	1,646	(838)
Prepaid and other current assets	2,027	(429)
Other assets	(45)	(24)
Accounts payable	(4,396)	(1,345)
Accrued expenses and other long-term liabilities	937	(987)
Accrued compensation	(2,187)	(1,287)
Income tax payable	3,917	2,282
Layaway deposits	1,039	825
Net cash provided by operating activities	15,052	6,394
Investing activities:		
Purchases of investment securities		(4,222)
Sales/redemptions of investment securities		3,516
Purchases of property and equipment	(3,925)	(7,058)
Net cash used in investing activities	(3,925)	(7,764)
Financing activities:		
Repayments on capital lease obligations	(415)	(404)
Excess tax benefits from stock-based payment arrangements	622	209
Proceeds from the exercise of stock options	153	127
Cash used to settle equity instruments granted under stock-based payment arrangements	(331)	(68)
Net cash provided by (used in) financing activities	29	(136)
Net increase (decrease) in cash and cash equivalents	11,156	(1,506)
Cash and cash equivalents:		
Beginning of period	33,516	6,203
End of period	\$ 44,672	\$ 4,697
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 35	\$ 82

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Cash paid for income taxes	\$	855	\$	1,303
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See accompanying notes to the condensed financial statements (unaudited).



Table of Contents

**Citi Trends, Inc.**

**Notes to the Condensed Financial Statements (unaudited)**

**May 2, 2009**

1. Basis of Presentation

Citi Trends, Inc. (the Company) is a rapidly growing, value-priced retailer of urban fashion apparel and accessories for the entire family. As of May 2, 2009, the Company operated 365 stores in 22 states.

The condensed balance sheet as of May 2, 2009 and the condensed statements of income and cash flows for the thirteen-weeks ended May 2, 2009 and May 3, 2008 have been prepared by the Company without audit. The condensed balance sheet as of January 31, 2009 has been derived from the audited financial statements as of that date, but does not include all required year end disclosures. In the opinion of management, such statements include all adjustments considered necessary to present fairly the Company's financial position as of May 2, 2009 and January 31, 2009, and its results of operations and cash flows for all periods presented. It is suggested that these condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest Annual Report on Form 10-K for the year ended January 31, 2009.

The accompanying unaudited condensed financial statements are prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Operating results for the thirteen weeks ended May 2, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending January 30, 2010.

The following contains references to years 2009 and 2008, which represent fiscal years ending or ended on January 30, 2010 (fiscal 2009) and January 31, 2009 (fiscal 2008), respectively. Fiscal 2009 and fiscal 2008 both have 52-week accounting periods.

2. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and use assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The most significant estimates made by management include those made in the valuation of inventory, investment securities, stock-based compensation, property and equipment, and income taxes. Management periodically evaluates estimates used in the preparation of the financial statements for continued reasonableness. Appropriate adjustments, if any, to the estimates used are made prospectively based on such periodic evaluations.

3. Earnings per Share

Basic earnings per common share amounts are calculated using the weighted average number of common shares outstanding for the period. Diluted earnings per common share amounts are calculated using the weighted average number of common shares outstanding plus the additional dilution for all potentially dilutive securities, such as stock options and nonvested restricted stock. During loss periods, diluted earnings per share amounts are based on the weighted average number of common shares outstanding.

In accordance with the Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 128, *Earnings per Share*, the Company calculates the dilutive effect of stock-based compensation arrangements using the treasury stock method. This method assumes that the proceeds the Company receives from the exercise of stock options are used to repurchase common shares in the market. In accordance with SFAS No. 123R, *Share-Based Payment*, the Company includes as assumed proceeds the amount of compensation cost attributed to future services and not yet recognized, and the amount of tax benefits, if any, that would be credited to additional paid-in capital assuming exercise of outstanding options and vesting of nonvested restricted stock. For the thirteen weeks ended May 2, 2009 and May 3, 2008, there were 69,000 and 81,000 options outstanding, respectively, to purchase shares of common stock excluded from the calculation of diluted earnings per share because of antidilution.

On February 1, 2009, the Company adopted FASB Staff Position Emerging Issues Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* ( FSP EITF 03-6-1 ). FSP EITF 03-6-1 addresses determinations as to whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share ( EPS ) under the two-class method described in paragraphs 60 and 61 of SFAS No. 128. Nonvested restricted stock awards granted to employees and non-employee directors contain nonforfeitable dividend rights and, therefore, are now considered participating securities in accordance with FSP EITF 03-6-1. We have prepared our current and prior period EPS computations to exclude net income allocated to nonvested share awards.

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### Table of Contents

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share amounts):

	May 2, 2009	May 3, 2008
<b>Basic:</b>		
<b>Numerator</b>		
Net Income	\$ 7,929	\$ 5,168
Net income allocated to participating securities	(149)	(41)
Net income attributable to common stockholders-basic	\$ 7,780	\$ 5,127
<b>Denominator</b>		
Weighted average common shares	14,318	14,048
Net income attributable to common stockholders per share-basic	\$ 0.54	\$ 0.36
<b>Diluted:</b>		
<b>Numerator</b>		
Net Income	\$ 7,929	\$ 5,168
Net income allocated to participating securities	(149)	(41)
Net income attributable to common stockholders-basic	\$ 7,780	\$ 5,127
<b>Denominator</b>		
Denominator for basic calculation	14,318	14,048
Effect of dilutive securities - stock options	21	169
Denominator for diluted calculation	14,339	14,217
Net income attributable to common stockholders per share-diluted	\$ 0.54	\$ 0.36

#### 4. Fair Value Measurement

Effective February 3, 2008, the Company adopted the methods of fair value as described in SFAS No. 157, *Fair Value Measurements*, to value its financial assets and liabilities. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market at the measurement date. This statement also establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. Level 3 inputs are given the lowest priority in the fair value hierarchy.

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As of May 2, 2009, the Company had \$38.3 million (\$43.8 million at par value) of investments in municipal auction rate securities (ARS) issued by student loan funding organizations. The ARS are classified as trading securities in noncurrent assets and are reflected at estimated fair value. These securities are high-grade (at least AA-rated with one or more rating agencies) and approximately 79% are either guaranteed by the Department of Education under the Federal Family Education Loan Program (37%) or backed by insurance companies, AMBAC Assurance Corporation (31%) or MBIA Insurance Corporation (11%). Historically, liquidity for investors in ARS was provided via an auction process that reset the interest rate every 35 days, allowing investors to either roll over their investments or sell them at par value. Beginning in February 2008, there was insufficient demand for these types of investments during the auctions and, as a result, these securities became illiquid. Although the auctions for the securities have failed, the Company has not experienced any defaults and continues to earn and receive interest on all of the investments still owned by the Company.

Table of Contents

There was insufficient observable market information available as of May 2, 2009 to determine the fair value of the Company's ARS. Accordingly, the Company estimated Level 3 fair values for these securities based on assumptions that market participants would use in their estimates of fair value. These assumptions included, among other things, discounted cash flow projections, the timing of expected future successful auctions or redemptions, collateralization of the underlying securities and the creditworthiness of the issuers and insurance companies. Based on this Level 3 valuation, the ARS investments were valued at \$38.3 million as of May 2, 2009, representing a \$5.5 million decline from par value.

In November 2008, the Company accepted an offer (the Right) from UBS AG (UBS) allowing the Company to sell at par value the remaining ARS to UBS at anytime during a two-year period from June 30, 2010 through July 2, 2012. In accepting the Right, the Company granted UBS the authority to sell or auction the ARS at par value at any time up until the expiration date of the Right and released UBS from any claims relating to the marketing and sale of ARS. The ARS will continue to earn interest until they are liquidated. The obligations of UBS under the Right are not secured by its assets and do not require UBS to obtain any financing to purchase the ARS. UBS has disclaimed any assurance that it will have sufficient financial resources to satisfy its obligations under the Right. If UBS does not have sufficient funding to buy back the ARS and no alternative buyers are located either through the auction process, issuer redemptions or other means, then the Company may not be able to access cash by selling these securities without incurring a loss of principal.

The Right represents a put option and is recognized as an instrument separate from the ARS. The Company elected to account for this Right at fair value under SFAS No. 159. The Right was valued at \$4.8 million as of May 2, 2009 using a discounted cash flow approach that includes estimates of interest rates and the credit risk associated with UBS. This valuation is based on unobservable inputs, therefore, represents a Level 3 fair value. Prior to the acceptance of the Right, the ARS were classified as available-for-sale. Upon acceptance of the Right, the ARS were reclassified to trading securities. The ARS and the Right included in the May 2, 2009 balance sheet are classified as noncurrent assets due to the expectation that liquidity will not occur during the next twelve months.

The following table provides a summary of activity for the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the thirteen weeks ended May 2, 2009 (in thousands):

	Put Option Related to ARS		Auction Rate Securities	
Balance as of January 31, 2009	\$	4,901	\$	38,924
Unrealized loss on trading securities included in earnings		(149)		(579)
Balance as of May 2, 2009	\$	4,752	\$	38,345

5. Comprehensive Income

The components of comprehensive income for all periods presented are as follows (in thousands):

	Thirteen Weeks Ended	
	May 2, 2009	May 3, 2008
Net income, as reported	\$ 7,929	\$ 5,168
Other comprehensive loss:		
Unrealized loss on available-for-sale securities, net of tax benefit of \$884 in the 13 weeks ended May 3, 2008		(1,371)

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Comprehensive income	\$	7,929	\$	3,797
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8

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Table of Contents

6. Revolving Line of Credit

On March 25, 2009, the Company's \$35 million unsecured revolving credit facility with Bank of America was amended to extend the expiration date to March 24, 2010 and to lower the commitment to \$20 million, reflecting the Company's cash position and the fact that there have been no borrowings under the facility. In addition, changes were made to the pricing of the facility, including an increase in the unused commitment fee from 0.15% to 0.25% and an amendment of the interest rates. Loans under the facility now bear interest at either (a) a rate equal to the highest of (i) the Federal Funds Rate plus 0.50%, (ii) LIBOR plus 1.0% and (iii) Bank of America's prime rate, plus an applicable margin; or (b) a rate equal to LIBOR plus an applicable margin. The applicable margin, which increased 0.75% under the amendment, is dependent on the Company's consolidated leverage ratio and ranges from 0.75% to 1.25% for loans bearing interest at the rate described under (a) above and from 1.75% to 2.25% for loans bearing interest at the rate described under (b) above.

7. Income Taxes

The Company's effective income tax rate increased to 34.2% in the first quarter of fiscal 2009 from 32.0% in the first quarter of fiscal 2008 due to a declining interest rate environment which resulted in a decrease in tax-free interest income on investments.

8. Commitments and Contingencies

The Company from time to time is involved in various legal proceedings incidental to the conduct of its business, including claims by customers, employees or former employees. While litigation is subject to uncertainties and the outcome of any litigated matter is not predictable, the Company is not aware of any legal proceedings pending or threatened against it that it expects to have a material adverse effect on its financial condition, results of operations or liquidity.

9. Recent Accounting Pronouncements

Effective February 3, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and requires additional disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of Statement No. 157*, which provided a one year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, the Company adopted the provisions of SFAS No. 157 with respect to its financial assets and financial liabilities only in fiscal 2008. The adoption of this statement did not have a material impact on the Company's financial statements. Effective February 1, 2009, the Company adopted SFAS No. 157 for non-financial assets and non-financial liabilities, and such adoption did not have a material impact on the Company's financial statements.

As discussed in Note 3, the Company adopted FSP EITF 03-6-1 on February 1, 2009. Implementation of FSP EITF 03-6-1 will change the way the Company calculates earnings per share and is expected to reduce basic and diluted earnings per share for the fiscal year ending January 30, 2010 by approximately \$0.03. All prior period earnings per share information must be adjusted retrospectively. Previously reported basic and

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diluted earnings per share for the year ended January 31, 2009 will decrease by \$0.02.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, which amends SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, to require an entity to provide interim disclosures about the fair value of all financial instruments within the scope of SFAS No. 107 and to include disclosures related to the methods and significant assumptions used in estimating those instruments. This FSP is effective for interim and annual periods ending after June 15, 2009. The adoption of this FSP is not expected to have a material impact on the Company's financial statements and related disclosures.



Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**Forward-Looking Statements**

Except for specific historical information, many of the matters discussed in this Form 10-Q may express or imply projections of revenues or expenditures, statements of plans and objectives for future operations, growth or initiatives, statements of future economic performance, or statements regarding the outcome or impact of pending or threatened litigation. These, and similar statements, are forward-looking statements concerning matters that involve risks, uncertainties and other factors that may cause the actual performance of the Company to differ materially from those expressed or implied by these statements. All forward-looking information should be evaluated in the context of these risks, uncertainties and other factors. The words believe, anticipate, project, plan, expect, estimate, objective, forecast, goal, intend, or will continue and similar words and expressions generally identify forward-looking statements. The Company believes the assumptions underlying these forward-looking statements are reasonable; however, any of the assumptions could be inaccurate, and therefore, actual results may differ materially from those projected in the forward-looking statements.

The factors that may result in actual results differing from such forward-looking information include, but are not limited to: transportation and distribution delays or interruptions; changes in freight rates; the Company's ability to negotiate effectively the cost and purchase of merchandise; inventory risks due to shifts in market demand; the Company's ability to gauge fashion trends and changing consumer preferences; changes in consumer spending on apparel; changes in product mix; interruptions in suppliers' businesses; interest rate fluctuations; a deterioration in general economic conditions caused by acts of war or terrorism or other factors; temporary changes in demand due to weather patterns; seasonality of the Company's business; delays associated with building, opening and operating new stores; delays associated with building, opening, expanding or converting new or existing distribution centers; the future liquidity of auction rate securities; and other factors described in the section titled Item 1A. Risk Factors and elsewhere in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2009 and in Part II, Item 1A. Risk Factors, and elsewhere in the Company's Quarterly Reports on Form 10-Q and any amendments thereto and in the other documents the Company files with the Securities and Exchange Commission (SEC), including reports on Form 8-K.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Form 10-Q. Except as may be required by law, the Company undertakes no obligation to update or revise publicly any forward-looking statements contained herein to reflect events or circumstances occurring after the date of this Form 10-Q or to reflect the occurrence of unanticipated events. Readers are advised, however, to read any further disclosures the Company may make on related subjects in its public disclosures or documents filed with the SEC.

**Overview**

We are a rapidly growing, value-priced retailer of urban fashion apparel and accessories for the entire family. Our merchandise offerings are designed to appeal to the preferences of fashion conscious consumers, particularly African-Americans. Originally our stores were located in the Southeast, and in recent years we expanded into the Mid-Atlantic and Midwest regions and Texas. We operated 365 stores in both urban and rural markets in 22 states as of May 2, 2009.

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We measure performance using key operating statistics. One of the main performance measures we use is comparable store sales growth. We define a comparable store as a store that has been opened for an entire fiscal year. Therefore, a store will not be considered a comparable store until its 13th month of operation at the earliest or until its 24th month at the latest. As an example, stores opened in fiscal 2008 and fiscal 2009 are not considered comparable stores in fiscal 2009. Relocated and expanded stores are included in the comparable store sales results. We also use other operating statistics, most notably average sales per store, to measure our performance. As we typically occupy existing space in established shopping centers rather than sites built specifically for our stores, store square footage (and therefore sales per square foot) varies by store. We focus on overall store sales volume as the critical driver of profitability. The average sales per store has increased over the years, as we have increased comparable store sales and opened new stores that are generally larger than our historical store base. Average sales per store increased from \$0.8 million in fiscal 2000 to \$1.4 million in fiscal 2008. In addition to sales, we measure gross profit as a percentage of sales and store operating expenses, with a particular focus on labor, as a percentage of sales. These results translate into store level contribution, which we use to evaluate overall performance of each individual store. Finally, we monitor corporate expenses against budgeted amounts.

### **Accounting Periods**

The following discussion contains references to fiscal years 2009 and 2008, which represent fiscal years ending or ended on January 30, 2010 (fiscal 2009) and January 31, 2009 (fiscal 2008), respectively. Fiscal 2009 and fiscal 2008 both have 52-week accounting periods. This discussion and analysis should be read with the condensed financial statements and the notes thereto.

Table of Contents

**Results of Operations**

The following discussion of the Company's financial performance is based on the condensed financial statements set forth herein. The nature of the Company's business is seasonal. Historically, sales in the first and fourth quarters have been higher than sales achieved in the second and third quarters of the fiscal year. Expenses and, to a greater extent, operating income, vary by quarter. Results of a period shorter than a full year may not be indicative of results expected for the entire year. Furthermore, the seasonal nature of the Company's business may affect comparisons between periods.

**Thirteen Weeks Ended May 2, 2009 and May 3, 2008**

*Net Sales.* Net sales increased \$22.1 million, or 18.3%, to \$143.1 million in the thirteen weeks ended May 2, 2009 from \$121.0 million in the thirteen weeks ended May 3, 2008. The increase in net sales was due primarily to 35 new stores opened since last year's first quarter, together with a 7.4% increase in comparable store sales, partially offset by the effect of closing one store. Comparable stores include locations that have been relocated or expanded. There were four stores relocated or expanded in the first quarter of 2009 and nine stores relocated or expanded in fiscal 2008, all of which impacted comparable store sales. Sales in comparable relocated and expanded stores increased 25.1% in the first quarter of 2009, while sales in all other comparable stores increased 6.6%. Approximately two-thirds of the 7.4% overall increase in comparable store sales was due to a higher average unit retail, with the other one-third being the result of an increase in the number of customer transactions. Comparable store sales changes by major merchandise class were as follows in the first quarter of 2009: Home +14%; Children's +13%; Accessories +8%; Men's +7%; Women's +4%.

The new stores opened in 2008 and 2009, net of the closed store, accounted for a \$13.5 million increase in total sales, while the 7.4% sales increase in the 318 comparable stores totaled \$8.6 million.

*Gross Profit.* Gross profit increased \$10.4 million, or 22.3%, to \$57.2 million in the first quarter of 2009 from \$46.8 million in last year's first quarter. The increase in gross profit is a result of the increase in sales, together with an improvement in the gross margin from 38.6% in last year's first quarter to 40.0% this year. Approximately 50 basis points of the gross margin improvement was related to lower freight costs as a percentage of sales that resulted from a reduction in fuel surcharges due to lower gasoline prices. Another 40 basis points of improvement was a result of the steps taken to better control inventory shrinkage, including a greater focus on problem stores by the store operations and loss prevention departments, the addition of sophisticated surveillance systems in high shrinkage stores, and lower inventory levels. The initial markup on merchandise was 30 basis points higher in this year's first quarter, and markdowns as a percentage of sales were lower by 20 basis points due to our continued efforts to closely manage inventory, combined with the strong comparable store sales results.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased \$3.9 million, or 10.7%, to \$40.1 million in the first quarter of 2009 from \$36.2 million in last year's first quarter. The increase in these expenses was due primarily to additional store level, distribution and corporate costs arising from the opening of 35 new stores since last year's first quarter. As a percentage of sales, selling, general and administrative expenses improved to 28.0% in the first quarter of fiscal 2009 from 30.0% in the first quarter of fiscal 2008, due primarily to the leveraging effect that occurs on expenses as a percentage of sales when comparable store sales increase at a rate that is higher than the rate of inflation on expenses. In addition, store and distribution payroll costs were managed closely, resulting in a 70 basis point improvement in total payroll expense as a percentage of sales.

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*Depreciation and Amortization.* Depreciation and amortization expense increased \$670,000, or 18.1%, to \$4.4 million in the first quarter of 2009 from \$3.7 million in the first quarter of 2008, as the result of capital expenditures incurred for new and relocated/expanded stores and the expansion of the Darlington distribution center.

*Interest Income.* Interest income decreased to \$139,000 in the first quarter of 2009 from \$868,000 in the first quarter of 2008 due to a declining interest rate environment which affected our returns on auction rate securities as well as cash and cash equivalents.

*Interest Expense.* Interest expense decreased to \$41,000 in the first quarter of 2009 from \$87,000 in the first quarter of 2008 due to the normal decline in the interest portion of payments on our capital lease obligations as the principal portion of such obligations is reduced.

*Unrealized Loss on Auction Rate Securities.* An impairment loss of \$728,000 on our investments in auction rate securities and a related put option is reflected in the first quarter of fiscal 2009 due primarily to the declining interest rates on such securities.

*Income Tax Expense.* Income tax expense increased 69.5% to \$4.1 million in this year's first quarter from \$2.4 million in the first quarter of 2008 due to an increase in pretax income, together with an increase in the effective income tax rate to 34.2% versus 32.0% last year as a result of the reduction in tax-exempt interest income, as discussed above.

*Net Income.* Net income increased 53.4% to \$7.9 million in the first quarter of 2009 from \$5.2 million in the first quarter of 2008 due to the factors discussed above.

Table of Contents

**Liquidity and Capital Resources**

Our cash requirements are primarily for working capital, expansion of our distribution infrastructure, construction of new stores, remodeling of our existing stores and the improvement of our information systems. Historically, we have met these cash requirements from cash flow from operations, short-term trade credit, borrowings under our revolving lines of credit, long-term debt, capital leases, and cash proceeds from our initial public offering. We expect to be able to meet future cash requirements with cash flow from operations, short-term trade credit, existing cash balances and, if necessary, borrowings under our revolving credit facility.

*Current Financial Condition.* As of May 2, 2009, we had total cash and cash equivalents of \$44.7 million compared with total cash and cash equivalents of \$33.5 million as of January 31, 2009. Inventory represented 34.1% of our total assets as of May 2, 2009. Management's ability to manage our inventory can have a significant impact on our cash flows from operations during a given interim period or fiscal year. In addition, inventory purchases can be seasonal in nature, such as the purchase of warm-weather or Christmas-related merchandise. Total inventories at the end of the first quarter of 2009 were up \$1.4 million, or 1.6%, compared to the first quarter of fiscal 2008, despite an increase in store selling square footage of 13%. Inventory in comparable stores was 7.6% lower than the first quarter of fiscal 2008, due to our efforts to conservatively control our investment in inventory.

*Cash Flows From Operating Activities.* Net cash provided by operating activities was \$15.1 million in the first quarter of fiscal 2009 compared to \$6.4 million in the first quarter of fiscal 2008. The main source of cash provided during the first quarter of this year was net income adjusted for noncash expenses such as depreciation and amortization, deferred income taxes, stock-based compensation expense, and the unrealized loss on auction rate securities, totaling \$12.7 million (compared to \$8.4 million in last year's first quarter). Other significant sources of cash in the first quarter of fiscal 2009 were (1) a \$3.9 million increase in income tax payable (compared to \$2.3 million in the first quarter of fiscal 2008), resulting from an increase in pretax income, (2) a \$2.0 million decrease in prepaid and other current assets (compared to a \$0.4 million increase in the first quarter of fiscal 2008) due primarily to the timing of collecting credit card receivables and receivables from landlords for tenant improvement reimbursements, and (3) a \$1.6 million decrease in inventory (compared to a \$0.8 million increase in the first quarter of fiscal 2008) as a result of efforts to conservatively manage inventory. Significant uses of cash included a \$4.4 million decrease in accounts payable (compared to \$1.3 million in last year's first quarter) due to the timing of payments made for spring merchandise purchases.

*Cash Flows From Investing Activities.* Cash used in investing activities was \$3.9 million in the first quarter of fiscal 2009 compared to \$7.8 million in the first quarter of fiscal 2008. Purchases of property and equipment included in cash flows from investing activities totaled \$3.9 million and \$7.1 million in the first quarter of fiscal 2009 and 2008, respectively, with the decrease being a result of capital expenditures in the first quarter last year related to the expansion of the Darlington distribution center. Such capital expenditures in both years included routine amounts for new stores, relocated and expanded stores and other general corporate purposes. Purchases of municipal auction rate securities, net of sales, used cash of \$0.7 million in the first quarter of fiscal 2008.

*Cash Flows From Financing Activities.* Cash flows from financing activities were insignificant in the first quarter of fiscal 2009 and 2008.

**Cash Requirements**

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Our principal sources of liquidity consist of: (i) cash and cash equivalents (which equaled \$44.7 million as of May 2, 2009); (ii) short-term trade credit; (iii) cash generated from operations on an ongoing basis as we sell our merchandise inventory; and (iv) a \$20 million revolving credit facility. Trade credit represents a significant source of financing for inventory purchases and arises from customary payment terms and trade practices with our vendors. Historically, our principal liquidity requirements have been for working capital and capital expenditure needs.

As of May 2, 2009, we had \$38.3 million (\$43.8 million at par value) of investments in municipal auction rate securities ( ARS ) issued by student loan funding organizations. These securities are high-grade (at least AA-rated with one or more rating agencies) and approximately 79% are either guaranteed by the Department of Education under the Federal Family Education Loan Program (37%) or backed by insurance companies, AMBAC Assurance Corporation (31%) or MBIA Insurance Corporation (11%). Historically, liquidity for investors in ARS was provided via an auction process that reset the interest rate every 35 days, allowing investors to either roll over their investments or sell them at par value. Beginning in February 2008, there was insufficient demand for these types of investments during the auctions and, as a result, these securities became illiquid. Although the auctions for the securities have failed, we have not experienced any defaults and continue to earn and receive interest on all of the investments that we still own.

In November 2008, we accepted an offer (the Right ) from UBS AG ( UBS ) allowing us to sell at par value our remaining ARS to UBS at anytime during a two-year period from June 30, 2010 through July 2, 2012. In accepting the Right, we granted UBS the authority to sell or auction the ARS at par value at any time up until the expiration date of the Right and released UBS from any claims relating to the marketing and sale of ARS. We will continue to earn interest on the ARS until they are liquidated. The obligations of UBS under the Right are not secured by its assets and do not require UBS to obtain any financing to purchase the ARS. UBS has disclaimed any assurance that it will have sufficient financial resources to satisfy its obligations under the Right. If UBS does not have sufficient funding to buy back the ARS and no alternative buyers are located either through the auction process, issuer redemptions or other means, then we may not be able to access cash by selling these securities without incurring a loss of principal. The Right was valued at \$4.8 million as of May 2, 2009.

We believe that our existing sources of liquidity will be sufficient to fund our operations and anticipated capital expenditures for at least the next 12 months.

Table of Contents

**Critical Accounting Policies**

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. There have been no material changes to the Critical Accounting Policies outlined in the Company's Annual Report on Form 10-K for fiscal 2008.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

We are exposed to financial market risks related to changes in interest rates connected with our revolving line of credit, which bears interest at variable rates. We cannot predict market fluctuations in interest rates. As a result, future results may differ materially from estimated results due to adverse changes in interest rates or debt availability. A hypothetical 100 basis point increase in prevailing market interest rates would not have materially impacted our financial position, results of operations or cash flows for the thirteen weeks ended May 2, 2009, because we did not borrow during this period of time. We do not engage in financial transactions for trading or speculative purposes and have not entered into any interest rate hedging contracts.

We source all of our product from apparel markets in the United States in U.S. Dollars and, therefore, are not directly subject to fluctuations in foreign currency exchange rates. However, fluctuations in foreign currency exchange rates could affect our purchasing power with vendors that import merchandise to sell to us. We have not entered into forward contracts to hedge against fluctuations in foreign currency prices.

As of May 2, 2009, we had \$38.3 million (\$43.8 million at par value) of investments in municipal auction rate securities (ARS) issued by student loan funding organizations. These securities are high-grade (at least AA-rated with one or more rating agencies) and approximately 79% are either guaranteed by the Department of Education under the Federal Family Education Loan Program (37%) or backed by insurance companies, AMBAC Assurance Corporation (31%) or MBIA Insurance Corporation (11%). Historically, liquidity for investors in ARS was provided via an auction process that reset the interest rate every 35 days, allowing investors to either roll over their investments or sell them at par value. Beginning in February 2008, there was insufficient demand for these types of investments during the auctions and, as a result, these securities became illiquid. Although the auctions for the securities have failed, we have not experienced any defaults and continue to earn and receive interest on all of the investments that we still own. However, interest rates have declined to levels that are much lower than in most of fiscal 2008. As a result, interest income is expected to be significantly lower in fiscal 2009 than in fiscal 2008.

In November 2008, we accepted an offer (the Right) from UBS AG (UBS) allowing us to sell at par value our remaining ARS to UBS at anytime during a two-year period from June 30, 2010 through July 2, 2012. In accepting the Right, we granted UBS the authority to sell or auction the ARS at par value at any time up until the expiration date of the Right and released UBS from any claims relating to the marketing and sale of ARS. We will continue to earn interest on the ARS until they are liquidated. The obligations of UBS under the Right are not secured by its assets and do not require UBS to obtain any financing to purchase the ARS. UBS has disclaimed any assurance that it will have sufficient financial resources to satisfy its obligations under the Right. If UBS does not have sufficient funding to buy back the ARS and no alternative buyers are located either through the auction process, issuer redemptions or other means, then we may not be able to access cash by selling these securities without incurring a loss of principal. The Right was valued at \$4.8 million as of May 2, 2009.

**Item 4. Controls and Procedures.**

We have carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of May 2, 2009 pursuant to Rules 13a-15 and 15d-15 of the Exchange Act. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer each concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information has been accumulated and communicated to our management, including the officers who certify our financial reports, as appropriate, to allow timely decisions regarding the required disclosures.

There were no changes in our internal control over financial reporting that occurred during the fiscal quarter ended May 2, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



Table of Contents

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

We are from time to time involved in various legal proceedings incidental to the conduct of our business, including claims by customers, employees or former employees. While litigation is subject to uncertainties and the outcome of any litigated matter is not predictable, we are not aware of any legal proceedings pending or threatened against us that we expect to have a material adverse effect on our financial condition, results of operations or liquidity.

**Item 1A. Risk Factors.**

There are no material changes to the Risk Factors described under the section ITEM 1A. RISK FACTORS in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2009.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

Not applicable.

**Item 3. Defaults Upon Senior Securities.**

Not applicable.

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

Not applicable.

**Item 5. Other Information.**

Not applicable.

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### Table of Contents

#### **Item 6. Exhibits.**

- 10.1 Employment Non-Compete, Non-Solicit and Confidentiality Agreement between the Company and R. Edward Anderson dated March 25, 2009\*
- 10.2 Employment Non-Compete, Non-Solicit and Confidentiality Agreement between the Company and R. David Alexander, Jr. dated March 25, 2009\*
- 10.3 Employment Non-Compete, Non-Solicit and Confidentiality Agreement between the Company and Elizabeth R. Feher dated March 25, 2009\*
- 10.4 Employment Non-Compete, Non-Solicit and Confidentiality Agreement between the Company and Bruce D. Smith dated March 25, 2009\*
- 10.5 Employment Non-Compete, Non-Solicit and Confidentiality Agreement between the Company and Ivy D. Council dated March 25, 2009\*
- 10.6 Employment Non-Compete, Non-Solicit and Confidentiality Agreement between the Company and James A. Dunn dated March 25, 2009\*
- 10.7 Severance Agreement between the Company and R. Edward Anderson dated March 25, 2009\*
- 10.8 Severance Agreement between the Company and R. David Alexander, Jr. dated March 25, 2009\*
- 10.9 Severance Agreement between the Company and Elizabeth R. Feher dated March 25, 2009\*
- 10.10 Severance Agreement between the Company and Bruce D. Smith dated March 25, 2009\*
- 10.11 Severance Agreement between the Company and Ivy D. Council dated March 25, 2009\*
- 10.12 Severance Agreement between the Company and James A. Dunn dated March 25, 2009\*
- 10.13 First Amendment to Credit Agreement, dated as of March 25, 2009, by and between the Company and Bank of America, N.A. (incorporated by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K for the year ended January 31, 2009)
- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

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\* Filed herewith.

Pursuant to Securities and Exchange Commission Release No. 33-8238, this certification will be treated as accompanying this Quarterly Report on Form 10-Q and not filed as part of such report for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of Section 18 of the Securities Exchange Act of 1934 and this certification will not be deemed to be incorporated by reference into

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any filing under the Securities Act of 1933 or the Securities Exchange Act 1934, except to the extent that the registrant specifically incorporates it by reference.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, and the undersigned also has signed this report in his capacity as the Registrant's Chief Financial Officer (Principal Financial Officer).

CITI TRENDS, INC.

Date: May 29, 2009

By:	/s/ Bruce D. Smith
Name:	Bruce D. Smith
Title:	Senior Vice President, Chief Financial Officer and Secretary