

Linens Holding Co.  
Form 10-Q  
November 13, 2007

# **UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

## **FORM 10-Q**

(Mark)

☒ x

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

**For the Quarterly Period Ended September 29, 2007**



or

☐

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

**Commission file numbers:**      **333-135646-12**  
   **001-12381**  
   **333-135646-11**

**LINENS HOLDING CO.**

**LINENS N THINGS, INC.**

**LINENS N THINGS CENTER, INC.**

(Exact names of registrants as specified in their charters)

**Delaware**  
**Delaware**  
**California**  
(States or other jurisdictions of  
incorporation or organization)

**20-4192917**  
**22-3463939**  
**59-2740308**  
(I.R.S. Employer  
Identification Nos.)

**6 Brighton Road, Clifton, New Jersey 07015**

(Address of principal executive offices) (Zip Code)

**(973) 778-1300**

(Registrants' telephone number, including area code)

Indicate by check mark whether the registrants (1) have 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) have been subject to such filing requirements for the past 90 days:

Yes ☒ No ☐

Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, or non-accelerated filers. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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Large Accelerated Filer ☐

Accelerated Filer ☐

Non-accelerated filer ☒

Indicate by check mark whether the registrants are a shell company (as defined in Rule 12b-2 of the Act):

Yes ☐ No ☒

As of October 31, 2007, there were 13,013,000 shares of Linens Holding Co. common stock, \$0.01 par value, outstanding; 1,000 shares of Linens n Things, Inc. common stock, \$0.01 par value, outstanding; and 100 shares of Linens n Things Center, Inc. common stock, no par value, outstanding.

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INDEX

	Page No.
<b><u>Explanatory Note and Forward-Looking Statements</u></b>	3
<b><u>Part I.</u></b>	
	<b><u>Financial Information</u></b>
<b><u>Item 1.</u></b>	<b><u>Financial Statements</u></b>
	<u>Condensed Consolidated Statements of Operations (Unaudited) for the thirteen weeks ended September 29, 2007 and September 30, 2006</u> 4
	<u>Condensed Consolidated Statements of Operations (Unaudited) for the thirty-nine weeks ended September 29, 2007 (Successor Entity); the period February 14, 2006 to September 30, 2006 (Successor Entity); and the period January 1, 2006 to February 13, 2006 (Predecessor Entity)</u> 5
	<u>Condensed Consolidated Balance Sheets (Unaudited) as of September 29, 2007; December 30, 2006; and September 30, 2006</u> 6
	<u>Condensed Consolidated Statements of Cash Flows (Unaudited) for the thirty-nine weeks ended September 29, 2007 (Successor Entity); the period February 14, 2006 to September 30, 2006 (Successor Entity); and the period January 1, 2006 to February 13, 2006 (Predecessor Entity)</u> 7
	<u>Notes to Unaudited Condensed Consolidated Financial Statements</u> 8
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b> 34
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures about Market Risk</u></b> 44
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b> 46
<b><u>Part II.</u></b>	<b><u>Other Information</u></b>
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b> 47
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b> 47
<b><u>Item 4.</u></b>	<b><u>Submission of Matters to a Vote of Security Holders</u></b> 47
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b> 47
	<b><u>Signatures</u></b> 48

#### EXPLANATORY NOTE

On November 8, 2005, Linens Merger Sub Co. was formed by affiliates of Apollo Management, L.P., and National Realty & Development Corp. and Silver Point Capital Fund Investments LLC (collectively, the Sponsors) to serve as a holding company. On February 14, 2006, Linens Merger Sub Co. merged with and into Linens n Things, Inc. (the Merger), and Linens n Things, Inc., as the surviving corporation, became a wholly owned subsidiary of Linens Holding Co. (the Company). The Merger was financed in part by the issuance of \$650.0 million aggregate principal amount of Senior Secured Floating Rate Notes (the Notes) due 2014 of Linens n Things, Inc. and Linens n Things Center, Inc., a wholly owned subsidiary of Linens n Things, Inc. The Notes are guaranteed by the Company and each of its domestic subsidiaries (other than Linens n Things, Inc. and Linens n Things Center, Inc.). This report also contains the condensed consolidated financial statements of the Company's predecessor entity, Linens n Things, Inc. and its subsidiaries, for the period January 1, 2006 to February 13, 2006. The accompanying condensed consolidated financial statements are those of Linens Holding Co. and its subsidiaries. The Company has not presented separate financial statements for Linens n Things, Inc. and its subsidiaries or Linens n Things Center, Inc. and its subsidiaries (collectively, the Issuers as described in Note 13) because management has determined that the differences in such financial statements are minor. Unless the context requires otherwise, we, us, our, or the Company refer to Linens Holding Co. and its subsidiaries and, for periods prior to February 14, 2006, the Company's predecessor entity and its subsidiaries.

#### FORWARD-LOOKING STATEMENTS



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This report may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934) with respect to the Company's financial condition, results of operations and business that is not historical information. All statements, other than statements of historical fact, included in this report are forward-looking statements. In particular, statements that the Company makes relating to its overall volume trends, industry forces, margin trends, anticipated capital expenditures and its strategies are forward-looking statements. When used in this document, the words believe, expect, anticipate, intend, estimate, project, plan, and similar expressions, as well as future or conditional verbs such as will, should, would are intended to identify forward-looking statements.

These statements are based on assumptions and assessments made by the Company's management in light of its experience and its perception of historical trends, current conditions, expected future developments and other factors it believes to be appropriate. The Company believes there is a reasonable basis for its expectations and beliefs, but they are inherently uncertain, the Company may not realize its expectations and its beliefs may not prove correct. Any forward-looking statements are not guarantees of the Company's future performance and are subject to risks and uncertainties that could cause actual results, developments and business decisions to differ materially from those described or implied by any such forward-looking statements. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. Such factors include, without limitation: general economic conditions; changes in the retailing environment and consumer spending habits; inclement weather and natural disasters; competition from existing and potential competitors; the amount of merchandise markdowns; loss or retirement of key members of management; increases in the costs of borrowings and unavailability of additional debt or equity capital; impact of the Company's substantial indebtedness on its operating income and its ability to grow; the cost of labor; labor disputes; increased healthcare benefit costs; other costs and expenses; and other important factors that could cause actual results to differ materially from those described or implied by the forward-looking statements contained in this report.



**PART I FINANCIAL INFORMATION**

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands) (Unaudited)

	Thirteen Weeks Ended September 29, 2007	Thirteen Weeks Ended September 30, 2006
<b>Net sales</b>	<b>\$ 666,791</b>	<b>\$ 658,155</b>
Cost of sales, including buying and distribution costs	405,687	388,579
<b>Gross profit</b>	<b>261,104</b>	<b>269,576</b>
Selling, general and administrative expenses	300,927	287,429
Impairment of property and equipment	16,779	
<b>Operating loss</b>	<b>(56,602)</b>	<b>(17,853)</b>
Interest income	(74)	(18)
Interest expense	24,197	23,572
Interest expense, net	24,123	23,554
Other (income) expense, net	(1,539)	323
<b>Loss before provision (benefit) for income taxes</b>	<b>(79,186)</b>	<b>(41,730)</b>
Provision (benefit) for income taxes	743	(14,355)
<b>Net loss</b>	<b>\$ (79,929)</b>	<b>\$ (27,375)</b>

*See accompanying Notes to Unaudited Condensed Consolidated Financial Statements*

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands) (Unaudited)

	Thirty-nine Weeks Ended September 29, 2007 (Successor Entity)	February 14, 2006 to September 30, 2006 (Successor Entity)	January 1, 2006 to February 13, 2006 (Predecessor Entity)
<b>Net sales</b>	<b>\$ 1,831,922</b>	<b>\$ 1,577,583</b>	<b>\$ 284,971</b>
Cost of sales, including buying and distribution costs	1,110,417	951,007	180,675
<b>Gross profit</b>	<b>721,505</b>	<b>626,576</b>	<b>104,296</b>
Selling, general and administrative expenses	873,042	708,113	175,424
Impairment of property and equipment	16,779		
<b>Operating loss</b>	<b>(168,316)</b>	<b>(81,537)</b>	<b>(71,128)</b>
Interest income	(338)	(137)	(668)
Interest expense	74,084	55,404	
Interest expense (income), net	73,746	55,267	(668)
Other income, net	(3,837)	(2,408)	(1,286)
<b>Loss before benefit for income taxes</b>	<b>(238,225)</b>	<b>(134,396)</b>	<b>(69,174)</b>
Benefit for income taxes	(58,136)	(50,322)	(21,270)
<b>Net loss</b>	<b>\$ (180,089)</b>	<b>\$ (84,074)</b>	<b>\$ (47,904)</b>

*See accompanying Notes to Unaudited Condensed Consolidated Financial Statements*

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)(Unaudited)

	September 29, 2007	December 30, 2006	September 30, 2006
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ 12,101	\$ 12,526	\$ 11,394
Accounts receivable	33,942	37,063	33,886
Inventories	976,005	793,002	999,316
Prepaid expenses and other current assets	17,253	15,308	66,788
Current deferred taxes	13,788	16,815	12,225
<b>Total current assets</b>	<b>1,053,089</b>	<b>874,714</b>	<b>1,123,609</b>
Property and equipment, net of accumulated depreciation of \$188,671, \$100,616 and \$74,339 at September 29, 2007, December 30, 2006 and September 30, 2006, respectively	447,773	530,829	572,500
Identifiable intangible assets, net	144,583	150,044	155,361
Goodwill	272,081	267,830	265,702
Deferred financing costs and other noncurrent assets	41,001	34,517	35,218
<b>Total assets</b>	<b>\$ 1,958,527</b>	<b>\$ 1,857,934</b>	<b>\$ 2,152,390</b>
<b>Liabilities and Shareholders' Equity</b>			
Current liabilities:			
Accounts payable	\$ 267,054	\$ 204,760	\$ 291,683
Accrued expenses and other current liabilities	203,528	241,911	195,120
Short-term borrowings			225,870
<b>Total current liabilities</b>	<b>470,582</b>	<b>446,671</b>	<b>712,673</b>
Senior secured notes and other long-term debt	978,180	689,876	652,092
Noncurrent deferred income taxes	67,914	125,977	170,491
Other long-term liabilities	59,611	50,667	48,512
<b>Total liabilities</b>	<b>1,576,287</b>	<b>1,313,191</b>	<b>1,583,768</b>
<b>Shareholders' equity:</b>			
Common stock, \$0.01 par value; 15,000,000 shares authorized; 13,013,000 shares issued and outstanding at September 29, 2007, December 30, 2006 and September 30, 2006	131	131	131
Additional paid-in capital	654,727	652,395	651,636
Accumulated deficit	(286,622)	(106,533)	(84,074)
Accumulated other comprehensive income (loss)	14,004	(1,250)	929
<b>Total shareholders' equity</b>	<b>382,240</b>	<b>544,743</b>	<b>568,622</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,958,527</b>	<b>\$ 1,857,934</b>	<b>\$ 2,152,390</b>

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements



## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)

	Successor Entity Thirty-nine Weeks Ended September 29, 2007	February 14, 2006 to September 30, 2006	Predecessor Entity January 1, 2006 to February 13, 2006
<b>Cash flows from operating activities:</b>			
Net loss	\$ (180,089)	\$ (84,074)	\$ (47,904)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	97,274	80,215	12,642
Deferred income taxes	(64,075)	(23,234)	(6,725)
Share-based compensation	2,330	3,363	12,484
Amortization of deferred financing charges	6,076	5,429	43
Loss on sales and disposals of property and equipment	539	416	
Impairment of property and equipment	16,779		
Changes in assets and liabilities, net of effect of acquisition:			
Decrease (increase) in accounts receivable	3,580	12,047	(2,240)
Increase in inventories	(172,723)	(177,910)	(31,886)
Decrease (increase) in prepaid expenses and other current assets	1,625	(34,097)	(12,153)
Decrease (increase) in identifiable intangible assets and other noncurrent assets	119	(2,498)	9,580
Increase in accounts payable	56,488	59,051	12,010
Decrease in accrued expenses and other liabilities	(29,217)	(42,038)	(7,807)
<b>Net cash used in operating activities</b>	<b>(261,294)</b>	<b>(203,330)</b>	<b>(61,956)</b>
<b>Cash flows from investing activities:</b>			
Acquisition of the Predecessor Entity, net of cash acquired(1)		(1,205,502)	
Additions to property and equipment	(31,247)	(48,776)	(10,956)
Proceeds from sales of property and equipment	5,400	3,100	
<b>Net cash used in investing activities</b>	<b>(25,847)</b>	<b>(1,251,178)</b>	<b>(10,956)</b>
<b>Cash flows from financing activities:</b>			
Issuance of common stock to Linens Investors LLC and others		650,650	
Issuance of floating rate notes		650,000	
Financing and direct acquisition costs	(2,146)	(59,930)	
Premium paid for derivative financial instrument		(700)	
Federal tax benefit from common stock issued under stock incentive plans			4,298
Net increase in borrowings under revolving credit facility	290,380	225,870	
Decrease in treasury stock			674
Payments on mortgage note	(2,076)	(38)	(10)
<b>Net cash provided by financing activities</b>	<b>286,158</b>	<b>1,465,852</b>	<b>4,962</b>

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Effect of exchange rate changes on cash and cash equivalents	558	50	125
Net (decrease) increase in cash and cash equivalents	(425)	11,394	(67,825)
<b>Cash and cash equivalents at beginning of period</b>	<b>12,526</b>		<b>158,158</b>

<b>Cash and cash equivalents at end of period</b>	<b>\$ 12,101</b>	<b>\$ 11,394</b>	<b>\$ 90,333</b>
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**Supplemental disclosure of cash flow information**

**Cash paid during the period for:**

Interest (net of amounts capitalized)	\$ 66,709	\$ 35,397	\$ 135
Income taxes			
Income taxes paid	\$ 13,012	\$ 40,858	\$ 57
Income tax refunds	\$ 1,351	\$ 2,229	\$

**Non-cash transactions:**

Increase (decrease) in goodwill due to purchase accounting adjustments, net	\$ 4,251	\$ (283)	\$
Decrease in accrued additions to property and equipment	\$ 7,734	\$ 7,638	\$ 3,180

(1) In connection with the Merger, net cash settlements of approximately \$20.0 million and \$4.4 million for stock options and restricted stock units, respectively, are included in Acquisition of the Predecessor Entity, net of cash acquired.

*See accompanying Notes to Unaudited Condensed Consolidated Financial Statements*

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation**

On November 8, 2005, Linens Merger Sub Co. was formed by affiliates of Apollo Management, L.P., and National Realty & Development Corp. and Silver Point Capital Fund Investments LLC (collectively, the Sponsors) to serve as a holding company. On February 14, 2006, Linens Merger Sub Co. merged with and into Linens n Things, Inc. (the Merger), and Linens n Things, Inc., as the surviving corporation, became a wholly owned subsidiary of Linens Holding Co. (the Company). The acquisition and related financings are referred to collectively as the Transactions and are discussed in more detail in Note 3 to the audited consolidated financial statements included in the Company's 2006 Annual Report on Form 10-K. As a result of the consummation of the Transactions, a new entity (the Successor or Successor Entity) was formed for financial accounting purposes with an effective date of February 14, 2006, consisting of Linens Holding Co. and Subsidiaries. The condensed consolidated financial statements as of September 29, 2007 and September 30, 2006, for the thirty-nine weeks ended September 29, 2007 and for the period February 14, 2006 to September 30, 2006 show the financial position and results of operations and cash flows of the Successor Entity, Linens Holding Co. and Subsidiaries. The condensed consolidated financial statements for the period January 1, 2006 to February 13, 2006 show the results of operations and cash flows of Linens n Things, Inc. and Subsidiaries (the Predecessor or Predecessor Entity).

The accompanying condensed consolidated financial statements are unaudited. In the opinion of management, the accompanying condensed consolidated financial statements for the Successor Entity and Predecessor Entity include all normal and recurring adjustments that are considered necessary to present fairly the financial position and the results of operations and cash flows for the respective periods presented. As a result of the consummation of the Transactions, the condensed consolidated financial statements for the periods after February 13, 2006 are presented on a different basis than that for the periods before February 14, 2006 as a result of the application of purchase accounting as of February 14, 2006 and, therefore, are not comparable.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Because of the seasonality of the specialty retailing business, operating results of the Company on a quarterly or interim basis may not be indicative of operating results for the full year.

These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the fiscal year ended December 30, 2006 included in the Company's 2006 Annual Report on Form 10-K available from the Securities and Exchange Commission (SEC) or through the Company's website at *lnt.com* posted on March 27, 2007 under *SEC Filings*. All significant intercompany accounts and transactions have been eliminated.

The accompanying condensed consolidated financial statements are those of Linens Holding Co. and its subsidiaries. The Company has not presented separate financial statements for Linens n Things, Inc. and its subsidiaries or Linens n Things Center, Inc. and its subsidiaries (collectively, the Issuers as described in Note 13) because management has determined that the differences in such financial statements are minor.

**2. Share-based Compensation**

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 123 (Revised 2004), *Share-Based Payment* ( SFAS No. 123 (Revised 2004) ), requiring the recognition of compensation cost for all equity classified awards granted, modified or settled after the effective date and for the unvested portion of awards outstanding as of the effective date using the fair-value measurement method. SFAS No. 123 (Revised 2004) revised SFAS No. 123, *Accounting for Stock-Based Compensation*, and superseded Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees*.

The Company recognizes the cost of all time-based employee stock options on a straight-line attribution basis and the cost of all performance-based employee stock options on an accelerated basis in accordance with Financial Accounting Standards Board Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* over their respective vesting periods, net of estimated forfeitures.



**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

***Share-based Compensation Plans Predecessor Entity***

Prior to the completion of the Merger, the Predecessor granted stock options and restricted stock units for a fixed number of shares to employees and directors under share-based compensation plans, which are more fully described in Note 13 to the audited consolidated financial statements included in the Company's 2006 Annual Report on Form 10-K under *Share-based Compensation Plans Predecessor Entity*. The exercise prices of the stock options were equal to the fair market value of the underlying shares at the date of grant. Compensation expense for restricted stock awards was measured at fair value on the date of grant based on the number of shares granted and the quoted market price of the Predecessor's common stock. Such value was recognized as an expense over the vesting period of the award adjusted for actual forfeitures.

Upon completion of the Merger and in accordance with the terms of the stock plans, all of the outstanding stock options became fully vested and immediately exercisable. Each option was valued at an amount equal to the excess of \$28.00 over the underlying stock option exercise price, less applicable withholding taxes. Each restricted stock unit award was exercised at \$28.00 in cash, without interest, less applicable withholding taxes.

There were no share-based grants during the period January 1, 2006 to February 13, 2006. The total intrinsic value of stock options and restricted stock units exercised due to the Merger was approximately \$20.0 million and \$4.4 million, respectively, for the period January 1, 2006 to February 13, 2006.

The total fair value of stock options and restricted stock units vested during the period from January 1, 2006 to February 13, 2006 was approximately \$11.2 million and \$4.0 million, respectively.

As of January 1, 2006, there was approximately \$9.3 million and \$3.2 million of total unrecognized compensation cost related to stock option grants and restricted stock unit awards, respectively, under the share-based compensation plans. The consummation of the Merger accelerated the recognition of compensation cost and, accordingly, all of this cost was included in selling, general and administrative expense in the condensed consolidated statements of operations for the period January 1, 2006 to February 13, 2006.

***Share-based Compensation Plans Successor Entity***

On February 14, 2006, the board of directors (the Board) and stockholders of Linens Holding Co. adopted the Linens Holding Co. Stock Option Plan (the Plan). The Plan provides employees or directors of the Company or its subsidiaries, who are in a position to contribute to the long-term success of these entities, with options to acquire shares in the Company to aid in attracting, retaining and motivating persons of outstanding ability. The Plan was amended in March 2006 to increase the number of shares of common stock, par value \$0.01 per share, of Linens Holding Co. (the Common Stock) available for issuance under the Plan to 1,157,298 shares.

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As of September 29, 2007, a total of 953,696 stock options were outstanding.

Stock options granted under the Plan to each optionee are equally divided between a Time Option and a Performance Option, as those terms are defined in the standard form of option grant letter. For each stock option granted the estimated fair market value of the underlying shares at the date of grant was less than or equal to the stock option's exercise price of \$50.00 per share, and expire seven years after the date of grant. Time Options become vested and exercisable in four equal installments on either (1) each of February 14, 2007, February 14, 2008, February 14, 2009, and February 14, 2010 with respect to options initially granted March 27, 2006 or (2) on each of the first four anniversaries of the date of grant for all other options. With respect to Performance Options and as provided for and defined in the standard form of grant letter, the stock options become vested and exercisable in two equal installments from a measurement date if, on such measurement date, the value per share equals or exceeds a target stock price.

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

The following is a summary of share-based option activity for the thirty-nine weeks ended September 29, 2007:

Options	Successor Entity		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)
	Shares			
<b>Outstanding at December 30, 2006</b>	<b>839,946</b>	<b>\$</b>	<b>50.00</b>	
Options granted	221,750		50.00	
Exercised				
Canceled	(108,000)		50.00	
<b>Outstanding at September 29, 2007</b>	<b>953,696</b>	<b>\$</b>	<b>50.00</b>	<b>5.77</b>
<b>Exercisable at September 29, 2007</b>	<b>190,157</b>	<b>\$</b>	<b>50.00</b>	<b>5.62</b>

There are no provisions in the Plan for the issuance of restricted stock units.

The weighted-average grant date fair value of options granted during the thirty-nine weeks ended September 29, 2007 and the period February 14, 2006 to September 30, 2006 was \$9.30 and \$17.34, respectively.

There were no stock option exercises during the thirty-nine weeks ended September 29, 2007 and the period February 14, 2006 to September 30, 2006.

The following is a summary of the activity for nonvested stock option grants as of September 29, 2007 and the changes for the thirty-nine weeks then ended:

	Successor Entity Stock Options	
	Options	Fair Value(1)
<b>Nonvested at December 30, 2006</b>	<b>736,946</b>	<b>\$ 17.41</b>
Grants	221,750	\$ 9.30
Vested	(90,655)	\$ 16.59
Canceled	(104,502)	\$ 16.91
<b>Nonvested at September 29, 2007</b>	<b>763,539</b>	<b>\$ 15.22</b>

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(1) Represents the weighted-average grant date fair value per option, using the Monte Carlo simulation option-pricing model for Performance Options, and the Black-Scholes option-pricing model for Time Options.

The total fair value of stock options vested during the thirty-nine weeks ended September 29, 2007 and the period February 14, 2006 to September 30, 2006 was approximately \$1.5 million and \$1.6 million, respectively.

As of September 29, 2007, there was approximately \$7.7 million of total unrecognized compensation cost related to stock option grants both under and outside the Plan. This cost is expected to be recognized over a remaining weighted-average period of 2.3 years. The compensation cost that has been charged against income for stock option grants was approximately \$0.9 million and \$1.0 million for the thirteen weeks ended September 29, 2007 and September 30, 2006, respectively. The compensation cost that has been charged against income for stock option grants was approximately \$2.3 million and \$3.4 million for the thirty-nine weeks ended September 29, 2007 and for the period February 14, 2006 to September 30, 2006, respectively. Such compensation cost is included in selling, general and administrative expenses in the condensed consolidated statements of operations.

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d

Prior to the adoption of SFAS 123 (Revised 2004) the Company used the Black-Scholes option-pricing model for estimating the fair value for all options granted. Beginning in the first quarter of 2006, the Company used the Monte Carlo simulation option-pricing model for estimating the fair value of Performance Options and the Black-Scholes option-pricing model for Time Options. This change was made in order to provide a better estimate of fair value. The Monte Carlo option-pricing model is particularly useful in the valuation of options with complicated features that make them difficult to value through a straight-forward Black-Scholes-style computation.

Presented below is a comparative summary of valuation assumptions for grants issued in each of the indicated periods:

	Thirteen Weeks Ended September 29, 2007 (Monte Carlo Simulation and Black-Scholes)	Thirteen Weeks Ended September 30, 2006 (Monte Carlo Simulation and Black-Scholes)
<b>Valuation Assumptions:</b>		
Weighted-average calculated value of options granted	\$ 9.03	\$ 16.43
Expected volatility (1)	N/A	N/A
Weighted-average volatility (1)	30.6%	36.2%
Weighted-average expected term (in years)	3.6	3.6
Dividend yield		
Risk-free interest rate	4.2% - 5.1%	4.6% - 5.0%
Weighted-average risk-free interest rate	4.6%	4.8%
Weighted average expected annual forfeiture	1.2%	1.6%

	Thirty-nine Weeks Ended September 29, 2007 (Monte Carlo Simulation and Black-Scholes) (Successor Entity)	February 14, 2006 to September 30, 2006 (Monte Carlo Simulation and Black-Scholes) (Successor Entity)	January 1, 2006 to February 13, 2006 (Black-Scholes) (Predecessor Entity)
<b>Valuation Assumptions:</b>			
Weighted-average calculated value of options granted	\$ 9.30	\$ 17.34	No Grants
Expected volatility (1)	N/A	N/A	No Grants
Weighted-average volatility (1)	33.6%	37.9%	No Grants
Weighted-average expected term (in years)	3.4	3.7	No Grants
Dividend yield			No Grants
Risk-free interest rate	4.2% - 5.1%	4.6% - 5.2%	No Grants
Weighted-average risk-free interest rate	4.6%	4.8%	No Grants
Weighted average expected annual forfeiture	1.9%	3.8%	No Grants

(1) The Company used the average of the historical volatility of each of the component companies included in the Standard & Poor's Specialty Retail Index as a substitute for expected volatility.

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It is not possible for the Company, whose stock is not publicly traded, to use Company-specific volatility in determining a reasonable estimate of fair value of options granted. Accordingly, the Company is required to use an alternative measurement method. Under the alternative measurement method, a nonpublic entity uses a calculated volatility, determined by applying the historical volatility of an appropriate index of public entities, as an input to the valuation models. The Company used the Standard & Poor's Specialty Retail Index for a period approximating the expected term as this index most closely approximates the Company's applicable operating industry. Expected term of share options granted represents the period of time that the option grants are expected to be outstanding. The Company is not expected to pay dividends and, accordingly, the dividend yield is zero. The risk-free interest rate within the expected term was based on the U.S. Treasury yield curve in effect at the time of grant.

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d

Share-based employee compensation expense included in net loss in the condensed consolidated statements of operations, net of related tax effects, is detailed as follows:

	Successor Entity		Predecessor Entity
(In thousands)	Thirty-nine Weeks Ended September 29, 2007	February 14, 2006 to September 30, 2006	January 1, 2006 to February 13, 2006
<b>Compensation expense:</b>			
Stock option grants	\$ 2,330	\$ 3,363	\$ 9,305
Restricted stock units			3,179
	2,330	3,363	12,484
<b>Benefit for income taxes:</b>			
Stock option grants	(569)	(1,258)	(2,861)
Restricted stock units			(978)
	(569)	(1,258)	(3,839)
<b>Share-based employee compensation expense, net of related tax effects</b>	<b>\$ 1,761</b>	<b>\$ 2,105</b>	<b>\$ 8,645</b>

## 3. Comprehensive Loss

Comprehensive loss for the thirteen weeks ended September 29, 2007 and September 30, 2006 is as follows:

(In thousands)	Thirteen Weeks Ended September 29, 2007	Thirteen Weeks Ended September 30, 2006
Net loss	\$ (79,929)	\$ (27,375)
Other comprehensive income (loss)		
Cumulative translation adjustments	6,007	(127)
Unrealized loss on hedge arrangements(1)	(22)	(898)
<b>Comprehensive loss</b>	<b>\$ (73,944)</b>	<b>\$ (28,400)</b>

(1) On July 7, 2006 the Issuers entered into a zero cost interest rate collar agreement to hedge the cash flows associated with the LIBOR component of the interest rate on the Notes. On July 7, 2006 the Issuers also purchased a one-year forward-starting interest rate cap agreement which takes effect on January 15, 2008 (see Note 9 for

disclosures regarding these derivatives).



**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

Comprehensive loss for the thirty-nine weeks ended September 29, 2007, the period February 14, 2006 to September 30, 2006 and the period January 1, 2006 to February 13, 2006 is as follows:

	<b>Successor Entity</b>		<b>Predecessor Entity</b>
	<b>Thirty-nine Weeks Ended September 29, 2007</b>	<b>February 14, 2006 to September 30, 2006</b>	<b>January 1, 2006 to February 13, 2006</b>
<b>(In thousands)</b>			
Net loss	\$ (180,089)	\$ (84,074)	\$ (47,904)
Other comprehensive income (loss)			
Cumulative translation adjustments	15,227	1,827	253
Unrealized gain (loss) on hedge arrangements(1)	27	(898)	
<b>Comprehensive loss</b>	<b>\$ (164,835)</b>	<b>\$ (83,145)</b>	<b>\$ (47,651)</b>

(1) On July 7, 2006 the Issuers entered into a zero cost interest rate collar agreement to hedge the cash flows associated with the LIBOR component of the interest rate on the Notes. On July 7, 2006 the Issuers also purchased a one-year forward-starting interest rate cap agreement which takes effect on January 15, 2008 (see Note 9 for disclosures regarding these derivatives).

**4. Impairment of Property and Equipment**

During the thirteen weeks ended September 29, 2007, the Company initiated a formal impairment analysis of both tangible and intangible long-term assets. Based on this analysis, the Company determined that the carrying value of certain property and equipment exceeded its related estimated future undiscounted cash flows. As a result, the Company reduced the carrying value of property and equipment to its fair value by approximately \$16.8 million.

**5. Identifiable Intangible Assets (Including Goodwill)**

The acquisition of Linens n Things, Inc. was accounted for as a business combination using the purchase method of accounting, whereby the purchase price (including liabilities assumed) was allocated to the assets acquired based on their estimated fair market values at the date of acquisition. Independent third-party appraisers were engaged to assist management and perform valuations of certain of the tangible and intangible assets acquired. The excess of the total purchase price over the fair value of the Company's net assets was allocated to goodwill.

**Goodwill**

The following table presents an analysis of the change in goodwill for the thirty-nine weeks ended September 29, 2007:

(in thousands)	Amount	
<b>Balance at December 30, 2006</b>	<b>\$</b>	<b>267,830</b>
Pre-existing tax adjustments		12,634
Pre-existing book adjustments		(11,130)
Other foreign currency translation		2,747
<b>Balance at September 29, 2007</b>	<b>\$</b>	<b>272,081</b>

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d

*Identifiable Intangible Assets*

The carrying amount and accumulated amortization of identifiable intangible assets consists of the following:

(in thousands)	September 29, 2007	December 30, 2006	September 30, 2006
Intangible assets subject to amortization:			
Credit card customer relationships	\$ 10,257	\$ 10,129	\$ 10,163
Customer list	406	406	406
Favorable leases	23,941	23,852	27,373
	34,604	34,387	37,942
Less: accumulated amortization	(12,709)	(7,031)	(5,269)
Total intangible assets subject to amortization	21,895	27,356	32,673
Total indefinite-lived trademarks	122,688	122,688	122,688
<b>Total identifiable intangible assets</b>	<b>\$ 144,583</b>	<b>\$ 150,044</b>	<b>\$ 155,361</b>

Customer list has an estimated life of 5 years, credit card customer relationships have an estimated life of 3 years and favorable leases have an average estimated life of 8 years. For the thirteen weeks ended September 29, 2007 and September 30, 2006 amortization expense of \$1.9 million and \$2.5 million, respectively, was recorded by the Company and is included in selling, general and administrative expenses in the condensed consolidated statements of operations. For the thirty-nine weeks ended September 29, 2007, the period February 14, 2006 to September 30, 2006 and the period January 1, 2006 to February 13, 2006, amortization expense of \$5.6 million, \$5.7 million and \$0.02 million, respectively, was recorded by the Company.

The following is a summary table representing the remaining amortization of identifiable intangible assets, net, with definitive lives, by year (in thousands):

Fiscal Year	Amortization
2007 (September 30, 2007 to December 29, 2007)	\$ 1,855
2008	6,538
2009	3,141
2010	2,416
2011	2,041
2012 and thereafter	5,904
<b>Total</b>	<b>\$ 21,895</b>

**6. Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities includes amounts due customers principally for gift card, customer rebate and sales return liabilities of \$48.5 million, \$55.3 million and \$40.0 million as of September 29, 2007, December 30, 2006 and September 30, 2006, respectively. Income from gift cards that are not expected to be redeemed is recorded in other income, net in the condensed consolidated statements of operations. Such amounts recognized for the thirteen weeks ended September 29, 2007 and September 30, 2006 were approximately \$1.1 million and \$1.0 million, respectively. Such amounts recognized for the thirty-nine weeks ended September 29, 2007, the period February 14, 2006 to September 30, 2006 and the period January 1, 2006 to February 13, 2006 were approximately \$2.7 million, \$2.6 million and \$0.5 million, respectively.

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d

**7. Senior Secured Notes, Asset-based Revolving Credit Facility and Other Long-Term Debt**

Senior secured notes, asset-based revolving credit facility and other long-term debt consists of the following:

(in thousands)	September 29, 2007	December 30, 2006	September 30, 2006
Senior secured floating rate notes due 2014	\$ 650,000	\$ 650,000	\$ 650,000
Asset-based revolving credit facility	328,180	37,800	(1)
Mortgage note payable		2,076	2,092
	<b>\$ 978,180</b>	<b>\$ 689,876</b>	<b>\$ 652,092</b>

(1) \$225,870 in borrowings outstanding under the asset-based revolving credit facility was classified as short-term borrowings as of September 30, 2006.

***Senior Secured Floating Rate Notes Due 2014***

Senior secured floating rate notes due 2014 consist of \$650.0 million aggregate principal amount of Senior Secured Floating Rate Notes due 2014 of Linens n Things, Inc. and Linens n Things Center, Inc.

The Notes bear interest at a per annum rate equal to LIBOR plus 5.625%, which is to be paid every three months on January 15, April 15, July 15 and October 15. The interest rate on the Notes is reset quarterly. The Notes mature on January 15, 2014. As of September 29, 2007 the interest rate on the Notes was 11.0%, based on a LIBOR rate of 5.4%.

On July 7, 2006 the Issuers entered into a zero cost interest rate collar agreement to hedge the cash flows associated with the LIBOR component of the interest rate on the Notes. On July 7, 2006 the Issuers also purchased a one-year forward-starting interest rate cap agreement which takes effect on January 15, 2008 (see Note 9).

Deferred financing costs of approximately \$31 million relating to the Notes are being amortized over eight years using the effective interest method.

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The Notes are fully and unconditionally guaranteed jointly and severally on a senior basis by the Company and by certain of the Company's domestic subsidiaries other than the Issuers (collectively, the Note Guarantors), and are secured by first-priority liens on all of the Company's and Note Guarantors' equipment, intellectual property rights and related general intangibles and the capital stock of the Issuers and certain subsidiaries and by second-priority liens on the Issuers' and the Note Guarantors' inventory, accounts receivable, cash, securities and other general intangibles. The lien on capital stock may be released under certain circumstances. As a result of the filing and effectiveness of a registration statement on Form S-4 with the SEC with respect to the Notes, the Issuers and the Note Guarantors became subject to applicable SEC rules with respect to information required to be included in the prospectus in the registration statement. To the extent that the securities of any Issuer or Note Guarantor constitute collateral for the Notes and the value of the securities equals or exceeds 20% of the principal amount, or \$130.0 million of the Notes, separate financial statements of the Issuer or Note Guarantor would be required under these SEC rules to be included in the Company's SEC filings. The indenture that governs the Notes provides, however, with respect to any direct or indirect subsidiary of Linens n Things, Inc., that the securities of the subsidiary are released from the lien on capital stock on the date that the lien triggers this separate financial statement requirement. Accordingly, for any subsidiary with securities that equal or exceed the 20% threshold, the lien on the capital stock securing the Notes has been released with respect to those securities. The lien on the capital stock of Linens n Things, Inc. remains in place.

If the Issuers sell certain assets or experience specific kinds of changes in control, the Issuers must offer to repurchase the Notes. The Issuers may, at their option, redeem the Notes at any time on or after January 15, 2008 at pre-determined prices. Prior to January 15, 2008, the Issuers may, at their option, redeem up to 35% of the Notes with the proceeds of certain sales of its equity or of its subsidiaries. Prior to January 15, 2008, the Issuers may, at their option, redeem the Notes at a price equal to 100% of the principal amount of the Notes plus a make-whole premium.

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

***Senior Secured Asset-based Revolving Credit Facility***

In February 2006, the Company entered into a new senior secured asset-based revolving credit facility agreement (the *Original Credit Facility*) with third-party institutional lenders, which expires February 14, 2011. In May 2007, the Company entered into an amended and restated credit agreement (the *Old Credit Facility*). The provisions of the Old Credit Facility are substantially the same as in the Original Credit Facility with several modifications that are generally favorable to the Company. The provisions of the Old Credit Facility were modified for: (i) a \$100.0 million increase in the Old Credit Facility maximum availability from \$600.0 million to \$700.0 million; (ii) a decrease in the *Excess Availability* threshold for purposes of mandatory compliance with certain financial ratio maintenance covenants from \$75.0 million to \$70.0 million; and (iii) several other modifications that are all favorable to the Company. A copy of the Old Credit Facility is attached as Exhibit 10.1 to Form 8-K filed with the SEC on May 29, 2007.

The Old Credit Facility provides senior secured financing of up to \$700.0 million, subject to a borrowing base consisting of certain eligible inventory and receivables, minus certain reserves. A portion of the Old Credit Facility, not to exceed \$40.0 million, is also available to a Canadian subsidiary of the Company subject to the Canadian borrowing base. The Company incurred deferred financing costs of approximately \$17 million and \$2 million related to the Original Credit Facility and the Old Credit Facility, respectively, which are being amortized over five years on a straight-line basis.

All obligations under the Old Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of the Company's, the Issuers' and the subsidiary guarantors' assets, including: (1) a first-priority security interest in inventory, accounts receivable, cash, securities and other general intangibles; and (2) a second-priority security interest in equipment, intellectual property rights and related general intangibles and all of the capital stock of the Issuers and the capital stock of certain subsidiaries.

Borrowings under the Old Credit Facility bear interest at a rate equal to, at the borrowers' option, either (a) an alternate base rate determined by reference to the higher of (1) the base rate in effect on such day and (2) the federal funds effective rate plus 0.50% or (b) a LIBOR rate, with respect to any Eurodollar borrowing, determined by reference to the costs of funds for U.S. dollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs, in each case plus an applicable margin. In addition to paying interest on outstanding principal under the Old Credit Facility, the Company is required to pay a variable rate commitment fee in respect of the unutilized commitments thereunder. The Old Credit Facility requires the Company to comply with financial ratio maintenance covenants if the excess availability under the Old Credit Facility, at any time, does not exceed \$70.0 million and also contains certain restrictive covenants including the Company's ability to pay dividends and certain customary affirmative and negative covenants and events of default. During the thirty-nine weeks ended September 29, 2007, the Company always maintained excess availability above \$70.0 million.

As of September 29, 2007, the Issuers had (i) \$328.2 million in borrowings outstanding under the Old Credit Facility at an average interest rate of 6.9%; (ii) \$12.1 million of cash on hand; (iii) \$109.0 million of letters of credit outstanding issued under the Old Credit Facility, which includes standby letters of credit and import letters of credit used for merchandise purchases; and (iv) \$238.5 million of excess availability under the Old Credit Facility.

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In October 2007, the Company entered into a new senior secured asset-based revolving credit facility agreement (the New Credit Facility ) with third-party institutional lenders, which expires October 24, 2012. The New Credit Facility replaced the Old Credit Facility described above (see Note 12).

### ***Mortgage Note Payable***

Mortgage note payable represented an 8.2% fixed-rate mortgage note on the land and building of one of the Company's closed stores. In July 2007 the land and building was sold and the mortgage was repaid.



## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, continued

**8. Income Taxes (Including the Adoption of FIN No. 48)***Adoption of Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes and interpretation of FASB Statement No. 109*

The Company is subject to tax in the United States and in various states and foreign jurisdictions. The Company, joined by its domestic subsidiaries, files a consolidated income tax return for Federal income tax purposes. With few exceptions, the Company is no longer subject to U.S. Federal, state and local income tax or non-U.S. income tax examinations by tax authorities for tax years before 2004. The Internal Revenue Service ( IRS ) commenced an examination of the Company's U.S. consolidated income tax returns for the years 2004 and 2005 and the period January 1, 2006 to February 13, 2006, inclusive, in the first quarter of 2007. Based on its work to date, the IRS has not proposed any adjustments to any of the Company's tax positions.

Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes and Interpretation of FASB Statement No. 109 ( FIN No. 48 ), was issued in July 2006 and interprets FASB SFAS No. 109, Accounting for Income Taxes ( SFAS No. 109 ). FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company, in its opening balance sheet for 2007, is required to reflect, as cumulative adjustments to the Company's retained earnings, the impact of FIN No. 48 on its income tax accruals for all prior years subject to adjustment by federal, state, local and foreign taxing authorities (open years). The Company has undertaken an analysis of all material tax positions in its tax accruals for all open years and has identified all of its outstanding tax positions and estimated the transition amounts with respect to each item at the effective date. The Company has determined that no adjustment to shareholders' equity is required as a result of applying FIN No. 48. The Company expects no material change for the next twelve months as a result of adopting FIN No. 48. The Company will continue its policy of classifying interest on tax liabilities as part of the provision for income taxes. The Company does not anticipate any significant payments with respect to any tax assessments within the next twelve months.

The Company adopted the provisions of FIN No. 48 on December 31, 2006. As a result of the implementation of FIN No. 48, the Company recognized no change with respect to any unrealized tax benefits and therefore made no change to the December 31, 2006 opening retained earnings balance. A reconciliation of the beginning and ending amount of unrecognized tax benefits, including accrued interest and penalties, is as follows (in thousands):

	Amount
Beginning balance at December 31, 2006 (date of adoption)	\$ 8,702
Additions for current year tax positions	76
Additions for prior year tax positions	4,821
Reductions for prior year tax positions	
Settlements	
Reductions due to a lapse of the applicable statute of limitations	
Ending balance at September 29, 2007	\$ 13,599

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Included in the ending balance at September 29, 2007 are approximately \$13.1 million of tax positions (\$11.6 million net of tax benefits) for which the ultimate deductibility is highly certain but for which uncertainty exists as to the timing of such deductions.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits as part of the provision for income taxes. At September 29, 2007 and December 31, 2006 (the date of adoption), accrued interest and penalties included in the FIN No. 48 reserve amounted to approximately \$2.0 million and \$0.9 million, respectively (net of tax benefits). The FIN No. 48 reserve is included in accrued expenses and other current liabilities in the condensed consolidated balance sheets. The Company recorded approximately \$0.8 million and \$1.2 million of interest and penalties during the thirteen weeks and thirty-nine weeks ended September 29, 2007, respectively, which is included in provision (benefit) for income taxes in the condensed consolidated statements of operations.

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

During the thirteen weeks ended September 29, 2007, the Company recorded income tax expense of approximately \$0.7 million on a loss before taxes of \$79.2 million at an effective income tax rate of 0.9%. A current quarter tax benefit on the loss before taxes was offset by a valuation allowance of \$25.1 million which was recorded against United States net operating losses resulting in an effective income tax rate lower than the Federal statutory rate of 35%.

During the thirty-nine weeks ended September 29, 2007, the Company recorded an income tax benefit of approximately \$58.1 million on a loss before taxes of \$238.2 million at an effective tax benefit rate of 24.4%. The Federal statutory rate of 35.0% is higher than the effective tax benefit rate primarily due to the valuation allowance against United States net operating losses referred to in the immediately preceding paragraph and to different tax rules outside the United States.

In assessing the realizability of deferred tax assets included in the condensed consolidated balance sheets, management considers whether it is more likely than not that some portion or all of the tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. In accordance with this policy and the requirements of SFAS No. 109, the valuation allowance of \$25.1 million referred to above was recorded against United States net operating losses in the current quarter.

## **9. Derivative Financial Instruments**

The Company accounts for derivative instruments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS No. 133 ), as amended. In accordance with SFAS No. 133, the Company reports all derivative financial instruments on its balance sheet at fair value and has established criteria for designation and evaluation of effectiveness of transactions entered into for hedging purposes.

The Company employs derivative financial instruments to manage its exposure to interest rate changes and to limit the volatility and impact of interest rate changes on earnings and cash flows.

The Company does not enter into other derivative financial instruments for trading or speculative purposes. The Company faces credit risk if the counterparties to these transactions are unable to perform their obligations. However, the Company seeks to minimize this risk by entering into transactions with counterparties that are major financial institutions with high credit ratings.

The Company records unrealized gains and losses on derivative financial instruments qualifying as cash flow hedges in accumulated other comprehensive income (loss) on the condensed consolidated balance sheets, to the extent that hedges are effective. For derivative financial instruments which do not qualify as cash flow hedges, any changes in fair value would be recorded in the condensed consolidated statements of operations.

The Company may at its discretion terminate or de-designate any such hedging instrument agreements prior to maturity. At that time, any gains or losses previously reported in accumulated other comprehensive income (loss) on termination would amortize into interest expense or interest income to correspond to the recognition of interest expense or interest income on the hedged debt. If such debt instrument was also terminated, the gain or loss associated with the terminated derivative included in accumulated other comprehensive income (loss) at the time of termination of the debt would be recognized in the condensed consolidated statements of operations at that time.

On July 7, 2006 the Issuers entered into a zero cost interest rate collar agreement (the Collar Agreement ) to hedge the cash flows associated with the LIBOR component of the interest rate on the Notes. The Collar Agreement provides for payments to be made to or received from the counterparty where the LIBOR component of the rate in effect for the Notes is below 4.45% or above 6.51% for a given reset period. Such payments represent the difference between the rates stated above in the Collar Agreement and those in effect on the Notes for the given reset period. Payment and reset dates under the Collar Agreement are matched exactly to those of the Notes. The Collar Agreement has an ultimate maturity of January 15, 2008. To the extent that the three-month LIBOR rate is below the Collar Agreement floor, payment is due from the Company to the counterparty for the difference. To the extent the three-month LIBOR rate is above the Collar Agreement cap, the Company is entitled to receive the difference from the counterparty. At the inception of the Collar Agreement, the Company determined that the hedging relationship would have no ineffectiveness, and the Company will continue to verify and document that the critical terms of the hedging instrument and the hedged item are exactly matched. At September 29, 2007, the notional amount of debt related to the Collar Agreement was \$650.0 million and the fair value of the Collar Agreement was a de minimis liability.

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

On July 7, 2006 the Issuers also purchased a one-year forward-starting interest rate cap agreement (the "Cap Agreement") which takes effect on January 15, 2008. The Cap Agreement provides for payments to be received from the counterparty where the LIBOR component of the rate in effect on a LIBOR-based borrowing arrangement is above 6.51% for a given reset period. Such payments represent the difference between the LIBOR rate stated above in the Cap Agreement and those in effect on a LIBOR-based borrowing arrangement for the given reset period. Payment and reset dates under the Cap Agreement are matched exactly to those of the LIBOR-based borrowing arrangement. The Cap Agreement has an ultimate maturity of January 15, 2009. The Issuers paid a premium of \$0.7 million to purchase the Cap Agreement. The Cap Agreement consists of two components, a forward contract and an interest rate cap agreement. The Company's intent is to hedge the cash flow associated with the LIBOR component of the interest rate on a LIBOR-based borrowing arrangement beyond 6.51% for the period January 15, 2008 through January 15, 2009. The forward contract should enable the Company to achieve this objective. The Company will assess the effectiveness of the forward contract quarterly. Once the forward contract becomes an interest rate cap agreement, effectiveness will be assessed and documented as a new relationship. The interest rate cap agreement is expected to be perfectly effective at such time, and the Company will continue to subsequently verify and document that the critical terms of the interest rate cap agreement and the hedged item continue to match exactly over the remaining life of the relationship. At September 29, 2007, the notional amount of debt related to the Cap Agreement was \$650.0 million and the fair value of the instrument was approximately a \$0.02 million asset.

The Company has determined that the Collar Agreement and the Cap Agreement have been appropriately designated and documented as cash flow hedges under SFAS No. 133. As such, changes in the fair value of the Collar Agreement and the Cap Agreement have been recorded in accumulated other comprehensive income (loss) on the condensed consolidated balances sheets. During the thirteen weeks ended September 29, 2007 and September 30, 2006 the Company has recorded a loss of approximately \$0.02 million and \$0.9 million, respectively, in accumulated other comprehensive income (loss) related to these changes in fair value. During the thirty-nine weeks ended September 29, 2007 and the period February 14, 2006 to September 30, 2006 the Company has recorded a gain of approximately \$0.03 million and a loss of approximately \$0.9 million, respectively, in accumulated other comprehensive income (loss) related to these changes in fair value. The Collar Agreement and the Cap Agreement had no ineffectiveness and provided no amounts received or paid under the hedges that affected net loss during the period. Both agreements are expected to have no ineffectiveness during their contractual lives.

**10. Recent Accounting Pronouncements**

In February 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115* ("SFAS No. 159"). SFAS No. 159 permits, but does not require, companies to report at fair value the majority of recognized financial assets, financial liabilities and firm commitments. Under this standard, unrealized gains and losses on items for which the fair value option is elected are reported in earnings at each subsequent reporting date. The Company is currently assessing the effect SFAS No. 159 may have, if any, on its consolidated financial statements when it becomes effective as of the beginning of fiscal 2008.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ("SFAS No. 158"). SFAS No. 158 requires, among other items, recognition of the overfunded or underfunded status of an entity's defined benefit postretirement plan as an asset or liability, respectively, in the balance sheet, requires the measurement of defined benefit postretirement plan assets and obligations as of the end of the employer's fiscal year, and requires recognition of changes in funded status of defined benefit postretirement plans in the year in which the changes occur in other comprehensive income. SFAS No. 158 is effective as of the end of the fiscal year ending after June 15, 2007 and early application is encouraged. The adoption of SFAS No. 158 is not expected to have a material effect on the Company's financial position or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS No. 157 ) which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. This statement defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. The Company is in the process of determining the effect, if any, that the adoption of SFAS No. 157 will have on its financial statements.

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( SAB No. 108 ). SAB No. 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB No. 108 establishes an approach that requires quantification of financial statement errors based on the effects on each of the Company's financial statements and related financial statement disclosures. SAB No. 108 permits existing public companies to record the cumulative effect of initially applying this approach in the first year ending after November 15, 2006 by recording the necessary correcting adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of retained earnings. Additionally, the use of the cumulative effect transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose.

In June 2006, the FASB's Emerging Issues Task Force reached a consensus on Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That Is, Gross versus Net Presentation)* ( EITF 06-3 ). EITF 06-3 includes sales, use, value-added and some excise taxes that are assessed by a governmental authority on specific revenue-producing transactions between a seller and a customer. EITF 06-3 requires disclosure of the method of accounting for the applicable assessed taxes and the amount of assessed taxes included in revenues if such taxes are accounted for under the gross method. EITF 06-3 became effective for both interim and annual periods beginning in fiscal year 2007. EITF 06-3 did not impact the Company's method for recording these applicable assessed taxes because the Company has historically presented sales excluding such taxes, that is net presentation.

**11. Related Party Transactions**

***Management Services Agreement***

Upon consummation of the Merger, the Company entered into a management services agreement with Apollo Management V, L.P., NRDC Linens B LLC and Silver Point Capital Fund Investments LLC (each of whom is an affiliate of the Company). Under this management services agreement, the Sponsors agreed to provide to the Company certain investment banking, management, consulting, financial planning and real estate advisory services on an ongoing basis for a fee of \$2.0 million per year. Under this management services agreement, Apollo Management V, L.P. also agreed to provide to the Company certain financial advisory and investment banking services from time to time in connection with major financial transactions that may be undertaken by it or its subsidiaries in exchange for fees customary for such services after taking into account Apollo Management V, L.P.'s expertise and relationships within the business and financial community. Under this management services agreement, the Company also agreed to provide customary indemnification. In addition, the Company paid a transaction fee of \$15.0 million in the aggregate (plus reimbursement of expenses) to the Sponsors for financial advisory services rendered in connection with the Merger. Thirty percent of this fee, or \$4.5 million, was included as part of the purchase price and the remaining 70%, or \$10.5 million, has been included in deferred financing costs. These services included assisting the Company in structuring the Merger, taking into account tax considerations and optimal access to financing, and assisting in the negotiation of the Company's material agreements and financing arrangements in connection with the Merger.

***Stockholders Agreement***

## Edgar Filing: Linens Holding Co. - Form 10-Q

The only stockholders of the Company are Linens Investors, LLC, a limited liability company owned by the Sponsors, two executives of the Company, Robert J. DiNicola, Chairman and Chief Executive Officer, and F. David Coder, Executive Vice President, Store Operations, and one nonemployee director, George G. Golleher. Linens Investors, LLC has entered into a stockholders' agreement with the Company, and each of the other stockholders have entered into joinder agreements to be bound by the stockholders' agreement. The stockholders' agreement sets forth certain provisions relating to the management of the Company. In addition, the stockholders' agreement contains customary drag along rights, tag along rights, registration rights, restrictions on the transfer of the Company's common stock and an indemnity of the Sponsors.



**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

**12. Subsequent Event**

In October 2007, the Company entered into a new senior secured asset-based revolving credit facility agreement with third-party institutional lenders, which expires October 24, 2012. The New Credit Facility replaced the Old Credit Facility, which is more fully described in Note 7.

The New Credit Facility extends \$700.0 million of revolving credit facilities to the Company, comprised of (i) a \$625.0 million Revolving Commitment and (ii) a \$75.0 million Tranche B Commitment, both of which are subject to a borrowing base. A portion of the New Credit Facility, not to exceed \$40.0 million, is also available to a Canadian subsidiary of the Company subject to the Canadian borrowing base. The borrowing base is a formula based on certain eligible inventory and receivables, minus certain reserves, and the New Credit Facility reflects increases in the Company's advance rates on this collateral, which will enhance the liquidity position of the Company in comparison to the Old Credit Facility. The New Credit Facility also eliminates all financial maintenance covenants. These changes will result in a material increase to the Company's aggregate borrowing base and excess availability as compared with the Old Credit Facility. As of September 29, 2007, if the New Credit Facility had been in effect at the end of the third quarter, the excess availability under the New Credit Facility on a pro forma basis would have been \$255.5 million, which compares to \$238.5 million under the Old Credit Facility. Insofar as the Old Credit Facility had a financial maintenance covenant (which as noted above has been eliminated in the New Credit Facility) that would have likely restricted the use of the last \$70.0 million of availability, the effective increase in excess availability under the New Credit Facility would have been \$87.0 million. Other terms and conditions in the New Credit Facility are similar to those under the Old Credit Facility.

All obligations under the New Credit Facility are unconditionally guaranteed by the Company and certain of its existing and future domestic subsidiaries. All obligations under the New Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of the assets of the borrowers, consisting of Linens 'n Things, Inc., Linens 'n Things Center, Inc. and Linens 'n Things Canada Corp. (collectively, the Borrowers), and the subsidiary guarantors, including: (i) a first-priority security interest in inventory, accounts receivable, cash, securities and other general intangibles; and (ii) a second-priority security interest in equipment, intellectual property rights and related general intangibles and all of the capital stock of Linens 'n Things, Inc. and the capital stock of certain subsidiaries.

Borrowings under the New Credit Facility bear interest at a rate equal to, at the Borrowers' option, either (a) an alternate base rate determined by reference to the higher of (1) the base rate in effect on such day and (2) the federal funds effective rate plus 0.50% or (b) a LIBOR rate, with respect to any Eurodollar borrowing, determined by reference to the costs of funds for U.S. dollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs, in each case plus an applicable margin. The initial applicable margin for borrowings under the New Credit Facility is 0.25% with respect to alternate base rate borrowings and 1.50% with respect to LIBOR borrowings. The applicable margin with respect to Tranche B Loans (consisting of per annum rate margins) shall be 2.75% in the case of Eurodollar borrowings and, in the event the adjusted LIBOR rate is not available, 1.25% in the case of alternate base rate borrowings. The applicable margin for borrowings under the New Credit Facility will be subject to adjustment based on the excess availability under the New Credit Facility. In addition to paying interest on outstanding principal under the New Credit Facility, the Borrowers are required to pay a commitment fee, initially 0.375% per annum, in respect of the unutilized commitments thereunder and the commitment fee will be subject to adjustment based on the excess availability under the New Credit Facility. The New Credit Facility contains certain customary affirmative and negative covenants and events of default, but all financial maintenance covenants were eliminated. The Borrowers must also pay customary letter of credit fees and agency fees. The Borrowers initiated borrowings under the New Credit Facility on October 24, 2007 to meet operational working capital needs. A portion of the proceeds of the New Credit Facility was used to pay off the outstanding amounts under and terminate the Old Credit Facility which is more fully described in Note 7.

The New Credit Facility will require the Company to accelerate the writeoff of approximately \$7.0 million of deferred financing costs related to the Old Credit Facility in the subsequent period.

A copy of the New Credit Facility is attached as Exhibit 10.1 to Form 8-K filed with the SEC on October 26, 2007.

### **13. Supplemental Condensed Consolidating Financial Information**

On February 14, 2006 Linens n Things, Inc. and Linens n Things Center, Inc. (collectively, the Issuers ) issued \$650.0 million aggregate principal amount of Senior Secured Floating Rate Notes due 2014. The Notes are fully and unconditionally guaranteed, jointly and severally, on a senior basis by the Company, and by each of the Company s direct and indirect subsidiaries that guarantee the Company s asset-based revolving credit facility except for its Canadian subsidiaries. The Company s Canadian subsidiaries (the Non-Guarantors ) are not guarantors of the Notes.

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, cont d**

The following tables present the supplemental condensed consolidating financial information for the Company (Parent), the Co-Issuers, the Guarantors (excluding the Company which is also a Guarantor but is separately presented) and the Non-Guarantors, together with eliminations, as of and for the periods indicated. The Company has not presented separate financial statements and other disclosures concerning the Co-Issuers, Guarantors and Non-Guarantors because management has determined that such information is not meaningful to investors. The accounting policies for Parent, Co-Issuers, Guarantors, and Non-Guarantors are the same as those more fully described in Note 2 to the audited consolidated financial statements included in the Company's 2006 Annual Report on Form 10-K under *Summary of Significant Accounting Policies*. The financial information may not necessarily be indicative of the financial position, results of operations or cash flows had the Parent, Co-Issuers, Guarantors and Non-Guarantors operated as independent entities.

The information (1) at September 29, 2007, December 30, 2006 and September 30, 2006 and (2) for the thirteen weeks ended September 29, 2007 and September 30, 2006, the thirty-nine weeks ended September 29, 2007 and the period February 14, 2006 to September 30, 2006, presents the financial position and results of operations and cash flows, respectively, of the Successor Entity. The information for the period January 1, 2006 to February 13, 2006 presents the results of operations and cash flows of the Predecessor Entity.

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

For the Thirteen Week Period Ended September 29, 2007

(InThousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Net sales</b>	\$	\$ 14,421	\$ 587,813	\$ 64,557	\$	\$ 666,791
Cost of sales, including buying and distribution costs		8,791	362,579	34,317		405,687
<b>Gross profit</b>		<b>5,630</b>	<b>225,234</b>	<b>30,240</b>		<b>261,104</b>
Selling, general and administrative expenses		5,589	269,094	26,244		300,927
Impairment of property and equipment			16,779			16,779
<b>Operating profit (loss)</b>		<b>41</b>	<b>(60,639)</b>	<b>3,996</b>		<b>(56,602)</b>
Interest income		(3,586)		(74)	3,586	(74)
Interest expense			27,437	346	(3,586)	24,197
Interest (income) expense, net		(3,586)	27,437	272		24,123
Other income, net		(26)	(1,122)	(391)		(1,539)
<b>Income (loss) before income taxes</b>		<b>3,653</b>	<b>(86,954)</b>	<b>4,115</b>		<b>(79,186)</b>
Provision (benefit) for income taxes		2,522	(3,201)	1,422		743
<b>Net income (loss)</b>	\$	\$ 1,131	\$ (83,753)	\$ 2,693	\$	\$ (79,929)

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

For the Thirteen Week Period Ended September 30, 2006

(InThousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non- Guarantors	Eliminations	Consolidated
<b>Net sales</b>	\$	\$ 16,195	\$ 590,722	\$ 51,238	\$	\$ 658,155
Cost of sales, including buying and distribution costs		9,396	353,872	25,311		388,579
<b>Gross profit</b>		<b>6,799</b>	<b>236,850</b>	<b>25,927</b>		<b>269,576</b>
Selling, general and administrative expenses		5,377	262,126	19,926		287,429
<b>Operating profit (loss)</b>		<b>1,422</b>	<b>(25,276)</b>	<b>6,001</b>		<b>(17,853)</b>
Interest income		(26,754)	(34)	(15)	26,785	(18)
Interest expense		23,273	26,732	352	(26,785)	23,572
Interest (income) expense, net		(3,481)	26,698	337		23,554
Other (income) expense, net		(23)	299	47		323
<b>Income (loss) before income taxes</b>		<b>4,926</b>	<b>(52,273)</b>	<b>5,617</b>		<b>(41,730)</b>
Provision (benefit) for income taxes		1,736	(18,423)	2,332		(14,355)
<b>Net income (loss)</b>	\$	\$ 3,190	\$ (33,850)	\$ 3,285	\$	\$ (27,375)

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

(Successor Entity)

## SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

For the Thirty-nine Week Period Ended September 29, 2007

(In Thousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Net sales</b>	\$	\$ 42,232	\$ 1,629,141	\$ 160,549	\$	\$ 1,831,922
Cost of sales, including buying and distribution costs		25,311	1,002,190	82,916		1,110,417
<b>Gross profit</b>		<b>16,921</b>	<b>626,951</b>	<b>77,633</b>		<b>721,505</b>
Selling, general and administrative expenses		15,774	785,720	71,548		873,042
Impairment of property and equipment			16,779			16,779
<b>Operating profit (loss)</b>		<b>1,147</b>	<b>(175,548)</b>	<b>6,085</b>		<b>(168,316)</b>
Interest income		(9)	(9)	(320)		(338)
Interest expense		10,454	62,631	999		74,084
Interest expense, net		10,445	62,622	679		73,746
Other expense (income), net		222	(2,394)	(1,665)		(3,837)
<b>(Loss) income before income taxes</b>		<b>(9,520)</b>	<b>(235,776)</b>	<b>7,071</b>		<b>(238,225)</b>
(Benefit) provision for income taxes		(2,377)	(58,029)	2,270		(58,136)
<b>Net (loss) income</b>	\$	\$ <b>(7,143)</b>	\$ <b>(177,747)</b>	\$ <b>4,801</b>	\$	\$ <b>(180,089)</b>

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

(Successor Entity)

## SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

For the Period February 14, 2006 - September 30, 2006

(In Thousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Net sales</b>	\$	\$ 40,129	\$ 1,424,163	\$ 113,291	\$	\$ 1,577,583
Cost of sales, including buying and distribution costs		23,596	870,081	57,330		951,007
<b>Gross profit</b>		<b>16,533</b>	<b>554,082</b>	<b>55,961</b>		<b>626,576</b>
Selling, general and administrative expenses		12,965	645,897	49,251		708,113
<b>Operating profit (loss)</b>		<b>3,568</b>	<b>(91,815)</b>	<b>6,710</b>		<b>(81,537)</b>
Interest income		(72,157)	(115)	(63)	72,198	(137)
Interest expense		55,628	71,000	974	(72,198)	55,404
Interest (income) expense, net		(16,529)	70,885	911		55,267
Other income, net		(680)	(1,185)	(543)		(2,408)
<b>Income (loss) before income taxes</b>		<b>20,777</b>	<b>(161,515)</b>	<b>6,342</b>		<b>(134,396)</b>
Provision (benefit) for income taxes		7,844	(60,196)	2,030		(50,322)
<b>Net income (loss)</b>	\$	\$ 12,933	\$ (101,319)	\$ 4,312	\$	\$ (84,074)

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**
**(Predecessor Entity)**
**SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**
**For the Period January 1, 2006 - February 13, 2006**
**(In Thousands) (Unaudited)**

	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Net sales</b>	<b>\$ 7,684</b>	<b>\$ 259,826</b>	<b>\$ 17,461</b>	<b>\$</b>	<b>\$ 284,971</b>
Cost of sales, including buying and distribution costs	4,749	165,927	9,999		180,675
<b>Gross profit</b>	<b>2,935</b>	<b>93,899</b>	<b>7,462</b>		<b>104,296</b>
Selling, general and administrative expenses	2,571	164,013	8,840		175,424
<b>Operating profit (loss)</b>	<b>364</b>	<b>(70,114)</b>	<b>(1,378)</b>		<b>(71,128)</b>
Interest income	(2,374)	(139)	(14)	1,859	(668)
Interest expense		1,730	129	(1,859)	
Interest (income) expense, net	(2,374)	1,591	115		(668)
Other income, net	(452)	(502)	(332)		(1,286)
<b>Income (loss) before income taxes</b>	<b>3,190</b>	<b>(71,203)</b>	<b>(1,161)</b>		<b>(69,174)</b>
Provision (benefit) for income taxes	976	(21,822)	(424)		(21,270)
<b>Net income (loss)</b>	<b>\$ 2,214</b>	<b>\$ (49,381)</b>	<b>\$ (737)</b>	<b>\$</b>	<b>\$ (47,904)</b>



## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET

September 29, 2007

(In Thousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Assets</b>						
Current assets:						
Cash and cash equivalents	\$	\$ 2,377	\$ 7,692	\$ 2,032	\$	\$ 12,101
Accounts receivable		428	30,954	2,560		33,942
Inventories		16,401	881,170	78,434		976,005
Prepaid expenses and other current assets		233	15,300	1,720		17,253
Current deferred taxes		191	13,317	280		13,788
<b>Total current assets</b>		<b>19,630</b>	<b>948,433</b>	<b>85,026</b>		<b>1,053,089</b>
Property and equipment, net		5,841	394,123	47,809		447,773
Identifiable intangible assets, net		622	142,371	1,590		144,583
Goodwill		11,254	241,905	18,922		272,081
Intercompany receivables			479,134	21,086	(500,220)	
Intercompany notes receivable		1,180,942		27,278	(1,208,220)	
Investment in subsidiaries	382,240	640,429			(1,022,669)	
Deferred financing costs and other noncurrent assets		40,308	639	54		41,001
<b>Total assets</b>	<b>\$ 382,240</b>	<b>\$ 1,899,026</b>	<b>\$ 2,206,605</b>	<b>\$ 201,765</b>	<b>\$ (2,731,109)</b>	<b>\$ 1,958,527</b>
<b>Liabilities and Shareholders' Equity</b>						
Current liabilities:						
Accounts payable	\$	\$	\$ 220,683	\$ 46,371	\$	\$ 267,054
Accrued expenses and other current liabilities		37,034	159,804	6,690		203,528
<b>Total current liabilities</b>		<b>37,034</b>	<b>380,487</b>	<b>53,061</b>		<b>470,582</b>
Intercompany payable		500,220			(500,220)	
Intercompany notes payable			1,153,800	54,420	(1,208,220)	
Senior secured notes and other long-term debt		978,180				978,180
Noncurrent deferred income taxes		529	61,199	6,186		67,914
Other long-term liabilities		823	54,281	4,507		59,611
<b>Total liabilities</b>		<b>1,516,786</b>	<b>1,649,767</b>	<b>118,174</b>	<b>(1,708,440)</b>	<b>1,576,287</b>
<b>Total shareholders' equity</b>	<b>382,240</b>	<b>382,240</b>	<b>556,838</b>	<b>83,591</b>	<b>(1,022,669)</b>	<b>382,240</b>
	<b>\$ 382,240</b>	<b>\$ 1,899,026</b>	<b>\$ 2,206,605</b>	<b>\$ 201,765</b>	<b>\$ (2,731,109)</b>	<b>\$ 1,958,527</b>

Total liabilities and  
shareholders equity

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET

December 30, 2006

(In Thousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Assets</b>						
Current assets:						
Cash and cash equivalents	\$	\$ 1,087	\$ 10,218	\$ 1,221	\$	\$ 12,526
Accounts receivable		435	33,083	3,545		37,063
Inventories		14,822	728,503	49,677		793,002
Prepaid expenses and other current assets		141	14,662	505		15,308
Current deferred taxes		16,561		254		16,815
<b>Total current assets</b>		<b>33,046</b>	<b>786,466</b>	<b>55,202</b>		<b>874,714</b>
Property and equipment, net		10,154	477,390	43,285		530,829
Identifiable intangible assets, net		731	147,650	1,663		150,044
Goodwill		7,357	244,485	15,988		267,830
Intercompany receivables			774,784	22,986	(797,770)	
Intercompany notes receivable		1,176,998		23,314	(1,200,312)	
Investment in subsidiaries	544,742	802,241			(1,346,983)	
Deferred financing costs and other noncurrent assets		33,813	687	17		34,517
<b>Total assets</b>	<b>\$ 544,742</b>	<b>\$ 2,064,340</b>	<b>\$ 2,431,462</b>	<b>\$ 162,455</b>	<b>\$ (3,345,065)</b>	<b>\$ 1,857,934</b>
<b>Liabilities and Shareholders Equity</b>						
Current liabilities:						
Accounts payable	\$	\$	\$ 181,159	\$ 23,601	\$	\$ 204,760
Accrued expenses and other current liabilities		38,466	186,994	16,451		241,911
<b>Total current liabilities</b>		<b>38,466</b>	<b>368,153</b>	<b>40,052</b>		<b>446,671</b>
Intercompany payable		797,770			(797,770)	
Intercompany notes payable			1,153,800	46,513	(1,200,313)	
Senior secured notes and other long-term debt		687,800	2,076			689,876
Noncurrent deferred income taxes		(5,343)	125,894	5,426		125,977
Other long-term liabilities		905	46,953	2,809		50,667
<b>Total liabilities</b>		<b>1,519,598</b>	<b>1,696,876</b>	<b>94,800</b>	<b>(1,998,083)</b>	<b>1,313,191</b>
<b>Total shareholders equity</b>	<b>544,742</b>	<b>544,742</b>	<b>734,586</b>	<b>67,655</b>	<b>(1,346,982)</b>	<b>544,743</b>
	<b>\$ 544,742</b>	<b>\$ 2,064,340</b>	<b>\$ 2,431,462</b>	<b>\$ 162,455</b>	<b>\$ (3,345,065)</b>	<b>\$ 1,857,934</b>

Total liabilities and  
shareholders equity

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

## SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET

September 30, 2006

(In Thousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Assets</b>						
Current assets:						
Cash and cash equivalents	\$	\$ 2,882	\$ 6,618	\$ 1,894	\$	\$ 11,394
Accounts receivable		454	30,598	2,834		33,886
Inventories		17,849	923,980	57,487		999,316
Prepaid expenses and other current assets		50,908	14,622	1,258		66,788
Current deferred taxes		2,224	9,777	224		12,225
<b>Total current assets</b>		<b>74,317</b>	<b>985,595</b>	<b>63,697</b>		<b>1,123,609</b>
Property and equipment, net		7,821	520,398	44,281		572,500
Identifiable intangible assets, net		767	152,751	1,843		155,361
Goodwill		7,600	241,136	16,966		265,702
Intercompany receivables			617,352		(617,352)	
Intercompany notes receivable		1,178,039		24,362	(1,202,401)	
Investment in subsidiaries	568,624	824,803			(1,393,427)	
Deferred financing costs and other noncurrent assets		34,625	575	18		35,218
<b>Total assets</b>	<b>\$ 568,624</b>	<b>\$ 2,127,972</b>	<b>\$ 2,517,807</b>	<b>\$ 151,167</b>	<b>\$ (3,213,180)</b>	<b>\$ 2,152,390</b>
<b>Liabilities and Shareholders Equity</b>						
Current liabilities:						
Accounts payable	\$	\$	\$ 278,636	\$ 13,047	\$	\$ 291,683
Accrued expenses and other current liabilities		40,253	143,526	11,341		195,120
Short-term borrowings		225,870				225,870
<b>Total current liabilities</b>		<b>266,123</b>	<b>422,162</b>	<b>24,388</b>		<b>712,673</b>
Intercompany payable		609,020		8,332	(617,352)	
Intercompany notes payable			1,153,800	48,602	(1,202,402)	
Senior secured notes and other long-term debt		650,000	2,092			652,092
Noncurrent deferred income taxes		33,080	131,923	5,488		170,491
Other long-term liabilities		1,128	44,655	2,729		48,512
<b>Total liabilities</b>		<b>1,559,351</b>	<b>1,754,632</b>	<b>89,539</b>	<b>(1,819,754)</b>	<b>1,583,768</b>
<b>Total shareholders equity</b>	<b>568,624</b>	<b>568,621</b>	<b>763,175</b>	<b>61,628</b>	<b>(1,393,426)</b>	<b>568,622</b>

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Total liabilities and shareholders equity	\$	568,624	\$	2,127,972	\$	2,517,807	\$	151,167	\$	(3,213,180)	\$	2,152,390
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## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

(Successor Entity)

## SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

For the Thirty-nine Week Period Ended September 29, 2007

(In Thousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Cash flows from operating activities:</b>						
Net (loss) income	\$	\$ (7,143)	\$ (177,747)	\$ 4,801	\$	\$ (180,089)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:						
Depreciation and amortization		1,884	88,302	7,088		97,274
Deferred income taxes		18,116	(82,060)	(131)		(64,075)
Share-based compensation		2,330				2,330
Amortization of deferred financing charges		6,075	1			6,076
Loss on sales and disposals of property and equipment		291	247	1		539
Impairment of property and equipment			16,779			16,779
Changes in assets and liabilities:						
Decrease in accounts receivable		8	2,129	1,443		3,580
Increase in inventories		(1,579)	(152,667)	(18,477)		(172,723)
(Increase) decrease in prepaid expenses and other current assets		(92)	(639)	2,356		1,625
Decrease (increase) in identifiable intangible assets and other noncurrent assets			148	(29)		119
Increase in accounts payable			39,525	16,963		56,488
Decrease in accrued expenses and other liabilities		(3,934)	(12,911)	(12,372)		(29,217)
<b>Net cash provided by (used in) operating activities</b>		<b>15,956</b>	<b>(278,893)</b>	<b>1,643</b>		<b>(261,294)</b>
<b>Cash flows from investing activities:</b>						
Additions to property and equipment		(1,878)	(25,287)	(4,082)		(31,247)
Proceeds from sales of property and equipment		3,300	2,100			5,400
		<b>1,422</b>	<b>(23,187)</b>	<b>(4,082)</b>		<b>(25,847)</b>

**Net cash provided by (used in) investing activities**

**Cash flows from financing activities:**

Financing and direct acquisition costs	(12,391)	9,591	654	(2,146)
Intercompany movements	(294,077)	292,039	2,038	
Net increase in borrowings under revolving credit facility	290,380			290,380
Payments on mortgage note		(2,076)		(2,076)

**Net cash (used in) provided by financing activities**

**(16,088) 299,554 2,692 286,158**

**Effect of exchange rate changes on cash and cash equivalents**

**558 558**

Net increase (decrease) in cash and cash equivalents	1,290	(2,526)	811	(425)
Cash and cash equivalents at beginning of period	1,087	10,218	1,221	12,526

**Cash and cash equivalents at end of period**

**\$ 2,377 \$ 7,692 \$ 2,032 \$ 12,101**



## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

(Successor Entity)

## SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

For the Period February 14, 2006 - September 30, 2006

(In Thousands) (Unaudited)

	Parent	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Cash flows from operating activities:</b>						
Net income (loss)	\$	\$ 12,933	\$ (101,319)	\$ 4,312	\$	\$ (84,074)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:						
Depreciation and amortization		1,370	73,923	4,922		80,215
Deferred income taxes		29,784	(52,789)	(229)		(23,234)
Share-based compensation		3,363				3,363
Amortization of deferred financing charges		5,429				5,429
Loss on sale and disposals of property and equipment			416			416
Changes in assets and liabilities, net of effect of acquisition:						
Decrease in accounts receivable		195	11,741	111		12,047
Increase in inventories		(3,430)	(167,646)	(6,834)		(177,910)
(Increase) decrease in prepaid expenses and other current assets		(50,574)	16,825	(348)		(34,097)
(Increase) decrease in identifiable intangible assets and other noncurrent assets		(3,402)	907	(3)		(2,498)
Increase (decrease) in accounts payable			60,953	(1,902)		59,051
(Decrease) increase in accrued expenses and other liabilities		(62,616)	19,554	1,024		(42,038)
<b>Net cash (used in) provided by operating activities</b>		<b>(66,948)</b>	<b>(137,435)</b>	<b>1,053</b>		<b>(203,330)</b>
<b>Cash flows from investing activities:</b>						
Acquisition of the Company, net of cash acquired		(1,220,465)	7,632	7,331		(1,205,502)
Investment in Linens n Things, Inc.	(741,675)				741,675	
Additions to property and equipment		(381)	(43,637)	(4,758)		(48,776)

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Proceeds from sale of property and equipment			3,100			3,100
Decrease (increase) in investment in subsidiary	91,025	(257)			(90,768)	
<b>Net cash (used in) provided by investing activities</b>	<b>(650,650)</b>	<b>(1,221,103)</b>	<b>(32,905)</b>	<b>2,573</b>	<b>650,907</b>	<b>(1,251,178)</b>
<b>Cash flows from financing activities:</b>						
Issuance of common stock to Linens Investors LLC and others	650,650			257	(257)	650,650
Investment from Parent		650,650			(650,650)	
Issuance of floating rate notes		650,000				650,000
Financing and direct acquisition costs		(59,254)	(676)			(59,930)
Premium paid for derivative financial instrument		(700)				(700)
Intercompany movements		(175,633)	177,672	(2,039)		
Net increase in borrowings under revolving credit facility		225,870				225,870
Payments on mortgage note			(38)			(38)
<b>Net cash provided by (used in) financing activities</b>	<b>650,650</b>	<b>1,290,933</b>	<b>176,958</b>	<b>(1,782)</b>	<b>(650,907)</b>	<b>1,465,852</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>				<b>50</b>		<b>50</b>
Net increase in cash and cash equivalents		2,882	6,618	1,894		11,394
Cash and cash equivalents at beginning of period						
<b>Cash and cash equivalents at end of period</b>	<b>\$</b>	<b>\$</b>	<b>2,882</b>	<b>\$</b>	<b>6,618</b>	<b>\$</b>
				<b>1,894</b>	<b>\$</b>	<b>\$</b>
						<b>11,394</b>

## LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)

(Predecessor Entity)

## SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

For the Period January 1, 2006 - February 13, 2006

(In Thousands) (Unaudited)

	Co-Issuers	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Cash flows from operating activities:</b>					
Net income (loss)	\$ 2,214	\$ (49,381)	\$ (737)	\$	\$ (47,904)
Adjustments to reconcile net income (loss) to net cash used in operating activities:					
Depreciation and amortization	203	11,662	777		12,642
Deferred income taxes	(730)	(6,108)	113		(6,725)
Share-based compensation	12,484				12,484
Amortization of deferred financing charges		43			43
Changes in assets and liabilities:					
(Increase) decrease in accounts receivable	(288)	(2,582)	630		(2,240)
Decrease (increase) in inventories	687	(30,481)	(2,092)		(31,886)
(Increase) decrease in prepaid expenses and other current assets	(250)	(12,595)	692		(12,153)
Decrease in identifiable intangible assets and other noncurrent assets	11	9,515	54		9,580
Increase (decrease) in accounts payable		13,064	(1,054)		12,010
(Decrease) increase in accrued expenses and other liabilities	(27,564)	24,083	(4,326)		(7,807)
<b>Net cash used in operating activities</b>	<b>(13,233)</b>	<b>(42,780)</b>	<b>(5,943)</b>		<b>(61,956)</b>
<b>Cash flows from investing activities:</b>					
Additions to property and equipment	(107)	(8,533)	(2,316)		(10,956)
<b>Net cash used in investing activities</b>	<b>(107)</b>	<b>(8,533)</b>	<b>(2,316)</b>		<b>(10,956)</b>
<b>Cash flows from financing activities:</b>					
Intercompany movements	(52,158)	49,564	2,594		
Federal tax benefit from common stock issued under stock incentive plans	4,298				4,298
Payments on mortgage note		(10)			(10)
Decrease in treasury stock		674			674
<b>Net cash (used in) provided by financing activities</b>	<b>(47,860)</b>	<b>50,228</b>	<b>2,594</b>		<b>4,962</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>					
			<b>125</b>		<b>125</b>
Net decrease in cash and cash equivalents	(61,200)	(1,085)	(5,540)		(67,825)
Cash and cash equivalents at beginning of period	136,569	8,718	12,871		158,158

Cash and cash equivalents at end of period	\$	75,369	\$	7,633	\$	7,331	\$		\$	90,333
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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**LINENS HOLDING CO. AND SUBSIDIARIES (AND PREDECESSOR)**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements of the Company and the notes thereto appearing elsewhere in this report.

**General**



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The Company is a holding company. It does not hold any assets other than its investment in Linens 'n Things, Inc., which the Company acquired in February 2006. Linens 'n Things, Inc., together with its subsidiaries, is the operating subsidiary of the Company.

The Company, under the name Linens 'n Things, is one of the leading national large format specialty retailers of home textiles, housewares and home accessories, carrying both national brands and private label goods. As of September 29, 2007, the Company operated 585 stores in 47 states and in seven provinces across Canada.

### **Critical Accounting Policies**





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The following includes discussion and analysis about the condensed consolidated financial statements of Linens Holding Co. and its subsidiaries and Predecessor. The Company has not presented separate financial statements for Linens n Things, Inc. and its subsidiaries or Linens n Things Center, Inc. and its subsidiaries (collectively, the issuers as described in Note 13) because management has determined that the differences in such financial statements are minor.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and 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 and timing of revenues and of expenses during the reporting periods. The Company bases its estimates on historical experience and on other assumptions that it believes to be relevant under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. The Company's management believes the following critical accounting estimates involve significant estimates and judgments inherent in the preparation of the condensed consolidated financial statements. The Company bases these estimates on historical results and various other assumptions believed to be reasonable at the time. These critical accounting estimates are discussed in detail in the Company's 2006 Annual Report on Form 10-K.

### *Business Combination*

On February 14, 2006, the Company acquired all of the outstanding common stock of the Company's Predecessor Entity, Linens n Things, Inc., for total cash consideration of approximately \$1.3 billion. The acquisition of Linens n Things, Inc. was accounted for as a business combination using the purchase method of accounting, whereby the purchase price (including liabilities assumed) was preliminarily allocated to the assets acquired based on their estimated fair market values at the date of acquisition. The purchase price paid by the Company to acquire Linens n Things, Inc. and related purchase accounting adjustments were pushed down and recorded in Linens n Things, Inc. and its subsidiaries' financial statements and resulted in a new basis of accounting for the Successor period beginning on the day the acquisition was completed. As a result, the purchase price and related costs were allocated to the estimated fair values of the assets acquired and liabilities assumed at the time of the acquisition based on management's best estimates, which were based in part on the work of third-party appraisers engaged to perform valuations of certain of the tangible and intangible assets acquired. In essence, the Company's assets and liabilities were adjusted to fair value as of the closing date of the acquisition, and the excess of the total purchase price over the fair value of the Company's net assets was allocated to goodwill.

### *Valuation of Inventory*

Merchandise inventory is a significant portion of the Company's balance sheet, representing approximately 49.8% of total assets at September 29, 2007. Inventories are valued using the lower of cost or market value, determined by the retail inventory method ( RIM ). Under RIM, the valuation of inventories at cost and the resulting gross margins are determined by applying a calculated cost-to-retail ratio to the retail value of inventories. RIM is an averaging method that is used in the retail industry due to its practicality. Inherent in RIM calculations are certain significant management judgments and estimates including, among others, merchandise mark-on, mark-up, markdowns and shrinkage based on historical experience between the dates of physical inventories, all of which significantly impact the ending inventory valuation at cost. The methodologies utilized by the Company in its application of RIM are consistent for all periods presented. Such methodologies include the development of the cost-to-retail ratios, the development of shrinkage reserves and the accounting for price changes. At any one time, inventories include items that have been written down to the Company's best estimate of their realizable value. Factors considered in estimating realizable value include the age of merchandise and anticipated demand. Actual realizable value could differ materially from this estimate based upon future customer demand or economic conditions.

### *Sales Returns*

The Company estimates future sales returns and records a provision in the period that the related sales are recorded based on historical return rates. Should actual returns differ from the Company's estimates, the Company may be required to revise estimated sales returns. Although these estimates have not varied materially from historical provisions, estimating sales returns requires management judgment as to changes in preferences and quality of products being sold, among other things; therefore, these estimates may vary materially in the future. The sales returns calculations are regularly compared with actual return experience. In preparing its condensed consolidated financial statements as of September 29, 2007, December 30, 2006 and September 30, 2006, the Company's sales returns reserve was approximately \$4.3 million, \$5.9 million and \$5.7 million, respectively.

### *Impairment of Long-Lived Assets (including Goodwill)*

Long-lived assets, such as property and equipment and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be fully recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount that the carrying value of the asset exceeds the fair value of the asset, which is determined by discounting the future cash flows expected to be generated by the asset.

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment. These assets are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

The Company's judgments regarding the existence of impairment indicators are based on market conditions and operational performance. Future events could cause the Company to conclude that impairment indicators exist and that the value of long-lived assets and goodwill is impaired. At September 29, 2007, December 30, 2006 and September 30, 2006, the Company's net book value for property and equipment was approximately \$447.8 million, \$530.8 million and \$572.5 million, respectively, goodwill was approximately \$272.1 million, \$267.8 million and \$265.7 million, respectively, and identifiable intangible assets, net was \$144.6 million, \$150.0 million and \$155.4 million, respectively.

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During the thirteen weeks ended September 29, 2007, the Company determined that the carrying value of certain property and equipment exceeded its related estimated future undiscounted cash flows. As a result, the Company reduced the carrying value of property and equipment to its fair value by approximately \$16.8 million.

There was no impairment loss recognized in the condensed consolidated statement of operations for any of the prior year periods presented.

### *Self-Insurance*

The Company purchases third-party insurance for workers' compensation, medical and general liability costs that exceed certain limits for each type of insurance program. The Company is responsible for the payment of claims under these insured excess limits. The Company establishes accruals for its insurance programs based on available claims data and historical trend and experience, as well as loss development factors for its medical insurance prepared with the assistance of third party actuaries. Workers' compensation is recorded at its net present value. In preparing the estimates, the Company also considers the nature and severity of the claims, analysis provided by third party claims administrators, as well as current legal, economic and regulatory factors. The ultimate cost of these claims may vary from the established accrual. While the Company believes 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 estimate process. The accrued obligation for these self-insurance programs was approximately \$16.1 million, \$16.2 million and \$14.7 million as of September 29, 2007, December 30, 2006 and September 30, 2006, respectively.

### *Share-based Compensation*

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment* (SFAS No. 123 (Revised 2004)), requiring the recognition of compensation cost for all equity classified awards granted, modified or settled after the effective date and for the unvested portion of awards outstanding as of the effective date using the fair-value measurement method.

Upon completion of the Merger and in accordance with the terms of the share-based plans existing at the time, all of the outstanding stock options and restricted stock units became fully vested and immediately exercisable. Accordingly, under SFAS No. 123 (Revised 2004) the Company recorded share-based compensation expense for the entire portion of previously granted share-based awards that remained unvested at the date of the adoption.

On February 14, 2006, the board of directors and stockholders of Linens Holding Co. adopted the Linens Holding Co. Stock Option Plan (the Plan). Under the Plan, the Company grants stock options for a fixed number of shares to key employees and directors. The Company recognizes the cost of all time-based employee stock option grants on a straight-line attribution basis and the cost of all performance-based employee stock option grants on an accelerated basis. There are no restricted stock units under the Plan.

The Company uses the Monte Carlo simulation option-pricing model for estimating the fair value of performance-based employee stock option grants and the Black-Scholes option-pricing model for time-based employee stock option grants issued under the Plan. Both models include various assumptions, including the expected life of stock options, the expected volatility and the expected risk-free interest rate. These assumptions reflect the Company's best estimates, but they involve inherent uncertainties based on certain conditions generally outside the control of the Company. As a result, if other assumptions had been used, total share-based compensation cost as determined in accordance with SFAS No. 123 (Revised 2004) could have been materially impacted. Furthermore, if the Company uses different assumptions for future grants, share-based compensation cost could be materially impacted in future periods.

Under SFAS No. 123 (Revised 2004), the Company is also required to record share-based compensation expense net of estimated forfeitures. The Company's forfeiture rate assumption used in determining its share-based compensation expense is estimated, primarily based upon historical data. The actual forfeiture rate could differ from these estimates.

*Derivative Financial Instruments*

The Company has designated certain derivative instruments entered into on July 7, 2006 as cash flow hedges and recognizes the fair value of the instruments on the condensed consolidated balance sheet. Gains and losses related to a hedge and that result from changes in the fair value of the hedge are either recognized in income to offset the gain or loss on the hedged item, or deferred and reported as a component of accumulated other comprehensive income (loss) in stockholders' equity on the condensed consolidated balance sheet and subsequently recognized in the condensed consolidated statement of operations when the hedged item affects income. The ineffective portion of the

change in fair value of a hedge is recognized in income immediately. There was no hedge ineffectiveness during the thirty-nine weeks ended September 29, 2007.

#### *Income Taxes*

The Company uses the asset and liability method to account for its income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to the taxable income in the year in which temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in the statement of operations in the period that includes the enactment date.

Determining the provision for income taxes and related accruals, deferred tax assets and deferred tax liabilities requires judgment. There are transactions and calculations arising in the ordinary course of business where the ultimate tax outcome is uncertain. Additionally, tax returns filed by the Company are subject to audit by various tax authorities. Although the Company believes that its estimates are reasonable, actual results could differ from these estimates.

The Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* ( FIN No. 48 ) at the beginning of the current fiscal year. FIN No. 48 addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN No. 48, the Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The Company's estimates of the tax benefit from uncertain tax positions may change in the future due to new developments in each matter.

#### *Litigation*

The Company records an estimated liability related to various claims and legal actions arising in the ordinary course of business, which is based on available information and advice from outside counsel where applicable. As additional information becomes available, the Company assesses the potential liability related to its pending claims and may adjust its estimates accordingly.

#### **Impact of the Merger and Related Transactions**



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On February 14, 2006, the Company acquired all of the outstanding common stock of Linens n Things, Inc. for total cash consideration of approximately \$1.3 billion.

The acquisition of Linens n Things, Inc. was accounted for as a business combination using the purchase method of accounting, whereby the purchase price (including liabilities assumed) was allocated to the assets acquired based on their estimated fair market values at the date of acquisition. The purchase price paid by the Company to acquire Linens n Things, Inc. and related purchase accounting adjustments were pushed down and recorded in Linens n Things, Inc. and its subsidiaries' financial statements and resulted in a new basis of accounting for the Successor period beginning on the day the acquisition was completed. As a result, the purchase price and related costs were allocated to the estimated fair values of the assets acquired and liabilities assumed at the time of the acquisition based on management's best estimates, which were based in part on the work of third-party appraisers engaged to perform valuations of certain of the tangible and intangible assets acquired. In essence, the Company's assets and liabilities were adjusted to fair value as of the closing date of the acquisition, and the excess of the total purchase price over the fair value of the Company's net assets was allocated to goodwill.

In connection with the acquisition, the Company incurred significant additional indebtedness, including \$650.0 million aggregate principal amount of Senior Secured Floating Rate Notes due 2014 issued by two of the Company's subsidiaries (the Notes), which increased the Company's interest expense. Payments required to service this indebtedness substantially increased the Company's liquidity requirements in fiscal 2006 as compared to fiscal 2005, and will do so in fiscal 2007 and future years. The Company's depreciation and amortization expense



increased significantly as well, primarily due to decreases in the depreciable lives of tangible assets and an increase in the fair values of the Company's amortizable intangible assets.

The following discussion and analysis of the Company's historical financial condition and results of operation covers periods prior to and after the consummation of the acquisition.

## **Results of Operations**



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*Thirteen Weeks Ended September 29, 2007 Compared with Thirteen Weeks Ended September 30, 2006*

Net sales for the thirteen weeks ended September 29, 2007 increased approximately 1.3% to \$666.8 million compared to \$658.2 million for the same period last year. The increase in net sales is primarily due to the opening of new stores since September 30, 2006 offset by the impact of a decline in comparable store sales. Comparable store sales decreased 1.4% for the thirteen weeks ended September 29, 2007 compared to an increase of 0.2% for the same period last year. The decline in comparable store sales is primarily due to a decline in guest transactions partially offset by an increase in average transaction value. At September 29, 2007, the Company operated 585 stores, including 38 stores in Canada, as compared with 561 stores, including 33 stores in Canada, at September 30, 2006. Store square footage increased approximately 3.6% to 19.3 million at September 29, 2007 compared with 18.6 million at September 30, 2006. During the thirteen weeks ended September 29, 2007, the Company opened five stores as compared with opening eight stores during the same period last year. There were no stores closed in the current period as compared with closing two stores during the same period last year.

In addition to the cost of inventory sold, the Company includes its buying and distribution expenses in its cost of sales. Buying expenses include all direct and indirect costs to procure merchandise. Distribution expenses include the cost of operating the Company's distribution centers and freight expense related to transporting merchandise. For the thirteen weeks ended September 29, 2007 gross profit was \$261.1 million, or 39.2% of net sales, compared with \$269.6 million, or 41.0% of net sales, for the same period last year. The decrease in gross profit as a percentage of net sales for the third quarter reflects the highly promotional environment in the current period.

The Company's selling, general and administrative expenses (SG&A) consist of store selling expenses, occupancy costs, advertising expenses and corporate office expenses. SG&A for the thirteen weeks ended September 29, 2007 was \$300.9 million, or 45.1% of net sales, compared with \$287.4 million, or 43.7% of net sales, for the same period last year. SG&A also includes depreciation and amortization of \$33.0 million, or 4.9% of net sales, for the thirteen weeks ended September 29, 2007, compared with \$33.4 million, or 5.1% of net sales, for the same period last year. The increase in SG&A (excluding depreciation and amortization) as a percentage of net sales from 38.6% to 40.2% is primarily due to higher occupancy costs and marketing costs in the face of negative comparable store sales.

The Company determined that the carrying value of certain property and equipment exceeded its related estimated future undiscounted cash flows. As a result, the Company reduced the carrying value of property and equipment to its fair value by approximately \$16.8 million, or 2.5% of net sales, which is included in impairment of property and equipment on the condensed consolidated statements of operations.

Operating loss for the thirteen weeks ended September 29, 2007 was approximately \$56.6 million, or (8.5%) of net sales, compared with an operating loss of \$17.9 million, or (2.7%) of net sales, for the same period last year. .

Interest expense, net for the thirteen weeks ended September 29, 2007 marginally increased to approximately \$24.1 million from \$23.6 million during the same period last year.

Other (income) expense, net for the thirteen weeks ended September 29, 2007 increased to \$1.5 million of income, net, compared to \$0.3 million of expense, net, for the same period last year.

The Company's income tax expense was approximately \$0.7 million for the thirteen weeks ended September 29, 2007 compared with an income tax benefit of \$14.4 million for the same period last year. The Company's effective income tax rate for the thirteen weeks ended September 29, 2007 was 0.9% compared to an effective tax benefit rate of 34.4% for the same period last year primarily due to the \$25.1 million valuation allowance which was recorded against United States net operating losses in the current quarter. See Note 8 for additional detail concerning the valuation allowance.



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The Company's net loss for the thirteen weeks ended September 29, 2007 was approximately \$79.9 million compared with a net loss of \$27.4 million for the same period last year. The increase in the net loss reflects the increase in the operating loss referred to above plus the impairment of property and equipment and the tax valuation allowance. Excluding the valuation allowance and the impairment charge, the Company's net loss for the thirteen weeks ended September 29, 2007 was approximately \$43.2 million.

## Thirty-nine Weeks Ended September 29, 2007 Compared with Thirty-nine Weeks Ended September 30, 2006

As a result of the acquisition, the prior period's financial results for the thirty-nine weeks ended September 30, 2006 have been separately presented in the condensed consolidated statements of operations split between the Predecessor Entity, covering the period January 1, 2006 through February 13, 2006 and the Successor Entity covering the period February 14, 2006 through September 30, 2006. For comparative purposes, the Company combined the two periods from January 1, 2006 through September 30, 2006 in its discussion below. This combination is not GAAP presentation. However, the Company believes this presentation is useful to provide the reader a more accurate comparison.

		Thirty-nine Weeks Ended September 30, 2006								
		January 1, 2006 to February 13, 2006  (Predecessor Entity)	February 14, 2006 to September 30, 2006 (Successor Entity)	January 1, 2006 to September 30, 2006 (Combined)	Increase (Decrease)					
Net sales	\$	1,831,922	\$	284,971	\$	1,577,583	\$	1,862,554	\$	(30,632)
Cost of sales, including buying and distribution costs		1,110,417		180,675		951,007		1,131,682		(21,265)
Gross profit		721,505		104,296		626,576		730,872		(9,367)
Selling, general and administrative expenses		873,042		175,424		708,113		883,537		(10,495)
Impairment of property and equipment		16,779								16,779
Operating loss		(168,316)		(71,128)		(81,537)		(152,665)		(15,651)
Interest income		(338)		(668)		(137)		(805)		467
Interest expense		74,084				55,404		55,404		18,680
Interest expense (income), net		73,746		(668)		55,267		54,599		19,147
Other income, net		(3,837)		(1,286)		(2,408)		(3,694)		(143)
Loss before benefit for income taxes		(238,225)		(69,174)		(134,396)		(203,570)		(34,655)
Benefit for income taxes		(58,136)		(21,270)		(50,322)		(71,592)		13,456
Net loss	\$	(180,089)	\$	(47,904)	\$	(84,074)	\$	(131,978)	\$	(48,111)

Net sales for the thirty-nine weeks ended September 29, 2007 decreased approximately 1.6% to \$1,831.9 million compared to \$1,862.6 million for the same period last year. The decrease in net sales is primarily due to the impact of a decline in comparable store sales offset by the opening of new stores since September 30, 2006. Comparable store sales decreased 4.6% for the thirty-nine weeks ended September 29, 2007 compared

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to a decline of 1.0% for the same period last year. The decline in comparable store sales is primarily due to a decline in guest transactions. During the thirty-nine weeks ended September 29, 2007, the Company opened 14 stores as compared with opening 21 stores during the same period last year. There were no stores closed in the current period as compared with closing two stores during the same period last year.

In addition to the cost of inventory sold, the Company includes its buying and distribution expenses in its cost of sales. Buying expenses include all direct and indirect costs to procure merchandise. Distribution expenses include the cost of operating the Company's distribution centers and freight expense related to transporting merchandise. For the thirty-nine weeks ended September 29, 2007 gross profit was \$721.5 million, or 39.4% of net sales, compared with \$730.9 million, or 39.2% of net sales, for the same period last year. The increase in gross profit as a percentage of net sales is due to lower markdowns offset by a decrease in product margin due to sales mix.

The Company's selling, general and administrative expenses (SG&A) consist of store selling expenses, occupancy costs, advertising expenses and corporate office expenses. SG&A for the thirty-nine weeks ended September 29, 2007 was \$873.0 million, or 47.7% of net sales, compared with \$883.5 million, or 47.4% of net sales, for the same period last year, which included approximately \$47.2 million of costs related to the acquisition, or 2.5% of net sales. SG&A also includes depreciation and amortization of \$97.3 million, or 5.3% of net sales, for the thirty-nine weeks ended September 29, 2007, compared with \$92.9 million, or 5.0% of net sales, for the same period last year. The increase in SG&A (excluding depreciation and amortization and costs related to the acquisition in the prior year) as a percentage of net sales from 39.9% to 42.4% is primarily due to higher occupancy costs and marketing costs in the face of negative comparable store sales.

The Company determined that the carrying value of certain property and equipment exceeded its related estimated future undiscounted cash flows. As a result, the Company reduced the carrying value of property and equipment to its fair value by approximately \$16.8 million, or 0.9% of net sales, which is included in impairment of property and equipment on the condensed consolidated statements of operations.

Operating loss for the thirty-nine weeks ended September 29, 2007 was approximately \$168.3 million, or (9.2%) of net sales, compared with an operating loss of \$152.7 million, or (8.2%) of net sales, for the same period last year.

Interest expense, net for the thirty-nine weeks ended September 29, 2007 increased to approximately \$73.7 million from \$54.6 million during the same period last year primarily due to the additional interest expense associated with the Notes issued on February 14, 2006.

Other income, net for the thirty-nine weeks ended September 29, 2007 increased marginally to \$3.8 million compared to \$3.7 million for the same period last year.

The Company's income tax benefit was approximately \$58.1 million for the thirty-nine weeks ended September 29, 2007 compared with an income tax benefit of \$71.6 million for the same period last year. The Company's effective tax benefit rate for the thirty-nine weeks ended September 29, 2007 decreased to 24.4% compared to 35.2% for the same period last year primarily due to the \$25.1 million valuation allowance which was recorded against United States net operating losses in the current year. See Note 8 for additional detail concerning the valuation allowance.

The Company's net loss for the thirty-nine weeks ended September 29, 2007 was approximately \$180.1 million compared with a net loss of \$132.0 million for the same period last year. As noted above, the net loss for the current period is not necessarily comparable to the net loss for the prior period as the current period includes property and equipment impairment and the tax valuation allowance while the prior period includes significantly higher costs related to the acquisition partially offset by lower interest, depreciation and amortization recorded prior to the completion of the Merger on February 14, 2006.

**Liquidity and Capital Resources**





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The Company incurred \$650.0 million aggregate principal amount of Senior Secured Floating Rate Notes due 2014 of Linens 'n Things, Inc. and Linens 'n Things Center, Inc. in connection with the Merger. The Notes bear interest at a per annum rate equal to LIBOR plus 5.625%, which is to be paid every three months on January 15, April 15, July 15 and October 15. The interest rate on the Notes is reset quarterly. The Notes mature on January 15, 2014. As of September 29, 2007 the interest rate on the Notes was 11.0%, based on a LIBOR rate of 5.4%. On July 7, 2006 the Issuers entered into a zero cost interest rate collar agreement to hedge the cash flows associated with the LIBOR component of the interest rate on the Notes. On July 7, 2006 the Issuers also purchased a one-year forward-starting interest rate cap agreement which takes effect on January 15, 2008.

The Notes are fully and unconditionally guaranteed jointly and severally on a senior basis by the Company and by certain of the Company's existing and future domestic subsidiaries other than the Issuers. All obligations under the Notes, and the guarantees of those obligations, are secured by first-priority liens, subject to permitted liens, on all of the Company's, the Issuers' and the subsidiary guarantors' equipment, intellectual property rights and related

general intangibles and the capital stock of the Issuers and certain of the subsidiaries. The Notes are also secured by second-priority liens on the Issuers' and the subsidiary guarantors' inventory, accounts receivable, cash, securities and other general intangibles.

The lien on capital stock may be released under certain circumstances. As a result of the filing and effectiveness of a registration statement on Form S-4 with the SEC with respect to the Notes, the Issuers and the guarantors became subject to applicable SEC rules with respect to information required to be included in the prospectus in the registration statement. To the extent that the securities of any Issuer or guarantor constitute collateral for the Notes and the value of the securities equals or exceeds 20% of the principal amount, or \$130.0 million of the Notes, separate financial statements of the Issuer or guarantor would be required under these SEC rules to be included in the Company's SEC filings. The indenture that governs the Notes provides, however, with respect to any direct or indirect subsidiary of Linens 'n Things, Inc., that the securities of the subsidiary are released from the lien on capital stock on the date that the lien triggers this separate financial statement requirement. Accordingly, for any subsidiary with securities that equal or exceed the 20% threshold, the lien on the capital stock securing the Notes has been released with respect to those securities. The lien on the capital stock of Linens 'n Things, Inc. remains in place.

Concurrent with the closing of the Merger in February 2006, the Issuers also entered into a new senior secured asset-based revolving credit facility agreement (the "Original Credit Facility") with third-party institutional lenders, which expires February 14, 2011. In May 2007, the Company entered into an amended and restated credit agreement (the "Old Credit Facility"). The provisions of the Old Credit Facility are substantially the same as in the Original Credit Facility with several modifications that are generally favorable to the Company. The provisions of the Old Credit Facility were modified for: (i) a \$100.0 million increase in the Old Credit Facility maximum availability from \$600.0 million to \$700.0 million; (ii) a decrease in the "Excess Availability" threshold for purposes of mandatory compliance with certain financial ratio maintenance covenants from \$75.0 million to \$70.0 million; and (iii) several other modifications that are all favorable to the Company. A copy of the Old Credit Facility is attached as Exhibit 10.1 to Form 8-K filed with the SEC on May 29, 2007. See Note 7 for additional detail concerning the Original Credit Facility and the Old Credit Facility.

As of September 29, 2007, the Issuers had (i) \$328.2 million in borrowings outstanding under the Old Credit Facility at an average interest rate of 6.9%; (ii) \$12.1 million of cash on hand; (iii) \$109.0 million of letters of credit outstanding issued under the Old Credit Facility, which includes standby letters of credit and import letters of credit used for merchandise purchases; and (iv) \$238.5 million of excess availability under the Old Credit Facility.

In October 2007, the Company entered into a new senior secured asset-based revolving credit facility agreement (the "New Credit Facility") with third-party institutional lenders, which expires October 24, 2012. The New Credit Facility replaced the senior secured asset-based revolving credit facility agreement originally entered into in February 2006 as amended and restated in May 2007 (see Note 12). The New Credit Facility provides for increased advance rates on inventory and accounts receivable and the elimination of all financial maintenance covenants. These changes will result in a material increase to the Company's aggregate borrowing base and excess availability as compared with the Old Credit Facility. As of September 29, 2007, pro forma as if the New Credit Facility were in place, excess availability would have been \$255.5 million compared to \$238.5 million under the Old Credit Facility. Insofar as the Old Credit Facility had a financial maintenance covenant (which as noted above has been eliminated in the New Credit Facility) that would have likely restricted the use of the last \$70.0 million of availability, the effective increase in excess availability under the New Credit Facility would have been \$87.0 million. Other terms and conditions in the New Credit Facility, which are summarized below, are similar to those under the Old Credit Facility.

The Credit Agreement extends \$700.0 million of revolving credit facilities to the Company, comprised of (i) a \$625.0 million Revolving Commitment and (ii) a \$75.0 million Tranche B Commitment, both of which are subject to a borrowing base. The borrowing base is a formula based on certain eligible inventory and receivables, minus certain reserves, and the New Credit Facility reflects increases in the Company's advance rates on this collateral. A portion of the New Credit Facility, not to exceed \$40.0 million, is also available to Linens 'n Things Canada Corp. subject to the Canadian borrowing base. The New Credit Facility contains certain customary affirmative and negative covenants and events of default, but all financial maintenance covenants were eliminated. The principal amount outstanding of the loans under the New Credit Facility, plus interest accrued and unpaid thereon, will be due and payable in full at maturity, five years from October 24, 2007.

All obligations under the New Credit Facility are unconditionally guaranteed by the Company and certain of its existing and future domestic subsidiaries. All obligations under the New Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of the assets of the borrowers, consisting

of Linens n Things, Inc., Linens n Things Center, Inc. and Linens n Things Canada Corp. (collectively, the Borrowers ), and the subsidiary guarantors, including: (i) a first-priority security interest in inventory, accounts receivable, cash, securities and other general intangibles; and (ii) a second-priority security interest in equipment, intellectual property rights and related general intangibles and all of the capital stock of Linens n Things, Inc. and the capital stock of certain subsidiaries.

Borrowings under the New Credit Facility bear interest at a rate equal to, at the Borrowers option, either (a) an alternate base rate determined by reference to the higher of (1) the base rate in effect on such day and (2) the federal funds effective rate plus 0.50% or (b) a LIBOR rate, with respect to any Eurodollar borrowing, determined by reference to the costs of funds for U.S. dollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs, in each case plus an applicable margin. The initial applicable margin for borrowings under the New Credit Facility is 0.25% with respect to alternate base rate borrowings and 1.50% with respect to LIBOR borrowings. The applicable margin with respect to Tranche B Loans (consisting of per annum rate margins) shall be 2.75% in the case of Eurodollar borrowings and, in the event the adjusted LIBOR rate is not available, 1.25% in the case of alternate base rate borrowings. After the delivery of the financial statements for the first full fiscal quarter after the closing date, the applicable margin for borrowings under the New Credit Facility will be subject to adjustment based on the excess availability under the New Credit Facility. In addition to paying interest on outstanding principal under the New Credit Facility, the Borrowers are required to pay a commitment fee, initially 0.375% per annum, in respect of the unutilized commitments thereunder. After the delivery of financial statements for the first full fiscal quarter after the closing date, the commitment fee will be subject to adjustment based on the excess availability under the New Credit Facility. The Borrowers must also pay customary letter of credit fees and agency fees. The Borrowers initiated borrowings under the New Credit Facility on October 24, 2007 to meet operational working capital needs.

The Company funds its operations through a combination of internally generated cash from operations and from borrowings under the Old Credit Facility through October 24, 2007 and the New Credit Facility thereafter. The Company s primary uses of cash are working capital requirements, new store expenditures, new store inventory purchases and debt service requirements. The Company anticipates that cash generated from operations together with amounts available under the New Credit Facility will be sufficient to meet its future working capital requirements, new store expenditures, new store inventory purchases and debt service obligations as they become due. However, the Company s ability to fund future operating expenses and capital expenditures and its ability to make scheduled payments of interest on, to pay principal on or refinance indebtedness and to satisfy any other present or future debt obligations will depend on future operating performance which will be affected by general economic, financial and other factors beyond the Company s control.

As a result of the acquisition, the cash flow results for the thirty-nine weeks ended September 30, 2006 have been separately presented in the condensed consolidated statements of cash flows split between the Predecessor Entity , covering the period January 1 to February 13, 2006 and the Successor Entity covering the period February 14 to September 30, 2006. The comparable period results for the current year are presented under Successor Entity. For comparative purposes, the Company combined the two periods from January 1, 2006 through September 30, 2006 in its discussion below. This combination is not a GAAP presentation. However, the Company believes this combination is useful to provide the reader a more accurate comparison and is provided to enhance the reader s understanding of cash flows for the periods presented.

Net cash used in operating activities for the thirteen weeks ended September 29, 2007 was \$59.3 million, which reflects seasonal working capital requirements as the Company prepares for the holiday selling season. This compares with net cash used in operating activities of \$55.9 million for the thirteen weeks ended September 30, 2006. Net cash used in operating activities for the thirty-nine weeks ended September 29, 2007 was \$261.3 million, which is marginally lower when compared with \$265.3 million used in operating activities for the same period last year, determined by combining net cash used in operating activities of \$203.3 million and \$62.0 million for the periods February 14, 2006 to September 30, 2006 and January 1, 2006 to February 13, 2006, respectively. The use of cash for the thirty-nine weeks ended September 29, 2007 reflects the Company s customary seasonal investment in working capital as it prepares for the upcoming holiday selling season as well as the payment of cash interest and income taxes.

Net cash used in investing activities for the thirteen weeks ended September 29, 2007 was \$6.7 million which reflects \$8.8 million for additions to property and equipment offset by \$2.1 million of proceeds from the sale of real



estate. This compares with net cash used in investing activities of \$16.0 million for the thirteen weeks ended September 30, 2006. Net cash used in investing activities for the thirty-nine weeks ended September 29, 2007 was \$25.8 million compared with \$1,262.1 million used in investing activities for the same period last year, determined by combining net cash used in investing activities of \$1,251.1 million and \$11.0 million for the periods February 14, 2006 to September 30, 2006 and January 1, 2006 to February 13, 2006, respectively. Excluding the prior period cost in connection with the acquisition, net cash used in investing activities decreased \$30.8 million from the prior year due to fewer new store openings and the receipt of \$5.4 million from sales of two real estate properties. The Company currently estimates capital expenditures will be approximately \$40 million in fiscal 2007, primarily to open approximately 20 new stores, to maintain existing stores, and for system enhancements and other capital additions.

Net cash provided by financing activities for the thirteen weeks ended September 29, 2007 was \$61.0 million primarily due to an increase in borrowings under the asset-based revolving credit facility. This compares with net cash provided by financing activities of \$69.9 million for the thirteen weeks ended September 30, 2006. Net cash provided by financing activities for the thirty-nine weeks ended September 29, 2007 was \$286.2 million compared with \$1,470.8 million provided by financing activities for the same period last year, determined by combining net cash provided by financing activities of \$1,465.8 million and \$5.0 million for the periods February 14, 2006 to September 30, 2006 and January 1, 2006 to February 13, 2006, respectively. Excluding the prior period cash flows resulting from the acquisition, net cash provided by financing activities increased \$61.0 million from the prior year. The increase in net cash provided by financing activities is due to higher borrowings from the asset-based revolving credit facility.

Management regularly reviews and evaluates its liquidity and capital needs. The Company experiences peak periods for its liquidity needs generally during the third quarter and fourth quarter of the fiscal year. As the Company's business continues to grow and its current store expansion plan is implemented, such peak periods may require increases in the amounts available under the New Credit Facility from those currently existing and/or other debt or equity funding. Management currently believes that the Company's cash flows from operations and its availability under the New Credit Facility will be sufficient to fund its expected capital expenditures, working capital and non-acquisition business expansion requirements as they become due; however, no assurance can be given that it will be able to obtain access to increases to the New Credit Facility or additional capacity from new credit facilities in the future should they become necessary.

#### **Off-Balance Sheet Arrangements**





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The Company does not have any transactions or relationships that could be considered material off-balance sheet arrangements.

### **Inflation**



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The Company does not believe that its operating results have been materially affected by inflation during the preceding three years. There can be no assurance, however, that the Company's operating results will not be affected by inflation in the future.

### **Seasonality**



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The Company's business is subject to substantial seasonal variations. Historically, the Company has realized a significant portion of its net sales and, prior to the Merger before the Company became highly leveraged, substantially all of its net income for the year during the third and fourth quarters. The Company's quarterly results of operations may also fluctuate significantly as a result of a variety of other factors, including the timing of new store openings. The Company believes this is the general pattern associated with its segment of the retail industry and expects this pattern will continue in the future. Consequently, comparisons between quarters are not necessarily meaningful and the results for any quarter are not necessarily indicative of future results.

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

The Company continuously evaluates the market risk associated with its financial instruments. Market risks relating to the Company's operations result primarily from changes in interest rates. The Company does not engage in financial transactions for trading or speculative purposes.

Market risk exposure has significantly increased due to the issuance of the Notes in connection with the Transactions.

**Interest Rate Risk**

The Company's financial instruments include cash and cash equivalents and borrowings under the Old Credit Facility, the New Credit Facility and the Notes. The asset-based revolving credit facility and the Notes carry floating rate interest and, therefore, the Company's condensed consolidated statement of operations and the condensed consolidated statement of cash flows for fiscal 2007 will be exposed to changes in interest rates. As of September 29, 2007, the Company had \$328.2 million in borrowings under the Old Credit Facility at an average interest rate of 6.9% and \$650.0 million aggregate principal amount in Notes at an interest rate of 11.0%, based on a LIBOR rate of 5.4%. As of September 29, 2007, a one percentage point change in floating rate interest would cause an increase to interest expense of approximately \$9.8 million.

The Company employs derivative financial instruments to manage its exposure to interest rate changes and to limit the volatility and impact of interest rate changes on earnings and cash flows.

The Company does not enter into other derivative financial instruments for trading or speculative purposes. The Company faces credit risk if the counterparties to these transactions are unable to perform their obligations. However, the Company seeks to minimize this risk by entering into transactions with counterparties that are major financial institutions with high credit ratings.

On July 7, 2006 the Issuers entered into a zero cost interest rate collar agreement to hedge the cash flows associated with the LIBOR component of the interest rate on the Notes. The collar agreement provides for payments to be made to or received from the counterparty where the LIBOR component of the rate in effect for the Notes is below 4.45% or above 6.51% for a given reset period. Such payments represent the difference between the rates stated above in the collar agreement and those in effect on the Notes for the given reset period. Payment and reset dates under the collar agreement are matched exactly to those of the Notes. The collar agreement has an ultimate maturity of January 15, 2008. At the inception of the collar agreement, the Company determined that the hedging relationship would have no ineffectiveness, and the Company will continue to verify and document that the critical terms of the hedging instrument and the hedged item are exactly matched. At September 29, 2007, the notional amount of debt related to the collar agreement was \$650.0 million and the fair value of the collar agreement was a de minimis liability.

On July 7, 2006 the Issuers also purchased a one-year forward-starting interest rate cap agreement which takes effect on January 15, 2008. The cap agreement provides for payments to be received from the counterparty where the LIBOR component of the rate in effect on a LIBOR-based borrowing arrangement is above 6.51% for a given reset period. Payment and reset dates under the cap agreement are matched exactly to those of the LIBOR-based borrowing arrangement. The cap agreement has an ultimate maturity of January 15, 2009. The Company paid a premium of \$0.7 million to purchase the cap agreement. The cap agreement consists of two components, a forward contract and an interest rate cap agreement. The Company's intent is to hedge the cash flow associated with the LIBOR component of the interest rate on a LIBOR-based

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borrowing arrangement beyond 6.51% for the period January 15, 2008 through January 15, 2009. The forward contract should enable the Company to achieve this objective. The Company will assess the effectiveness of the forward contract quarterly. Once the forward contract becomes an interest rate cap agreement, effectiveness will be assessed and documented as a new relationship. The interest rate cap agreement is expected to be perfectly effective at such time, and the Company will continue to subsequently verify and document that the critical terms of the interest rate cap agreement and the hedged item continue to match exactly over the remaining life of the relationship. At September 29, 2007, the notional amount of debt related to the cap agreement was \$650.0 million and the fair value of the instrument was approximately a \$0.02 million asset.

The Company has determined that the collar agreement and the cap agreement have been appropriately designated and documented as cash flow hedges under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. During the thirteen weeks ended September 29, 2007 and September 30, 2006 the Company has recorded a loss of approximately \$0.02 million and \$0.9 million, respectively, in accumulated other comprehensive income (loss) related to these changes in fair value. During the thirty-nine weeks ended September 29, 2007 and the period February 14, 2006 to September 30, 2006 the Company has recorded a gain of approximately \$0.03 million and a loss of approximately \$0.9 million, respectively, in accumulated other comprehensive income (loss) related to these changes in fair value. The collar agreement and the cap agreement had no ineffectiveness and provided no amounts received or paid under the hedges that affected net loss during the period. Both agreements are expected to have no ineffectiveness during their contractual lives.

#### **Foreign Currency Risk**

The Company enters into some purchase obligations outside of the United States, which are predominately settled in U.S. dollars, and therefore, the Company does not have a material exposure to foreign currency exchange risks. The Company operated 38 stores in Canada as of September 29, 2007. The Company believes its foreign currency translation risk is not material, as a hypothetical 10% strengthening or weakening of the U.S. dollar relative to the Canadian dollar would not materially affect the Company's results from operations or cash flow. As of September 29, 2007 and for the thirty-nine weeks then ended the Company did not hedge against foreign currency risks.



**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**



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The Company's management, including its Chief Executive Officer and its Chief Financial Officer, performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 29, 2007. Based upon that evaluation, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report.

### **Changes in Internal Control Over Financial Reporting**



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There have been no significant changes to the Company's internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**PART II - OTHER INFORMATION**



**Item 1. Legal Proceedings**

The Company is subject to litigation in the normal course of business, but it does not believe that the resolution of any pending proceedings will have a material impact on the Company's financial position or results of operations.

**Item 1A. Risk Factors**

There have been no material changes in the risk factors previously disclosed in the Company's 2006 Annual Report on Form 10-K.

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

Effective July 18, 2007, the Company's stockholders executed a unanimous written consent in lieu of annual meeting for the purpose of re-electing each of the then current directors of the Company and ratifying the actions of the Company's directors. As of the same date, the Company as the sole stockholder of Linens n Things, Inc. and Linens n Things, Inc. as the sole stockholder of Linens n Things Center, Inc. executed respective written consents in lieu of annual meeting to re-elect the then current directors and to ratify the actions of directors.

**Item 6. Exhibits**

- 31.1 Certification of Principal Executive Officer of Linens Holding Co. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer of Linens Holding Co. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 Certification of Principal Executive Officer of Linens n Things, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.4 Certification of Principal Financial Officer of Linens n Things, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.5 Certification of Principal Executive Officer of Linens n Things Center, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.6 Certification of Principal Financial Officer of Linens n Things Center, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer and Principal Financial Officer of Linens Holding Co. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Principal Executive Officer and Principal Financial Officer of Linens n Things, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of Principal Executive Officer and Principal Financial Officer of Linens n Things Center, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.





**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

**LINENS HOLDING CO.**  
**LINENS N THINGS, INC.**  
**LINENS N THINGS CENTER, INC.**

Date: November 13, 2007

By: /s/ Robert J. DiNicola  
Robert J. DiNicola  
Chairman and Chief Executive Officer  
(principal executive officer)

Date: November 13, 2007

By: /s/ Francis M. Rowan  
Francis M. Rowan  
Senior Vice President and Chief Financial Officer  
(principal financial and accounting officer)