

REEDS JEWELERS INC
Form 10-Q
October 15, 2002

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON DC 20549**

FORM 10-Q

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

**FOR THE QUARTER ENDED AUGUST 31, 2002
COMMISSION FILE NUMBER 0-15247**

REEDS JEWELERS, INC.

(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

56-1441702

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

**2525 South Seventeenth Street
Wilmington, North Carolina**

(Address of principal executive offices)

28401

(Zip code)

Registrant's telephone number, including area code:

(910) 350-3100

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

Yes No

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

The number of outstanding shares of Common Stock, par value \$0.10 per share, as of October 15, 2002 was 8,476,372.

PART I

Item 1. *Financial Statements*

The consolidated financial statements included herein have been prepared by Reeds Jewelers, Inc. (the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations; however, the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest annual report on Form 10-K for the fiscal year ended February 28, 2002.

REEDS JEWELERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	February 28 2002	August 31 2002	August 31 2001
ASSETS		(unaudited)	(unaudited)
Current assets:			
Cash and cash equivalents	\$ 809,000	\$ 353,000	\$ 776,000
Accounts receivable:			
Customers, less allowance for doubtful accounts of \$1,043,000, \$581,000 and \$3,730,000, respectively (Note E)	133,000	199,000	42,902,000
Other	488,000	1,198,000	993,000
Merchandise inventories	44,337,000	48,362,000	52,066,000
Income taxes receivable	6,776,000	2,092,000	2,421,000
Deferred income taxes, net of valuation allowance of \$132,000 in 2001 (Note C)			1,939,000
Other	654,000	900,000	1,020,000
	<u>53,197,000</u>	<u>53,104,000</u>	<u>102,117,000</u>
Property, furniture and equipment:			
Land and building	83,000	83,000	83,000
Furniture and equipment	20,650,000	20,148,000	27,362,000
Leasehold improvements	9,186,000	9,206,000	12,303,000
	<u>29,919,000</u>	<u>29,437,000</u>	<u>39,748,000</u>
Less accumulated depreciation and amortization	17,765,000	18,316,000	20,654,000
	<u>12,154,000</u>	<u>11,121,000</u>	<u>19,094,000</u>
Net property, furniture and equipment	12,154,000	11,121,000	19,094,000
Other assets:			
Goodwill, net of accumulated amortization of \$3,216,000 in 2001			5,180,000
Deferred income taxes, net of valuation allowance of \$19,000 in 2001 (Note C)			284,000
Restricted investments (Note D)			2,367,000
Other Receivable, less allowance of \$906,000, \$906,000, and \$0, respectively	5,474,000	5,474,000	
Miscellaneous	1,123,000	1,051,000	975,000
	<u>6,597,000</u>	<u>6,525,000</u>	<u>8,806,000</u>
TOTAL ASSETS	\$ 71,948,000	\$ 70,750,000	\$ 130,017,000
	<u> </u>	<u> </u>	<u> </u>
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Accounts payable	\$ 17,233,000	\$ 12,558,000	\$ 21,944,000
Accrued compensation	2,011,000	1,267,000	1,287,000
Accrued expenses	3,805,000	2,383,000	1,951,000
Current portion of long-term debt			60,100,000
	<u>23,049,000</u>	<u>16,208,000</u>	<u>85,282,000</u>
Total current liabilities	23,049,000	16,208,000	85,282,000
Revolving credit note	15,809,000	23,880,000	
Subordinated notes payable to shareholders	2,579,000	2,579,000	845,000
Deferred income taxes (Note C)			2,095,000
Other long-term liabilities	855,000	855,000	874,000

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Total liabilities	42,292,000	43,522,000	89,096,000
Shareholders' equity:			
Common stock, par value \$0.10 per share; 25,000,000 shares authorized; 8,476,372 shares issued and outstanding in 2002 and 2001	847,000	847,000	847,000
Additional paid-in capital	10,560,000	10,560,000	10,560,000
Retained earnings	18,249,000	15,821,000	29,514,000
Total shareholders' equity	29,656,000	27,228,000	40,921,000
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 71,948,000	\$ 70,750,000	\$ 130,017,000

REEDS JEWELERS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three months ended August 31		Six months ended August 31	
	2002	2001	2002	2001
Net sales	\$ 19,212,000	\$ 22,306,000	\$ 40,319,000	\$ 43,599,000
Cost of sales	9,708,000	12,146,000	20,278,000	23,029,000
Gross profit	9,504,000	10,160,000	20,041,000	20,570,000
Selling, general and administrative expenses	10,689,000	12,707,000	21,663,000	25,048,000
Depreciation and amortization	599,000	1,029,000	1,207,000	2,009,000
Restructuring charge (Note F)	270,000		270,000	
Operating loss	(2,054,000)	(3,576,000)	(3,099,000)	(6,487,000)
Interest expense	372,000	557,000	755,000	1,045,000
Loss from continuing operations before income taxes	(2,426,000)	(4,133,000)	(3,854,000)	(7,532,000)
Income tax benefit	(898,000)	(1,311,000)	(1,426,000)	(2,384,000)
Loss from continuing operations	(1,528,000)	(2,822,000)	(2,428,000)	(5,148,000)
Income from discontinued credit operations, net of income tax expense of \$200,000 and \$449,000 in 2001		462,000		1,037,000
Net loss	\$ (1,528,000)	\$ (2,360,000)	\$ (2,428,000)	\$ (4,111,000)
Basic and diluted net loss from continuing operations per share	\$ (0.18)	\$ (0.33)	\$ (0.29)	\$ (0.61)
Basic and diluted net income from discontinued credit operations per share		0.05		0.12
Basic and diluted net loss per share	\$ (0.18)	\$ (0.28)	\$ (0.29)	\$ (0.49)
Weighted average shares outstanding-diluted	8,476,372	8,476,372	8,476,372	8,476,372

REEDS JEWELERS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Six months ended August 31, 2002	Six months ended August 31, 2001
Operating activities		
Net loss	\$(2,428,000)	\$(4,111,000)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities of continuing operations:		
Income from discontinued credit operations		(1,486,000)
Depreciation	1,148,000	1,728,000
Amortization	59,000	281,000
Loss on sale of property, furniture and equipment	24,000	18,000
Changes in operating assets and liabilities:		
Accounts receivable	(776,000)	7,858,000
Merchandise inventories	(4,025,000)	(3,514,000)
Other current assets and other assets	(233,000)	(206,000)
Accounts payable	(4,675,000)	8,526,000
Accrued compensation and expenses	(2,166,000)	(1,415,000)
Income taxes	4,684,000	(2,073,000)
Other long-term liabilities		663,000
Net cash (used in) provided by operating activities of continuing operations	(8,388,000)	6,269,000
Investing activities		
Proceeds from sale of property, furniture and equipment	285,000	
Purchases of property, furniture and equipment	(424,000)	(2,730,000)
Proceeds from sale of restricted investments		2,517,000
Purchase of restricted investments		(2,304,000)
Net cash used in investing activities	(139,000)	(2,517,000)
Financing activities		
Net proceeds from (payments on) revolving credit note	8,071,000	(3,661,000)
Net cash provided by (used in) financing activities	8,071,000	(3,661,000)
Net (decrease) increase in cash and cash equivalents	(456,000)	91,000
Cash and cash equivalents at beginning of period	809,000	685,000
Cash and cash equivalents at end of period	\$ 353,000	\$ 776,000
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest	\$ 1,016,000	\$ 2,170,000
Income taxes	\$(6,422,000)	\$ 53,000

REEDS JEWELERS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. MANAGEMENT'S OPINION

These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Form 10-K for the fiscal year ended February 28, 2002.

Management of Reeds Jewelers, Inc. believes that the consolidated financial statements contained herein contain all adjustments necessary to present fairly the financial position, consolidated results of operations, and cash flows for the interim period. Management also believes that all adjustments so made are of a normal and recurring nature.

B. RECLASSIFICATIONS

Certain reclassifications were made to the 2001 financial statements to conform to the classifications used in 2002. The reclassifications had no effect on net loss or shareholders' equity as previously reported.

C. INCOME TAXES

Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws anticipated to be in effect when those differences are expected to reverse. For the six months ended August 31, 2002 and 2001 the Company generated net losses. The Company has established a valuation allowance for these net operating loss carryforwards and certain other deferred tax assets. The Company will reduce the valuation allowance when, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will be realized.

D. RESTRICTED INVESTMENTS

	08/31/02	08/31/01
Cash	\$	\$2,307,000
Equity investment		60,000
	_____	_____
Total restricted investments	\$	\$2,367,000
	_____	_____

Restricted investments in the accompanying balance sheet represent cash and stock held by the Company's subsidiary, First Retail Bank N.A., to comply with the Federal Banking Regulations.

The Company's equity investment, carried at cost, consisted of 1,200 shares of Federal Reserve Bank stock with a \$50 par value at August 31, 2001.

In October 2001, the company dissolved the First Retail Bank, N. A. and as a result, the restricted investments became available for general use.

E. OPERATING SEGMENT INFORMATION

On February 28, 2002, Reeds Jewelers discontinued its credit segment. The Company sold substantially all of the outstanding accounts receivable owned by its subsidiary Reeds Financial Services, Inc. (RFSI). In connection with the sale of the accounts receivable portfolio the Company signed a seven-year agreement with the purchaser whereby the purchaser will provide a full-service private label credit card program to Reeds Jewelers, Inc. Upon outsourcing its credit operations, the Company closed its credit facilities in Wilmington, NC and Flowery Branch, GA. In accordance with SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, the Company reported two segments, retail operations and credit operations. Separate financial information was produced internally and was regularly reviewed by the chief operating decision-maker (CODM). The retail operations segment consists of all store locations and corporate headquarters. The stores have all been combined into one segment because they have similar basic characteristics, such as the nature of products, and the class of customers for their products. Corporate headquarters is included in this same segment due to the fact that its revenues earned are incidental to the Company s activities and it serves as a support system to the stores. The credit operations segment was primarily engaged in providing and maintaining financing for the Company s customers. This operation was segregated since the CODM evaluated it separately. It also met one of the three quantitative thresholds, the asset test, since it represented 10.0% or more of the combined assets of all operating segments.

The following table summarizes the net sales, revenues, operating earnings, interest expense, assets, depreciation, and capital expenditures for each reportable segment for the quarters and six-months ended August 31, 2002 and 2001. In the financial statements, other revenues are reflected as a reduction of selling, general, and administrative expenses and inter-segment revenue eliminates in consolidation.

	Retail Operations	Credit Operations	Total
<i>For the quarter ended August 31, 2002</i>			
Net Sales	\$ 19,212,000	\$	\$ 19,212,000
Other revenues	310,000		310,000
Inter-segment revenue			
Operating loss excluding inter-segment revenue	(2,054,000)		(2,054,000)
Interest expense	372,000		372,000
Identifiable assets	70,750,000		70,750,000
Depreciation and amortization	599,000		599,000
Capital expenditures	277,000		277,000

	Retail Operations	Credit Operations	Total
<i>For the quarter ended August 31, 2001</i>			
Net Sales	\$ 22,306,000	\$	\$ 22,306,000
Other revenues	367,000	3,233,000	3,600,000
Inter-segment revenue		242,000	242,000
Operating (loss) earnings excluding inter-segment revenue	(3,576,000)	1,141,000	(2,435,000)
Interest expense	557,000	479,000	1,036,000
Identifiable assets	84,419,000	45,598,000	