

STEIN MART INC  
Form 10-Q  
September 08, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended July 31, 2010

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-20052

**STEIN MART, INC.**

(Exact name of registrant as specified in its charter)

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|   |   |
|---|---|
| <b>Florida</b><br>(State or other jurisdiction of<br>incorporation or organization)             | <b>64-0466198</b><br>(I.R.S. Employer<br>Identification Number) |
| <b>1200 Riverplace Blvd., Jacksonville, Florida</b><br>(Address of principal executive offices) | <b>32207</b><br>(Zip Code)                                      |
| <b>Registrant's telephone number, including area code: (904) 346-1500</b>                       |   |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares outstanding of the Registrant's common stock as of August 27, 2010 was 43,453,518.

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**Table of Contents****Stein Mart, Inc.****Condensed Consolidated Balance Sheets****(Unaudited)****(In thousands, except for share data)**

|  | July 31, 2010 | January 30, 2010 | August 1, 2009 |
|--|---------------|------------------|----------------|
| <b>ASSETS</b>  |               |                  |                |
| Current assets:  |               |                  |                |
| Cash and cash equivalents  | \$ 79,805     | \$ 80,975        | \$ 45,036      |
| Trade and other receivables  | 8,104         | 10,178           | 13,040         |
| Inventories  | 218,372       | 218,125          | 184,866        |
| Income taxes receivable  |               |                  | 8,323          |
| Prepaid expenses and other current assets  | 12,277        | 11,112           | 13,308         |
| Total current assets   | 318,558       | 320,390          | 264,573        |
| Property and equipment, net  | 75,074        | 68,415           | 78,835         |
| Other assets   | 14,867        | 15,408           | 17,645         |
| Total assets   | \$ 408,499    | \$ 404,213       | \$ 361,053     |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |               |                  |                |
| Current liabilities:   |               |                  |                |
| Accounts payable   | \$ 74,997     | \$ 80,318        | \$ 58,028      |
| Accrued liabilities  | 67,349        | 84,330           | 76,329         |
| Income taxes payable   | 1,557         | 2,961            |                |
| Total current liabilities  | 143,903       | 167,609          | 134,357        |
| Other liabilities  | 21,221        | 20,915           | 20,692         |
| Total liabilities  | 165,124       | 188,524          | 155,049        |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |               |                  |                |
| Stockholders' equity:  |               |                  |                |
| Preferred stock - \$.01 par value; 1,000,000 shares authorized; no shares issued or outstanding  |               |                  |                |
| Common stock - \$.01 par value; 100,000,000 shares authorized; 43,456,366, 42,872,457 and 42,775,961 shares issued and outstanding, respectively | 435           | 429              | 428            |
| Additional paid-in capital   | 18,026        | 15,977           | 12,044         |
| Retained earnings  | 224,342       | 198,705          | 192,762        |
| Accumulated other comprehensive income   | 572           | 578              | 770            |
| Total stockholders' equity   | 243,375       | 215,689          | 206,004        |
| Total liabilities and stockholders' equity   | \$ 408,499    | \$ 404,213       | \$ 361,053     |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****Stein Mart, Inc.****Condensed Consolidated Statements of Income****(Unaudited)****(In thousands, except per share amounts)**

|  | <b>13 Weeks Ended<br/>July 31, 2010</b> | <b>13 Weeks Ended<br/>August 1, 2009</b> | <b>26 Weeks Ended<br/>July 31, 2010</b> | <b>26 Weeks Ended<br/>August 1, 2009</b> |
|--|---|--|---|--|
| Net sales                                    | \$ 275,955                              | \$ 287,501                               | \$ 576,953                              | \$ 607,071                               |
| Cost of merchandise sold                     | 206,851                                 | 212,052                                  | 420,346                                 | 434,792                                  |
| Gross profit                                 | 69,104                                  | 75,449                                   | 156,607                                 | 172,279                                  |
| Selling, general and administrative expenses | 70,089                                  | 74,220                                   | 141,687                                 | 154,076                                  |
| Other income, net                            | 14,462                                  | 4,310                                    | 19,735                                  | 9,307                                    |
| Income from operations                       | 13,477                                  | 5,539                                    | 34,655                                  | 27,510                                   |
| Interest income (expense), net               | 16                                      | 21                                       | 24                                      | (258)                                    |
| Income before income taxes                   | 13,493                                  | 5,560                                    | 34,679                                  | 27,252                                   |
| Provision for income taxes                   | 2,204                                   | 4,036                                    | 9,042                                   | 9,642                                    |
| Net income                                   | \$ 11,289                               | \$ 1,524                                 | \$ 25,637                               | \$ 17,610                                |
| Net income per share:                        |   |  |   |  |
| Basic  | \$ 0.26                                 | \$ 0.04                                  | \$ 0.59                                 | \$ 0.41                                  |
| Diluted                                      | \$ 0.25                                 | \$ 0.04                                  | \$ 0.57                                 | \$ 0.41                                  |
| Weighted-average shares outstanding:         |   |  |   |  |
| Basic  | 42,610                                  | 41,753                                   | 42,561                                  | 41,728                                   |
| Diluted                                      | 43,970                                  | 42,414                                   | 43,813                                  | 42,167                                   |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****Stein Mart, Inc.****Condensed Consolidated Statements of Cash Flows****(Unaudited)****(In thousands)**

|   | 26 Weeks Ended<br>July 31, 2010 | 26 Weeks Ended<br>August 1, 2009 |
|---|---------------------------------|----------------------------------|
| <b>Cash flows from operating activities:</b>                                      |                                 |                                  |
| Net income  | \$ 25,637                       | \$ 17,610                        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |                                  |
| Depreciation and amortization   | 8,605                           | 9,717                            |
| Impairment of property and other assets   | 266                             | 726                              |
| Change in valuation allowance for deferred tax assets                             | (3,742)                         | (2,729)                          |
| Deferred income taxes   | 3,742                           | 3,015                            |
| Store closing charges   | 207                             | 1,072                            |
| Share-based compensation  | 1,256                           | 1,805                            |
| Tax benefit from equity issuances   | 2,055                           | 62                               |
| Excess tax benefits from share-based compensation                                 | (2,011)                         | (54)                             |
| Changes in assets and liabilities:  |                                 |                                  |
| Trade and other receivables   | 2,074                           | (4,029)                          |
| Inventories   | (247)                           | 22,273                           |
| Income taxes receivable   |                                 | 16,116                           |
| Prepaid expenses and other current assets   | (1,165)                         | (1,219)                          |
| Other assets  | 53                              | 3,616                            |
| Accounts payable  | (5,321)                         | 2,345                            |
| Accrued liabilities   | (16,872)                        | (3,835)                          |
| Income taxes payable  | (1,404)                         |                                  |
| Other liabilities   | 177                             | (7,661)                          |
| Net cash provided by operating activities   | 13,310                          | 58,830                           |
| <b>Cash flows from investing activities:</b>                                      |                                 |                                  |
| Capital expenditures  | (15,235)                        | (2,943)                          |
| Net cash used in investing activities   | (15,235)                        | (2,943)                          |
| <b>Cash flows from financing activities:</b>                                      |                                 |                                  |
| Borrowings under notes payable to banks   |                                 | 57,134                           |
| Repayments of notes payable to banks  |                                 | (157,134)                        |
| Excess tax benefits from share-based compensation                                 | 2,011                           | 54                               |
| Proceeds from exercise of stock options   | 439                             | 127                              |
| Proceeds from employee stock purchase plan  | 368                             | 96                               |
| Repurchase of common stock for employee withholdings                              | (2,063)                         | (31)                             |
| Net cash provided by (used in) financing activities                               | 755                             | (99,754)                         |
| Net decrease in cash and cash equivalents   | (1,170)                         | (43,867)                         |
| Cash and cash equivalents at beginning of year                                    | 80,975                          | 88,903                           |
| Cash and cash equivalents at end of period  | \$ 79,805                       | \$ 45,036                        |

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The accompanying notes are an integral part of these condensed consolidated financial statements.

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**STEIN MART, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Dollars in tables in thousands, except per share amounts)**

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting primarily of normal and recurring adjustments) considered necessary for a fair statement have been included. Due to the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year. For further information, refer to the consolidated financial statements and footnotes thereto included in our annual report on Form 10-K for the year ended January 30, 2010.

As used herein, the terms we , our , us , Stein Mart and the Company refer to Stein Mart, Inc. and its wholly-owned subsidiaries.

***Recent Accounting Pronouncements***

In October 2009, the FASB issued guidance impacting the determination of when individual deliverables included in an arrangement with multiple deliverables may be treated as separate units of accounting. The guidance, which was incorporated into ASC Topic 605, *Revenue Recognition*, eliminates the residual method of allocation for multiple-deliverable revenue arrangements, and requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. This guidance is effective for fiscal years beginning on or after June 15, 2010, however early adoption is permitted. We will use this new guidance to account for our Co-brand Credit Card Consumer Program Agreement. We do not anticipate that adoption of this guidance will have a material effect on our consolidated financial statements.

**2. Gift Cards and Merchandise Return Cards/Revenue Recognition**

We offer electronic gift cards and electronic merchandise return cards to our customers. These cards do not have expiration dates. No revenue is recognized at the time gift cards are sold; rather, the issuance is recorded as a liability to customers. At the time merchandise return cards are issued for returned merchandise, the sale is reversed and the issuance is recorded as a liability to customers. Card liabilities are reduced and sales revenue is recognized when cards are redeemed for merchandise. Card liabilities are included within Accrued Liabilities in the Condensed Consolidated Balance Sheets.

During the second quarter of 2010, we recognized \$9.7 million of other income related to cumulative breakage on unused gift and merchandise return cards since the inception of these programs. Breakage income is recognized when the likelihood of the card being redeemed by the customer is remote and we have determined that there is no legal obligation to remit card balances to relevant jurisdictions. Prior to the second quarter of 2010, we had not recognized breakage on card balances pending our final determination of the escheat laws applicable to our operations and historical redemption patterns. We follow the Redemption Recognition Method to account for breakage of unused cards where breakage is recognized as cards are redeemed for the purchase of merchandise based upon a historical breakage rate over an estimated redemption period (48 months). While we expect to continue to recognize gift card and merchandise return card breakage each period, the amount will be significantly less than recognized in the second quarter of 2010 due to this multi-year calculation. Breakage income is recorded within Other Income, net in the Condensed Consolidated Statement of Income.

**3. Fair Value Measurements**

We follow the guidance of ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance also establishes the following three-level hierarchy based upon the transparency of inputs to the valuation of an asset or liability on the measurement date:



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- Level 1: Observable inputs that reflect unadjusted quoted prices for identical assets or liabilities traded in active markets.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: Unobservable inputs that reflect assumptions about what market participants would use in pricing assets or liabilities based on the best information available.

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**STEIN MART, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in tables in thousands, except per share amounts)**

***Assets and Liabilities Measured at Fair Value on a Recurring Basis***

We have money market fund investments classified as cash equivalents which are Level 1 assets because fair value is based on readily available market prices. The fair value of these assets was \$68.9 million at July 31, 2010, \$70.2 million at January 30, 2010 and \$30.4 million at August 1, 2009.

***Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis***

Fair value, as used in our asset impairment calculations, is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Store-related assets are considered Level 3 assets in the fair value hierarchy as the inputs for calculating the fair value of these assets are based on historical transactions for similar assets. Based on our historical experience, the resale value of used fixtures and equipment is de minimis and since we lease all our store locations, our leasehold improvements cannot be sold in a market transaction, and therefore have little to no fair value.

We recorded \$0.3 million and \$0.7 million of asset impairment charges during the second quarter of 2010 and 2009, respectively. These and previously impaired store-related assets have no fair value at July 31, 2010.

**4. Revolving Credit Agreement**

We have a \$150 million senior revolving secured credit agreement (the Agreement) with a group of lenders which extends through January 2012. The amount available for borrowing was \$136.2 million at July 31, 2010 and is based on a percentage of eligible inventories less reserves, as defined in the Agreement. Availability was further reduced to \$127.6 million after deducting outstanding letters of credit of \$8.6 million. We had no direct borrowings at July 31, 2010, and are in compliance with the terms of the Agreement.

**5. Income Taxes**

We established a valuation allowance against deferred tax assets in 2008 because operating results produced a cumulative three-year loss, which is considered a significant factor when determining if a valuation allowance is required per ASC Topic 740, *Income Taxes*. We perform a quarterly assessment of net deferred tax assets and plan to carry a valuation allowance until such time that positive evidence is sufficient to justify realization. The valuation allowance was \$12.9 million at July 31, 2010, \$16.7 million at January 30, 2010 and \$16.2 million at August 1, 2009.

The income tax provision for both the first half of 2010 and the first half of 2009 was based on an estimated annual effective tax rate (ETR). The ETR of 26.1 percent for the first half of 2010 was lower than the federal statutory rate of 35.0 percent due to a benefit from the projected annual reduction in our valuation allowance which is the result of favorable changes in book/tax differences that reduced deferred tax assets. The ETR for the second quarter of 2010 was 16.3 percent due to a reduction in the estimated annual ETR that was used in the first quarter of 2010. The ETR for the first half of 2009 was 35.4 percent compared to the ETR of 72.6 percent for the second quarter of 2009, a result of changing from the discrete period method used in the first quarter of 2009.

**6. Stockholders' Equity**

***Stock Repurchase Plan***

During the 26 weeks ended July 31, 2010, we repurchased 249,870 shares of our common stock related to withholding taxes due on the vesting of employee stock awards at a total cost of \$2.1 million. Repurchases during the 26 weeks ended August 1, 2009 were immaterial.

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### *Performance Share Awards*

For fiscal 2009, short-term and long-term incentives earned were paid in performance share awards when the performance goal was met on January 30, 2010. One-half of the 1.5 million performance shares earned on the award date (February 1, 2010) vested immediately resulting in 0.7 million shares being issued in February 2010. The other half will vest one year after the award date (February 1, 2011).

### *Share-Based Compensation*

For the 13 weeks and 26 weeks ended July 31, 2010 and August 1, 2009, pre-tax share-based compensation expense was recorded as follows:

|   | 13 Weeks Ended<br>July 31, 2010 | 13 Weeks Ended<br>August 1,<br>2009 | 26 Weeks Ended<br>July 31, 2010 | 26 Weeks Ended<br>August 1,<br>2009 |
|---|---------------------------------|-------------------------------------|---------------------------------|-------------------------------------|
| Cost of merchandise sold                      | \$ 685                          | \$ 639                              | \$ 814                          | \$ 1,149                            |
| Selling, general and administrative expenses  | 373                             | 360                                 | 442                             | 656                                 |
| <b>Total share-based compensation expense</b> | <b>\$ 1,058</b>                 | <b>\$ 999</b>                       | <b>\$ 1,256</b>                 | <b>\$ 1,805</b>                     |

Share-based compensation expense was lower during the first half of 2010 due to pre-vesting forfeitures of employee stock options.

**Table of Contents****STEIN MART, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****(Dollars in tables in thousands, except per share amounts)****7. Earnings Per Share**

We calculate earnings per share (EPS) using the two-class method. Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of EPS. Our restricted stock awards are considered participating securities because they contain non-forfeitable rights to dividends.

The following table presents the calculation of basic and diluted income per common share (shares in thousands):

|  | 13 Weeks Ended<br>July 31, 2010 | 13 Weeks Ended<br>August 1,<br>2009 | 26 Weeks Ended<br>July 31, 2010 | 26 Weeks Ended<br>August 1,<br>2009 |
|--|---------------------------------|-------------------------------------|---------------------------------|-------------------------------------|
| <b>Numerator:</b>                                      |                                 |                                     |                                 |                                     |
| Net income   | \$ 11,289                       | \$ 1,524                            | \$ 25,637                       | \$ 17,610                           |
| Income allocated to participating securities           | 205                             | 34                                  | 475                             | 400                                 |
| Net income available to common stockholders            | \$ 11,084                       | \$ 1,490                            | \$ 25,162                       | \$ 17,210                           |
| <b>Denominator:</b>                                    |                                 |                                     |                                 |                                     |
| Basic weighted-average shares outstanding              | 42,610                          | 41,753                              | 42,561                          | 41,728                              |
| Incremental shares from share-based compensation plans | 1,360                           | 661                                 | 1,252                           | 439                                 |
| Diluted weighted-average shares outstanding            | 43,970                          | 42,414                              | 43,813                          | 42,167                              |
| <b>Net income per share:</b>                           |                                 |                                     |                                 |                                     |
| Basic  | \$ 0.26                         | \$ 0.04                             | \$ 0.59                         | \$ 0.41                             |
| Diluted  | \$ 0.25                         | \$ 0.04                             | \$ 0.57                         | \$ 0.41                             |

Options to purchase approximately 1.7 million and 1.8 million shares of common stock that were outstanding during the 13 weeks ended July 31, 2010 and August 1, 2009, respectively, were not included in the computation of diluted net income per share as the exercise prices of these options were greater than the average market price of the common shares. For the 26 weeks ended July 31, 2010 and August 1, 2009, options to purchase 1.5 million and 1.9 million shares of common stock, respectively, were not included in the computation of diluted net income per share for the aforementioned reason.

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**STEIN MART, INC.**

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

As used herein, the terms we, our, us, Stein Mart and the Company refer to Stein Mart, Inc. and its wholly-owned subsidiaries.

***Forward-Looking Statements***

This report contains forward-looking statements which are subject to certain risks, uncertainties or assumptions and may be affected by certain factors, including but not limited to the matters discussed in Item A. Risk Factors of our Form 10-K for the fiscal year ended January 30, 2010. Wherever used, the words plan, expect, anticipate, believe, estimate and similar expressions identify forward-looking statements. Should one or more of these risks, uncertainties or other factors materialize, or should underlying assumptions prove incorrect, our actual results, performance or achievements may vary materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements are based on beliefs and assumptions of our management and on information currently available to such management. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to publicly update or revise our forward-looking statements in light of new information or future events. Undue reliance should not be placed on such forward-looking statements, which are based on current expectations. Forward-looking statements are no guarantee of performance.

***Overview***

Stein Mart is a national retailer offering the fashion merchandise, service and presentation of a better department or specialty store. Our focused assortment of merchandise features current-season moderate to better fashion apparel for women and men, as well as accessories, gifts, linens and shoes, all offered at prices competitive with off-price retail chains. We believe we differentiate ourselves from typical off-price retail chains by offering: (i) primarily current-season merchandise carried by better department or specialty stores, (ii) moderate to better price levels, (iii) a stronger merchandising statement, consistently offering more depth of color and size in individual stock-keeping units, and (iv) merchandise presentation and customer service more comparable to department stores and upscale retailers.

For the second quarter of 2010, we had net income of \$11.3 million or \$0.25 per diluted share as compared to net income of \$1.5 million or \$0.04 per diluted share for the same 2009 period. Pretax income for the second quarter of 2010 was \$13.5 million compared to \$5.6 million in 2009. Net income for the second quarter of 2010 includes a \$9.7 million pretax gain to recognize breakage income on unused gift and merchandise return cards, an offsetting \$1.2 million charge associated with changing our physical inventory process and a favorable tax rate adjustment of \$1.3 million. Our 2009 second quarter results were impacted by an unfavorable tax rate adjustment of \$2.1 million. Excluding the impact of these items, our second quarter diluted earnings per share would have been \$0.08 in 2010 compared to \$0.09 in 2009. Without the breakage gain and the charge associated with changing our physical inventory process, pretax income would have been \$5.0 million for the second quarter of 2010 compared to \$5.6 million in 2009.

We are pleased with our continued progress in managing expenses and inventory levels during the first half of 2010. We are focused on several initiatives aimed at improving our top line sales results, including growing the career apparel business and the re-invention of the Stein Mart home store. Our organization and expense structure is well set to give us an advantage when our sales initiatives take hold. A positive indicator is that for the second quarter and first half of 2010 the numbers of transactions on a comp store basis were up 1.8 percent and 1.3 percent, respectively, although the average transaction amount was down 3.8 percent and 4.3 percent, respectively. We believe the number of transactions reflects increasing numbers of customers in our stores.

We have completed our new supply chain network, we are rolling out improvements to our point of sale system and we continue to devote significant resources to the implementation of our new Merchandise Information System. These efforts are important foundations for the future and remain on schedule and on budget. We continue to expect total supply chain savings of approximately \$10 million this year and in early 2011. These savings occurred more heavily in the first half of 2010 (approximately \$6 million of savings), with a smaller amount of savings expected in the second half of this year and some in the first quarter of 2011. For the full year, we expect selling, general and administrative (SG&A) expense savings from supply chain will slightly more than offset the add-backs of compensation and other expenses that were temporarily lowered in 2009.

Inventories at the end of the second quarter of 2010 were \$218.4 million including \$30 million of merchandise in third-party distribution centers that was received earlier than last year as part of our new supply chain network. This compares to \$184.9 million of inventories at the end of the second quarter of 2009 which included only \$3 million of distribution center inventories due to our being in the start-up phase of supply chain. Excluding merchandise in the distribution centers, our average store inventory increased 5.9 percent from the end of the second quarter of 2009.

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The increase in inventory was planned to give us more balanced quantities across merchandise product lines and to support receipts for the home store re-invention.

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There were 264 stores open as of July 31, 2010 compared to 270 stores open as of August 1, 2009. We plan to open two new stores, relocate one store and close one store for a net planned increase of one store for the remainder of this year.

|                                 | 13 Weeks Ended<br>July 31, 2010 | 13 Weeks Ended<br>August 1, 2009 | 26 Weeks Ended<br>July 31, 2010 | 26 Weeks Ended<br>August 1, 2009 |
|---------------------------------|---------------------------------|----------------------------------|---------------------------------|----------------------------------|
| Stores at beginning of period   | 265                             | 275                              | 267                             | 276                              |
| Stores opened during the period |                                 |                                  |                                 | 1                                |
| Stores closed during the period | (1)                             | (5)                              | (3)                             | (7)                              |
| Stores at the end of period     | 264                             | 270                              | 264                             | 270                              |

**Results of Operations**

The following table sets forth each line item of the Condensed Consolidated Statements of Income expressed as a percentage of our net sales (numbers may not add due to rounding):

|  | 13 Weeks Ended<br>July 31, 2010 | 13 Weeks Ended<br>August 1, 2009 | 26 Weeks Ended<br>July 31, 2010 | 26 Weeks Ended<br>August 1, 2009 |
|--|---------------------------------|----------------------------------|---------------------------------|----------------------------------|
| Net sales                                    | 100.0%                          | 100.0%                           | 100.0%                          | 100.0%                           |
| Cost of merchandise sold                     | 75.0                            | 73.8                             | 72.9                            | 71.6                             |
| Gross profit                                 | 25.0                            | 26.2                             | 27.1                            | 28.4                             |
| Selling, general and administrative expenses | 25.4                            | 25.8                             | 24.6                            | 25.4                             |
| Other income, net                            | 5.2                             | 1.5                              | 3.4                             | 1.5                              |
| Income from operations                       | 4.9                             | 1.9                              | 6.0                             | 4.5                              |
| Interest income (expense), net               |                                 |                                  |                                 |                                  |
| Income before income taxes                   | 4.9                             | 1.9                              | 6.0                             | 4.5                              |
| Provision for income taxes                   | 0.8                             | 1.4                              | 1.6                             | 1.6                              |
| Net income                                   | 4.1%                            | 0.5%                             | 4.4%                            | 2.9%                             |

**For the 13 weeks ended July 31, 2010 compared to the 13 weeks ended August 1, 2009**

Net sales for the second quarter of 2010 were \$276.0 million, down 4.0 percent from \$287.5 million for last year's second quarter. The \$11.5 million sales decrease reflects a \$5.8 million decrease in the comparable store group and a \$7.7 million decrease in the closing/closed store group, offset by a \$2.0 million increase in the non-comparable store group due to the inclusion of sales for two stores opened in 2009. The closing/closed store group includes the four stores we plan to close in 2010 and eleven stores closed in 2009. Comparable store sales for the second quarter of 2010 decreased 2.0 percent compared to the second quarter of 2009.

Gross profit for the second quarter of 2010 was \$69.1 million or 25.0 percent of net sales compared to \$75.4 million or 26.2 percent of net sales for the second quarter of 2009. The \$6.3 million decrease in gross profit reflects a \$5.0 million decrease in the comparable store group and a \$1.7 million decrease in the closing/closed store group, offset by a \$0.4 million increase in the non-comparable store group due to the inclusion of operating results for two stores opened in 2009. Gross profit as a percent of sales decreased during the second quarter of 2010 as a result of higher buying expenses and their negative leverage on lower sales, and slightly lower purchase markup related to higher home and Fabulous

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Finds receipts, which carry lower markup but have lower markdowns.

SG&A expenses were \$70.1 million or 25.4 percent of net sales for the second quarter of 2010 as compared to \$74.2 million or 25.8 percent of net sales for the same 2009 period. The \$4.1 million decrease in SG&A expenses reflects a \$7.3 million decrease in store expenses, offset by a \$2.7 million increase in advertising expenses and a \$0.5 million increase in corporate expenses. Store expense reductions include a \$3.0 million decrease in personnel expense reductions from our new supply chain process, a \$2.6 million decrease in other store operating and depreciation expenses, a \$1.7 million decrease due to the elimination of operating costs from closed stores and a \$1.2 million decrease in store closing costs (fewer closed stores), offset by a \$1.2 million charge associated with changing our physical inventory process. Store operating expenses were lower as a result of continued cost savings initiatives. Depreciation expense was lower as a result of asset impairment charges taken at the end of fiscal 2009. The \$1.2 million charge related to a change in the process and timing of our physical inventories, as well as accelerating one-half of our stores' inventory observations to mid-year from year-end. Advertising spend was higher to support our revenues in the current economic environment.

Other income, net for the second quarter of 2010 increased \$10.2 million to \$14.5 million compared to \$4.3 million for the second quarter of 2009. During the second quarter of 2010, we recognized \$9.7 million of other income related to cumulative breakage on unused gift and merchandise return cards since the inception of these programs. Breakage income is recognized when the likelihood of the card being redeemed by the customer is remote and we have determined that there is no legal obligation to remit card balances to relevant jurisdictions. Prior to the second quarter of 2010, we had not recognized breakage on card balances pending our final determination of the escheat laws applicable to our operations and historical redemption patterns. We follow the Redemption Recognition Method to account



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for breakage of unused cards where breakage is recognized as cards are redeemed for the purchase of merchandise based upon a historical breakage rate over an estimated redemption period (48 months). While we expect to continue to recognize gift card and merchandise return card breakage each period, the amount will be significantly less than recognized in the second quarter of 2010 due to this multi-year calculation. The remaining increase in Other Income was from our magazine subscription program which began in the third quarter of 2009.

The effective tax rate ( ETR ) of 16.3 percent for the second quarter of 2010 was lower than the federal statutory rate of 35.0 percent due to a benefit from the projected annual reduction in our valuation allowance for deferred tax assets which was the result of favorable changes in book/tax differences that reduced deferred tax assets. The ETR of 72.6 percent for the second quarter of 2009 is the result of changing from the discrete period method used in the first quarter of 2009 when the ETR was 25.8%. The higher second quarter 2009 ETR was required to adjust the ETR for the first half of 2009 to the estimated annual ETR. Our ETR will continue to fluctuate in 2010 due to the impact of book/tax differences on the valuation allowance.

***For the 26 weeks ended July 31, 2010 compared to the 26 weeks ended August 1, 2009***

Net sales for the first half of 2010 were \$577.0 million, down 5.0 percent from \$607.1 million for last year's first half. The \$30.1 million sales decrease reflects a \$17.4 million decrease in the comparable store group and a \$17.8 million decrease in the closing/closed store group, offset by a \$5.1 million increase in the non-comparable store group due to the inclusion of sales for two stores opened in 2009. Comparable store sales for the first half of 2010 decreased 3.0 percent compared to the first half of 2010.

Gross profit for the first half of 2010 was \$156.6 million or 27.1 percent of net sales compared to \$172.3 million or 28.4 percent of net sales for the first half of 2009. The \$15.7 million decrease in gross profit reflects a \$12.6 million decrease in the comparable store group and a \$4.4 million decrease in the closing/closed store group, offset by a \$1.3 million increase in the non-comparable store group due to the inclusion of operating results for two stores opened in 2009. Gross profit as a percent of sales decreased during the first half of 2010 primarily as a result of margins being enhanced in the first quarter of 2009 due to an accelerated markdown cadence at the end of fiscal 2008 and higher buying expenses and their negative leverage on lower sales.

SG&A expenses were \$141.7 million or 24.6 percent of net sales for the first half of 2010 as compared to \$154.1 million or 25.4 percent of net sales for the same 2009 period. The \$12.4 million decrease in SG&A expenses reflects a \$14.6 million decrease in store expenses and a \$0.1 million decrease in corporate expenses, offset by a \$2.3 million increase in advertising expenses. Store expense reductions include a \$6.0 million decrease in personnel expenses resulting from our new supply chain process, a \$4.7 million decrease in other store operating and depreciation expenses, a \$3.8 million decrease due to the elimination of operating costs from closed stores and a \$1.3 million decrease in store closing costs (fewer closed stores), offset by a \$1.2 million charge associated with changing our physical inventory process. Store operating expenses were lower as a result of continued cost savings initiatives. Depreciation expense was lower as a result of asset impairment charges taken at the end of fiscal 2009. The \$1.2 million charge related to a change in the process and timing of our physical inventories, as well as accelerating one-half of our stores' inventory observations to mid-year from year-end. Advertising spend was higher to support our revenues in the current economic environment.

Other income, net for the first half of 2010 increased \$10.4 million to \$19.7 million compared to \$9.3 million for the first half of 2009 primarily due to our recognition of cumulative breakage income of \$9.7 million discussed in the 13 weeks section above. The remaining increase was from our magazine subscription program.

The ETR of 26.1 percent for the first half of 2010 was lower than the federal statutory rate of 35.0 percent due to a benefit from the projected annual reduction in our valuation allowance for deferred tax assets which was the result of favorable changes in book/tax differences that reduced deferred tax assets. Our ETR will continue to fluctuate in 2010 due to the impact of book/tax differences on the valuation allowance.

***Liquidity and Capital Resources***

Our primary source of liquidity is the sale of merchandise inventories. Capital requirements and working capital needs are funded through a combination of internally generated funds, a revolving credit facility and credit terms from vendors. Working capital is needed to support store inventories and capital investments for system improvements, new store openings and to maintain existing stores. Historically, our working capital needs are lowest in the first quarter and highest at the beginning of the fourth quarter in anticipation of the holiday selling season. As of July 31, 2010, we had \$79.8 million in cash and cash equivalents and no direct borrowings on our revolving credit facility.

Net cash provided by operating activities was \$13.3 million for the first half of 2010 compared \$58.8 million for the first half of 2009. Less cash was provided by operating activities during the first half of 2010 compared to the first half of 2009 primarily due to \$30.2 million more cash used for inventories and accounts payable, \$17.5 million less cash from income tax refunds, net of taxes paid, and \$2.6 million less cash

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provided by other operating activities, offset by \$4.8 million more cash provided by net income plus non-cash charges. Inventories at the end of the first half this year include \$27 million more merchandise in third-party distribution centers that was received earlier than at the end of the first half last year as part of our new supply chain network which was in the start-up phase last year. The effect of earlier ownership of inventories also increased accounts payable at the end of the first half this year compared to last year.

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Net cash used in investing activities was \$15.2 million for the first half of 2010 compared to \$2.9 million for the first half of 2009. Capital expenditures are planned at approximately \$30 million for 2010 compared to \$7.6 million in 2009. Approximately \$20 million is for systems improvements, with the largest portion for our new merchandise information system. The remaining capital amounts are for improvements in our point-of-sale system, upgrades to store fixtures and for new and relocated stores.

Net cash provided by financing activities was \$0.8 million for the first half of 2010 compared to cash used in financing activities of \$99.8 million for the first half of 2009. More cash was used in financing activities during the first half of 2009 due to the repayment of all direct borrowings under our revolving credit agreement.

We have a \$150 million senior revolving secured credit agreement (the Agreement) with a group of lenders which extends through January 2012. The amount available for borrowing was \$136.2 million at July 31, 2010 and is based on a percentage of eligible inventories less reserves, as defined in the Agreement. Availability was further reduced to \$127.6 million after deducting of outstanding letters of credit of \$8.6 million. We had no direct borrowings at July 31, 2010, and are in compliance with the terms of the Agreement.

We believe that we will generate positive cash flow from operations on a full year basis, which, along with our available cash and borrowing capacity under the revolving credit agreement, will provide the means needed to fund our operations for the foreseeable future.

***Recent Accounting Pronouncements***

In October 2009, the FASB issued guidance impacting the determination of when individual deliverables included in an arrangement with multiple deliverables may be treated as separate units of accounting. The guidance, which was incorporated into ASC Topic 605, *Revenue Recognition*, eliminates the residual method of allocation for multiple-deliverable revenue arrangements, and requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. This guidance is effective for fiscal years beginning on or after June 15, 2010, however early adoption is permitted. We will use this new guidance to account for our Co-brand Credit Card Consumer Program Agreement. We do not anticipate that adoption of this guidance will have a material effect on our consolidated financial statements.

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

For information regarding our exposure to certain market risk, see Quantitative and Qualitative Disclosures About Market Risk in Part II, Item 7A of our Form 10-K for the year ended January 30, 2010, filed with the Securities and Exchange Commission on April 15, 2010. There were no material changes to our market risk during the quarter ended July 31, 2010.

**ITEM 4. CONTROLS AND PROCEDURES**

Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of July 31, 2010 to provide reasonable assurance that the objectives of disclosure controls and procedures are met.

There were no changes in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table provides information regarding repurchases by the Company of its common stock during the 13-week period ended July 31, 2010:

| Period       |               | ISSUER PURCHASES OF EQUITY SECURITIES |                              |  |  |
|--------------|---------------|---------------------------------------|------------------------------|--|--|
|              |               | Total number of shares purchased      | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs (1) | Maximum number of shares that may yet be purchased under the plans or programs (1) |
| May 2, 2010  | May 29, 2010  | 469                                   | \$ 9.31                      | 469  | 545,132  |
| May 30, 2009 | July 3, 2010  | 2,450                                 | \$ 7.42                      | 2,450  | 542,682  |
| July 4, 2010 | July 31, 2010 | 2,561                                 | \$ 7.52                      | 2,561  | 540,121  |
| Total        |               | 5,480                                 | \$ 7.63                      | 5,480  | 540,121  |

- (1) The Company's Open Market Repurchase Program is conducted pursuant to authorizations made from time to time by the Company's Board of Directors. The shares reported in the table are covered by an April 17, 2007 Board authorization to repurchase 2.5 million shares of common stock which does not have an expiration date. This quarter's repurchases are related to taxes due on the vesting of employee stock awards which fall under the Company's repurchase program.

**ITEM 6. EXHIBITS**

- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a)  
 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a)  
 32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350  
 32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

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**SIGNATURES**

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

STEIN MART, INC.

Date: September 8, 2010

By: /s/ DAVID H. STOVALL, JR.  
**David H. Stovall, Jr.**  
**President and Chief Executive Officer**

/s/ GREGORY W. KLEFFNER  
**Gregory W. Kleffner**  
**Executive Vice President and Chief Financial Officer**