NEIMAN MARCUS GROUP INC
Form 10-Q
June 08, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended April 29, 2006

OR

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

Commission file no. 1-9659

The Neiman Marcus Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**95-4119509**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Marcus Square

1618 Main Street

Dallas, Texas 75201

(Address of principal executive offices)

(214) 741-6911

(Registrant s telephone number, including area code)

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.(1)

YES o NO ý

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

Large accelerated filer ý Accelerated filer o Non-accelerated filer o

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

YES o NO ý

There were 900 shares of the registrant s common stock, par value $.01 per share, outstanding at April 29, 2006.

(1) After October 6, 2005, the registrant was not subject to reporting requirements under the Exchange Act of 1934, but complied with those requirements pursuant to contractual obligations.

THE NEIMAN MARCUS GROUP, INC.

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THE NEIMAN MARCUS GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands)	April 29, 2006 (Successor)	July 30, 2005 (Predecessor)	April 30, 2005 (Predecessor)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 108,982	$ 853,482	$ 337,589
Restricted cash			37,500
Accounts receivable, net of allowance	56,744	29,886	666,455
Merchandise inventories	854,979	748,366	788,915
Other current assets	64,700	76,747	49,715
Total current assets	1,085,405	1,708,481	1,880,174
Property and equipment, net	1,045,184	855,009	821,810
Customer lists, net	554,650		
Favorable lease commitments, net	469,591		
Trademarks	1,691,155	56,645	56,645
Goodwill	1,681,021	14,872	14,872
Debt issuance costs	101,034	3,526	3,656
Other assets	31,974	22,127	62,649
Total assets	$ 6,660,014	$ 2,660,660	$ 2,839,806
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 251,444	$ 282,887	$ 246,971
Accrued liabilities	389,756	332,937	352,526
Notes payable and current maturities of long-term liabilities	15,129	1,450	200
Current portion of borrowings under Credit Card Facility			187,500
Total current liabilities	656,329	617,274	787,197
Long-term liabilities:			
Senior secured term loan facility	1,875,000		
Senior debentures due 2028	120,663	124,823	124,820
Senior notes	700,000		
Senior subordinated notes	500,000		
Senior notes due 2008		124,957	124,953
Deferred real estate credits	11,099	86,575	74,429
Deferred income taxes	1,129,899		33,614
Other long-term liabilities	186,169	120,973	99,500
Total long-term liabilities	4,522,830	457,328	457,316
Minority interest	12,810	12,112	13,498
Predecessor:			
Common stocks (par value $0.01 per share, issued 49,716,309 shares at July 30, 2005 and 48,947,578 shares at April 30, 2005)		497	497
Successor:			
Common stock (par value $0.01 per share, issued 900 shares)			
Additional paid-in capital	1,473,139	520,414	511,338
Carryover basis adjustment for management shareholders	(69,200)		

Accumulated other comprehensive income (loss)	9,666	(47,030)	(3,432)
Retained earnings	54,440	1,125,726	1,099,053
Treasury stock, at cost (768,731 shares at July 30, 2005 and 768,731 shares at April 30, 2005)		(25,661)	(25,661)
Total shareholders equity	1,468,045	1,573,946	1,581,795
Total liabilities and shareholders equity	$ 6,660,014	$ 2,660,660	$ 2,839,806

See Notes to Condensed Consolidated Financial Statements.

THE NEIMAN MARCUS GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(UNAUDITED)

(in thousands)		Thirteen weeks ended April 29, 2006 (Successor)		Thirteen weeks ended April 30, 2005 (Predecessor)
Revenues	$	1,027,009	$	933,372
Cost of goods sold including buying and occupancy costs (excluding depreciation)		602,957		549,740
Selling, general and administrative expenses (excluding depreciation)		255,380		240,396
Income from credit card operations, net		(15,136)		(19,030)
Depreciation expense		32,913		27,614
Amortization of customer lists		13,715		
Amortization of favorable lease commitments		4,502		
Operating earnings		132,678		134,652
Interest expense, net		67,216		2,933
Earnings before income taxes and minority interest		65,462		131,719
Income taxes		24,953		50,713
Earnings before minority interest		40,509		81,006
Minority interest in net loss (earnings) of subsidiaries		38		(1,231)
Net earnings	$	40,547	$	79,775

See Notes to Condensed Consolidated Financial Statements.

(in thousands)	Thirty weeks ended April 29, 2006 (Successor)	Nine weeks ended October 1, 2005 (Predecessor)	Thirty-nine weeks ended April 30, 2005 (Predecessor)
Revenues	$ 2,583,215	$ 651,648	$ 2,970,533
Cost of goods sold including buying and occupancy costs (excluding depreciation)	1,634,187	378,767	1,816,602
Selling, general and administrative expenses (excluding depreciation)	623,972	168,853	747,432
Income from credit card operations, net	(35,894)	(7,818)	(52,414)
Depreciation expense	77,977	19,960	79,338
Amortization of customer lists	31,652		
Amortization of favorable lease commitments	10,389		
Transaction and other costs		23,544	
Loss on disposition of Chef s Catalog			15,348
Operating earnings	240,932	68,342	364,227
Interest expense (income), net	150,626	(866)	10,948
Earnings before income taxes and minority interest	90,306	69,208	353,279
Income taxes	34,791	25,607	136,014
Earnings before minority interest	55,515	43,601	217,265
Minority interest in net (earnings) loss of subsidiaries	(1,075)	553	(2,787)
Net earnings	$ 54,440	$ 44,154	$ 214,478

See Notes to Condensed Consolidated Financial Statements.

THE NEIMAN MARCUS GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)	Thirty weeks ended April 29, 2006 (Successor)	Nine weeks ended October 1, 2005 (Predecessor)	Thirty-nine weeks ended April 30, 2005 (Predecessor)
CASH FLOWS - OPERATING ACTIVITIES			
Net earnings	$ 54,440	$ 44,154	$ 214,478
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	77,977	19,960	79,338
Amortization of debt issue costs	8,183		465
Amortization of customer lists and favorable lease commitments	42,041		
Non-cash charges related to step-up in carrying value of inventory	38,067		
Stock-based compensation charges	2,509	19,968	3,646
Deferred income taxes	(27,110)	(7,327)	
Loss on disposition of Chef s Catalog			15,348
Minority interest	1,075	(553)	2,787
Other, primarily costs related to defined benefit pension plans	8,876	1,656	23,111
	206,058	77,858	339,173
Changes in operating assets and liabilities:			
Increase in accounts receivable	(19,481)	(7,377)	(114,270)
Decrease (increase) in merchandise inventories	67,217	(173,829)	(78,955)
Decrease in other current assets	39,185	6,164	10,530
Decrease (increase) in other assets	735	(2,274)	12,276
(Decrease) increase in accounts payable and accrued liabilities	(27,629)	114,604	38,763
Payment of deferred compensation and stock-based awards	(12,901)		
Increase in deferred real estate credits	11,270	4,289	2,531
Funding of defined benefit pension plan			(20,000)
Net cash provided by operating activities	264,454	19,435	190,048
CASH FLOWS - INVESTING ACTIVITIES			
Capital expenditures	(112,214)	(26,311)	(150,830)
Acquisition of The Neiman Marcus Group, Inc.	(5,156,423)		
Increase in cash restricted for repayment of borrowings under Credit Card Facility			(37,500)
Proceeds from the sale of Chef s Catalog			14,419
Net cash used for investing activities	(5,268,637)	(26,311)	(173,911)
CASH FLOWS - FINANCING ACTIVITIES			
Proceeds from borrowings on lines of credit	21,000	5,750	7,750
Repayment of borrowings on lines of credit	(16,000)	(750)	(9,113)
Borrowings under asset-based revolving credit facility	150,000		
Repayment of borrowings under asset-based revolving credit facility	(150,000)		
Borrowings under senior term loan facility	1,975,000		
Repayment of borrowings under senior term loan facility	(100,000)		
Borrowings of senior notes and subordinated debt	1,200,000		
Repayment of senior notes due 2008	(134,734)		
Repayment of borrowings under Credit Card Facility			(37,500)
Capital lease obligation payments	(1,078)		
Debt issuance costs paid	(102,854)		
Cash equity contributions	1,427,739		

Acquisitions of treasury stock						(3,088)
Proceeds from stock-based compensation awards						16,432
Cash dividends paid				(7,346)		(20,042)
Distribution paid		(168)				(1,354)
Net cash provided by (used for) financing activities		4,268,905		(2,346)		(46,915)
CASH AND CASH EQUIVALENTS						
Decrease during the period		(735,278)		(9,222)		(30,778)
Beginning balance		844,260		853,482		368,367
Ending balance	$	108,982	$	844,260	$	337,589
Supplemental Schedule of Cash Flow Information						
Cash paid (received) during the period for:						
Interest	$	122,253	$	207	$	12,992
Income taxes	$	(13,332)	$	10,693	$	98,942
Noncash activities:						
Equity contribution from Parent	$	25,000	$		$	
Equity contribution from management shareholders	$	17,891	$		$	
Capital lease additions	$	11,909	$		$	

See Notes to Condensed Consolidated Financial Statements.

THE NEIMAN MARCUS GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation

The Neiman Marcus Group, Inc. (Company) was acquired on October 6, 2005 through a merger transaction with Newton Acquisition Merger Sub, Inc., a wholly-owned subsidiary of Neiman Marcus, Inc. (formerly Newton Acquisition, Inc.) (Parent). The acquisition was accomplished through the merger of Newton Acquisition Merger Sub, Inc. with and into the Company, with the Company being the surviving entity (the Acquisition). Subsequent to the Acquisition, we are a subsidiary of the Parent, which is controlled by Newton Holding, LLC (Holding). Both the Parent and Holding were formed by investment funds affiliated with Texas Pacific Group and Warburg Pincus LLC (the Sponsors). Although we continued as the same legal entity after the Acquisition, the accompanying condensed consolidated statements of earnings and cash flows present our results of operations and cash flows for the periods preceding the Acquisition (Predecessor) and the periods succeeding the Acquisition (Successor), respectively.

Our fiscal year ends on the Saturday closest to July 31. All references to the third quarter of fiscal year 2006 relate to the thirteen weeks ended April 29, 2006 of the Successor. All references to the third quarter of fiscal year 2005 relate to the thirteen weeks ended April 30, 2005 of the Predecessor. All references to the year-to-date fiscal year 2006 period relate to the combined thirty-nine weeks ended April 29, 2006 and all references to the year-to-date fiscal year 2005 period relate to the thirty-nine weeks ended April 30, 2005.

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Therefore, these financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended July 30, 2005.

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly our financial position, results of operations and cash flows for the applicable interim periods. The results of operations for these periods are not necessarily comparable to, or indicative of, results of any other interim period or for the fiscal year as a whole.

We are required to make estimates and assumptions about future events in preparing financial statements in conformity with generally accepted accounting principles. These estimates and assumptions affect the amounts of assets, liabilities, revenues and expenses and the disclosure of gain and loss contingencies at the date of the unaudited condensed consolidated financial statements. While we believe that our past estimates and assumptions have been materially accurate, our current estimates are subject to change if different assumptions as to the outcome of future events were made. We evaluate our estimates and judgments on an ongoing basis and predicate those estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances. We make adjustments to our assumptions and judgments when facts and circumstances dictate. Since future events and their effects cannot be determined with absolute certainty, actual results may differ from the estimates used in preparing the accompanying unaudited condensed consolidated financial statements.

We believe the following critical accounting policies, among others, encompass the more significant judgments and estimates used in the preparation of our financial statements:

Preliminary allocation of the price paid to acquire the Company to our assets and liabilities as of the date of the Acquisition (as more fully described in Note 3);

Recognition of revenues;

Valuation of merchandise inventories, including determination of original retail values, recognition of markdowns and vendor allowances, estimation of inventory shrinkage, and determination of cost of goods sold;

Determination of impairment of long-lived assets;

Recognition of advertising and catalog costs;

Measurement of liabilities related to our loyalty programs;

Recognition of income taxes; and

Measurement of accruals for litigation, general liability, workers compensation and health insurance, short-term disability, pension and postretirement health care benefits.

A description of our critical accounting policies is included in our Annual Report on Form 10-K for the fiscal year ended July 30, 2005.

Certain prior period balances have been reclassified to conform to the current period presentation. Depreciation expense and income from credit card operations, net are now shown as separate line items on our statements of earnings. Prior to the second quarter of fiscal year 2006, depreciation expense was included in buying and occupancy costs and the income from our credit card operations was included as a reduction to selling, general and administrative expenses.

Recent Accounting Pronouncements. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (R), Share-Based Payment (SFAS No. 123(R)). This standard is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB No. 25) and its related implementation guidance. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values and was effective for the first interim period or annual reporting period beginning after June 15, 2005. We adopted SFAS No. 123(R) as of the beginning of our first quarter of fiscal year 2006 using the modified prospective method, which requires companies to record stock compensation for all unvested and new awards as of the adoption date. Accordingly, we have not restated the prior period amounts presented herein. See Note 5 for further description of our stock-based compensation.

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143 (FIN 47). FIN 47 clarifies that conditional asset retirement obligations meet the definition of liabilities and should be recognized when incurred if their fair values can be reasonably estimated. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005 with the cumulative effect of initially applying FIN 47 being recognized as a change in accounting principle. We are in the process of evaluating the expected effect of FIN 47, if any, on our consolidated financial statements.

2. The Transactions

As discussed in Note 1, the Acquisition was completed on October 6, 2005 and was financed by:

Borrowings under our senior secured asset-based revolving credit facility (Asset-Based Revolving Credit Facility) and our secured term loan credit facility (Senior Secured Term Loan Facility) (collectively, the Secured Credit Facilities);

the issuance of 9.0%/9.75% senior notes due 2015 (Senior Notes);

the issuance of 10.375% senior subordinated notes due 2015 (Senior Subordinated Notes); and

equity investments from Parent funded by direct and indirect equity investments from the Sponsors, co-investors and management.

The Acquisition occurred simultaneously with:

the closing of the financing transactions and equity investments described above;

the call for redemption of, the deposit into a segregated account of the estimated amount of the redemption payment related to, and the ratable provision of security pursuant to the terms thereof, for our 6.65% senior notes due 2008 (2008 Notes);

the ratable provision of security to our 7.125% senior debentures due 2028 (2028 Debentures) pursuant to the terms thereof; and

the termination of our previous $350 million unsecured revolving credit agreement (Credit Agreement).

We refer to the above transactions, the Acquisition and our payment of any costs related to these transactions collectively herein as the Transactions. We refer to the Senior Notes and Senior Subordinated Notes collectively herein as the Notes.

Transaction and Other Costs. During the period from July 30, 2005 to October 1, 2005, the Predecessor expensed $23.5 million in connection with the Transactions. These costs consisted primarily of $4.5 million of accounting, investment banking, legal and other costs associated with the Transactions and a $19.0 million non-cash charge for stock compensation resulting from the accelerated vesting of Predecessor stock options and restricted stock in connection with the Acquisition.

Carryover Basis Adjustment for Management Shareholders. Executive management participants held certain equity interests, including stock options, in the Predecessor prior to the Transactions and continue to hold equity interests in the Parent, representing indirect equity interests in the Successor after the Transactions. In accordance with the provisions of Emerging Issues Task Force No. 88-16, Basis in Leveraged Buyout Transactions, the basis of executive management s indirect interests in the Successor after the Transactions is carried over at the basis of their interests in the Predecessor prior to the Transactions. The carryover basis of such interests less the net cash received by the management participants represents a deemed dividend of $69.2 million to the management participants and has been recognized as a reduction to shareholders equity of the Successor.

3. Purchase Accounting

We have accounted for the Acquisition in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, whereby the purchase price paid to effect the Acquisition is allocated to state the acquired assets and liabilities at fair value. The Acquisition and the preliminary allocation of the purchase price have been recorded as of October 1, 2005, the beginning of our October accounting period. The purchase price was approximately $5,461.7 million. The sources and uses of funds in connection with the Transactions and the redemption of our 2008 Notes are summarized below (in millions):

Sources		
Asset-Based Revolving Credit Facility	$	150.0
Secured Term Loan Facility		1,975.0
Senior Notes		700.0
Senior Subordinated Notes		500.0
Cash on hand		666.1
Equity contribution cash		1,427.7
Equity contribution non-cash		42.9
Total sources	$	5,461.7
Uses		
Consideration paid to stockholders (including non-cash management rollover of $17.9 million)	$	5,110.8
Transaction costs (including non-cash items of $18.8 million)		82.3
Redemption of existing 2008 Notes		134.7
Debt issuance costs (including non-cash items of $6.3 million)		109.2
Payment of deferred compensation obligations and other accrued liabilities		24.7
Total uses	$	5,461.7

In connection with the preliminary purchase price allocation, we have made estimates of the fair values of our long-lived and intangible assets based upon assumptions related to future cash flows, discount rates and asset lives utilizing currently available information. As of April 29, 2006, we have recorded preliminary purchase accounting adjustments to increase the carrying value of our property and equipment and inventory, to establish intangible assets for our tradenames, customer lists and favorable lease commitments and to revalue our long-term benefit plan obligations, among other things. This allocation of the purchase price is preliminary and subject to our review and finalization of asset valuations.

The purchase price has been preliminarily allocated as follows (in millions):

Cash consideration:		
Paid to shareholders		$ 5,092.9
Transaction costs		63.5
		5,156.4
Non-cash consideration		36.7
Total consideration		5,193.1
Net assets acquired at historical cost		1,638.1
Adjustments to state acquired assets at fair value:		
1) Increase carrying value of property and equipment	$ 135.9	
2) Increase carrying value of inventory	38.1	
3) Write-off historical goodwill and tradenames	(71.5)	
4) Record intangible assets acquired		
Customer lists	586.3	
Favorable lease commitments	480.0	
Tradenames	1,691.1	
5) Write-off other assets, primarily debt issue costs	(3.7)	
6) Adjustment to state 2008 Notes at redemption value	(6.2)	
7) Adjustment to state 2028 Debentures at fair value	4.5	
8) Write-off deferred real estate credits	90.2	
9) Increase in long-term benefit obligations, primarily pension obligations	(57.6)	
10) Tax impact of valuation adjustments	(1,082.3)	
Deemed dividend to management shareholders	69.2	1,874.0
Net assets acquired at fair value		3,512.1
Excess purchase price recorded as goodwill		$ 1,681.0

Our tradenames have indefinite lives and are not subject to amortization. Our tradenames and goodwill will be reviewed at least annually for impairment.

Total estimated amortization of all acquisition-related intangible assets during the period from October 6, 2005 through July 29, 2006 and for each of our fiscal years ending in July 2006 to 2010 is currently estimated as follows (in thousands):

October 6, 2005 through July 29, 2006	$ 60,261
2007	72,874
2008	72,874
2009	72,874
2010	72,874

Pro Forma Financial Information. The following unaudited pro forma results of operations assume that the Transactions occurred on August 1, 2004. The following unaudited pro forma results do not give effect to the sale of our credit card receivables, which was completed on July 7, 2005, or the disposition of Chef s Catalog, which was completed on November 8, 2004. This unaudited pro forma information should not be relied upon as necessarily being indicative of the historical results that would have been obtained if the Transactions had actually occurred on that date, nor the results that may be obtained in the future.

Thirteen weeks ended