VALUE CITY DEPARTMENT STORES INC /OH
Form 10-Q
June 15, 2001

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended May 5, 2001

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 1-10767

VALUE CITY DEPARTMENT STORES, INC.
(Exact name of registrant as specified in its charter)

Ohio	31-1322832
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3241 Westerville Road, Columbus, Ohio	43224
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (614) 471-4722

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 __X__ No _____

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

Class	Outstanding at June 1, 2001
Common Stock, Without Par Value	34,274,712 Shares

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PART 1. - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)
(UNAUDITED)

	MAY 5, 2001	FEBRUA 200
ASSETS		
Current assets:		
Cash and equivalents	$ 48,757	$ 10,
Accounts receivable, net	45,526	44,
Receivables from affiliates	1,742	9,
Inventories	484,145	393,
Prepaid expenses and other assets	25,955	22,
Deferred income taxes	57,019	51,
Total current assets	663,144	532,
Property and equipment, at cost:		
Furniture, fixtures and equipment	229,787	223,
Leasehold improvements	178,398	176,
Land and building	801	
Capital leases	37,414	38,
	446,400	439,
Accumulated depreciation and amortization	(198,025)	(190,
Property and equipment, net	248,375	249,
Investment in joint venture	7,408	8,
Goodwill and tradenames, net	62,505	67,
Other assets	45,423	51,
Total assets	$ 1,026,855	$ 908,
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 248,124	$ 180,
Accounts payable to affiliates	19,738	13,
Accrued expenses:		
Compensation	17,963	19,
Taxes	27,257	31,
Other	68,080	75,
Current maturities of long-term obligations	562	
Total current liabilities	381,724	321,
Long-term obligations, net of current maturities	391,762	326,
Deferred income taxes and other noncurrent liabilities	12,212	10,
Commitments and contingencies	--	
Shareholders' equity:		
Common shares, without par value; 80,000,000 authorized; issued, including treasury shares, 34,340,863 and 33,552,230 shares, respectively	145,741	145,
Retained earnings	103,355	111,
Deferred compensation expense, net	(5,770)	(6,

Treasury shares, at cost, 7,651 shares	(59)	
Other comprehensive loss	(2,110)	
Total shareholders' equity	241,157	250,
Total liabilities and shareholders' equity	$ 1,026,855	$ 908,

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

VALUE CITY DEPARTMENT STORES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	THREE MONTHS ENDED	
	MAY 5, 2001	APRIL 2 2000
Net sales, excluding sales of licensed departments	$ 530,114	$ 462,0
Cost of sales	(328,221)	(284,3
Gross profit	201,893	177,7
Selling, general and administrative expenses	(208,513)	(174,4
License fees from affiliates	2,112	2,1
Other operating income	495	2
Operating (loss) profit	(4,013)	5,7
Interest expense, net	(8,436)	(5,3
Gain (loss) on disposal of assets, net	1	(
(Loss) income before equity in loss of joint venture and benefit (provision) for income taxes	(12,448)	3
Equity in loss of joint venture	(884)	(2
(Loss) income before benefit (provision) for income taxes	(13,332)	
Benefit (provision) for income taxes	5,533	(
Net (loss) income	$ (7,799)	$
Basic and diluted (loss) earnings per share	$ (0.23)	$ 0.

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

VALUE CITY DEPARTMENT STORES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	THREE MONTHS ENDE	
	MAY 5, 2001	AP
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (7,799)	$
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	12,832	
Deferred income taxes and other noncurrent liabilities	(3,031)	
Equity in loss of joint venture	884	
(Gain) loss on disposal of assets	(1)	
Change in working capital, assets and liabilities excluding effects of acquisition:		
Receivables	7,112	
Inventories	(90,568)	(
Prepaid expenses and other assets	(2,629)	
Accounts payable	73,471	
Accrued expenses	(8,769)	
Net cash used in operating activities	(18,498)	
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(9,534)	
Proceeds from sale of assets	1	
Acquisition	--	
Other assets and lease acquisition costs	1,401	
Net cash used in investing activities	(8,132)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common shares	82	
Net proceeds from issuance of debt	64,743	
Net cash provided by financing activities	64,825	
Net increase in cash and equivalents	38,195	

Cash and equivalents, beginning of period	10,562	
Cash and equivalents, end of period	$ 48,757	$
Non-cash transactions:		
Issuance of common shares related to acquisition	--	$
Contribution made in treasury shares	--	$

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

VALUE CITY DEPARTMENT STORES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MAY 5, 2001 AND APRIL 29, 2000
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements include the accounts of Value City Department Stores, Inc. (VCDS) and its wholly owned subsidiaries. These entities are herein referred to collectively as the Company. The Company operates a chain of full-line, off-price department stores, principally under the name Value City, as well as better-branded off-price shoe stores, under the name "DSW Shoe Warehouse." As of May 5, 2001 a total of 221 stores were open, including 119 Value City stores located principally in Ohio (23 stores) and Pennsylvania (19 stores) with the remaining stores dispersed throughout the Midwest, East and South and 83 DSW Shoe Warehouse stores (DSW) located throughout the United States and 19 Filene's Basement stores ("Filene's") located principally in the New England states.

The accompanying financial statements reflect all adjustments consisting of only normal recurring adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position and results of operations for the periods presented.

2. LONG-TERM OBLIGATIONS AND NOTES PAYABLE

The Company entered into a $75.0 million Senior Subordinated Convertible Loan Agreement ("Senior Facility"), dated as of March 15, 2000. The Senior Facility bears interest at various rates, currently equal to 250 basis points over LIBOR. The interest rate increases an additional 50 basis points every 90 days after the first anniversary date. The Senior Facility is due in September 2003. In December 2000, pursuant to terms of the Senior Facility, Schottenstein Stores Corporation ("SSC"), direct owner of approximately 53.0% of the Company's common shares, purchased the outstanding balance under the same continuing terms. The terms, as amended, provide that if prior to August 5, 2001, the balance outstanding thereunder is not repaid from the proceeds of an equity offering or other subordinated debt acceptable to lenders under the Credit Agreement, then after that date

SSC, as the lender, has the right to convert the debt into our common stock at a price equal to 95% of the 20-day average of high and low sales prices reported on the New York Stock Exchange at the time of conversion. The Company paid SSC a one time fee of 200 basis points, or $1.5 million, in December 2000 as consideration for entering into a Put Agreement associated with the Senior Facility.

The Company believes the availability under its credit facilities along with its current available cash plus expected cash flows from its operations, will enable the Company to fund its expected needs for working capital, capital expenditures, and debt service requirements. Achievement of expected cash flows from operations, vendor and their factor relations, flow of merchandise, and compliance with the credit facilities covenants are dependent upon the Company's attainment of its Fiscal 2001 business plan.

3. VALUATION ACCOUNTS

During the quarter ended May 5, 2001, charges to the inventory realignment reserve and the accrued severance liability were $24.7 million and $1.0 million, respectively.

4. ADOPTION OF ACCOUNTING STANDARDS

The Financial Accounting Standards Board (FASB) periodically issues Statements of Financial Accounting Standards ("SFAS"), some of which require implementation by a date falling within or after the close of our fiscal year.

Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, is effective for all fiscal years beginning after June 15, 2000. SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Company's adoption of SFAS 133 effective February 4, 2001 did not have a significant impact on the financial position, results of operations, or cash flows of the Company.

The Company utilizes interest rate swap agreements to manage its interest rate risks on borrowings under its $300 million variable rate credit agreement. The Company does not hold or issue derivative financial instruments for trading purposes. The Company does not have derivative financial instruments that are held or issued and accounted for as hedges of anticipated transactions.

VALUE CITY DEPARTMENT STORES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MAY 5, 2001
(UNAUDITED)

5. OTHER COMPREHENSIVE LOSS

Other comprehensive loss is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. The difference between net earnings and comprehensive earnings for the quarter ending May 5, 2001 relates to the change in the fair market value of interest rate swap agreements. Comprehensive income equals net income for the quarter ended May 5, 2001.

6. SEGMENT REPORTING

The Company is managed in three operating segments: Value City Department Stores, DSW Shoe Warehouse stores and Filene's Basement stores, acquired effective March 17, 2000. All of the operations are located in the United States. The Company has identified such segments based on management responsibility and measures segment profit as operating (loss) profit which is defined as income before interest expense and income taxes. Corporate assets include goodwill and loan costs related to the Shonac acquisition.

THREE MONTH PERIOD ENDED MAY 5, 2001 (IN THOUSANDS):

	VALUE CITY	DSW	FILENE'S	CORPOR
Net sales	$344,842	$121,750	$63,522	
Operating (loss) profit	(8,751)	5,113	(375)	
Identifiable assets	760,322	126,248	112,636	$27,6
Capital expenditures	3,073	5,628	833	
Depreciation and amortization	8,783	1,610	1,511	9

THREE MONTH PERIOD ENDED APRIL 29, 2000 (IN THOUSANDS):

	VALUE CITY	DSW	FILENE'S	CORPOR
Net sales	$347,807	$88,387	$25,859	
Operating profit	347	2,991	2,397	
Identifiable assets	832,675	59,621	61,185	$30,9
Capital expenditures	11,259	2,120	--	
Depreciation and amortization	7,980	475	380	9

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

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RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, the percentage relationships to net sales of the listed items included in the Company's Consolidated Statements of Operations.

	Three Months Ended	
	May 5, 2001	April 29, 2000
Net sales	100.0%	100.0%
Gross profit	38.1	38.5
Selling, general and administrative expenses	(39.3)	(37.8)
License fees from affiliates and other operating income	0.5	0.5
Operating (loss) profit	(0.7)	1.2
Interest expense, net, and gain (loss) on disposals	(1.6)	(1.1)
Equity in loss of joint venture	(0.2)	(0.1)
(Loss) income before income taxes	(2.5)	0.0
Benefit (provision) for income taxes	1.0	0.0
Net (loss) income	(1.5)%	0.0%

VALUE CITY DEPARTMENT STORES, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

THREE MONTHS ENDED MAY 5, 2001 COMPARED TO THREE MONTHS ENDED APRIL 29, 2000

The Company's net sales increased $68.0 million, or 14.7%, from $462.1 million to $530.1 million. Fiscal 2001 includes sales of $63.5 million for Filene's Basement which was acquired in March 2000. The prior year first quarter sales for Filene's Basement were $25.9 million. Comparable stores sales for the quarter were (3.9)%. By segment comparable store sales were:

	2001	2000
Value City Department Stores	(6.5)%	3.9%
DSW	2.4%	20.4%
Filene's Basement	18.9%	n/a
TOTAL	(3.9)%	6.5%

Value City's non-apparel comparable sales increased 8.7% while apparel sales decreased 11.1%. Each of the three apparel divisions had negative comparable sales for the quarter. Children's was down 6.0%; Men's declined 8.5%; and Ladies' 14.8%.

DSW sales were $121.8 million, a 37.9% increase in the quarter which includes a net increase of 24 stores and a comparable store sales increase of 2.4%.

Gross profit increased $24.2 million from $177.7 million to $201.9 million, and decreased as a percentage of sales from 38.5% to 38.1% due primarily to an increase in the level of markdowns as a percentage of sales particularly in Filene's Basement. Gross profit as a percent of sales by segment in the first quarter were:

	2001	2000
Value City Department Stores	38.0%	38.3%
DSW	39.8%	37.8%
Filene's Basement	35.5%	43.0%
TOTAL	38.1%	38.5%

Selling, general and administrative expenses ("SG&A") increased $34.1 million from $174.4 million to $208.5 million, and increased as a percentage of sales from 37.8% to 39.5%. The percentage increase was due in part to the weak sales performance in our Value City department stores. $10.6 million of the increase in SG&A is attributable to new stores, net of closed stores. SG&A expenses for Filene's Basement were $22.8 million. New store pre-opening expenses for the quarter were $2.8 million less than last year. In the first half of the quarter we reduced or eliminated the operation at many of our third party warehouse locations. SG&A as a percent of sales by segment in the first quarter were:

	2001	2000
Value City Department Stores	41.2%	38.4%
DSW	35.3%	35.6%
Filene's Basement	36.9%	36.2%
TOTAL	39.3%	37.8%

Based upon its experience, the Company estimates the average cost of opening a new department store to range from approximately $4.5 million to $6.5 million and the cost of opening a new shoe store to range from approximately $1.0 million to $2.0 million including leasehold improvements, fixtures, inventory, pre-opening expenses and other costs. Similar costs for a Filene's store are in the $2.5 to $3.5 million range. Preparations for opening a department store generally take between eight and twelve weeks, and preparations for a shoe store generally takes eight to ten weeks. Pre-opening costs are expensed as incurred. It has been the Company's experience that new stores generally achieve profitability and contribute to net income after the first full year of operations. 15 department stores opened less than twelve months had an operating loss of $4.0 million for the current three-month period. 14

department stores opened less than 12 months during last year's three month period had an operating loss of $1.4 million including $2.6 million of preopening expenses. 24 DSW stores opened less than twelve months had an operating loss of $6.1 million, including $4.7 million of pre-opening expenses. 16 DSW stores opened less than twelve months during last year's three month period had an operating loss of $1.7 million after recognizing $1.7 million of pre-opening expenses.

License fees from affiliates and other operating income increased $0.2 million from $2.4 million to $2.6 million and remained flat as a percentage of sales.

Operating profit decreased $10.5 million from $5.7 million to a loss of $4.8 million and decreased as a percentage of sales from 1.2% to a loss of 0.9%.

Interest expense, net of interest income, increased $3.1 million from $5.3 million to $8.4 million and increased as a percentage of sales from 1.2% to 1.6%. The increase is due primarily to increased borrowings for the acquisition of Gramex Retail Stores, Inc. and Filene's Basement, new store openings and an increase in inventory levels primarily for DSW Shoe Warehouse and Filene's Basement offset by reductions in Value City Department Stores.

Equity in the loss of the joint venture represents the Company's fifty percent interest in a joint venture with Mazel Stores, Inc. The loss increased from $0.3 million to $0.9 million.

LIQUIDITY AND CAPITAL RESOURCES

Net working capital was $281.4 million at May 5, 2001 compared to $277.1 million at April 29, 2000. Current ratios at those dates were each 1.74 and 1.77, respectively.

Net cash used in operating activities totaled $18.5 million and $86.1 million for the three months ended May 5, 2001 and April 29, 2000, respectively. Net income, adjusted for depreciation and amortization, provided $5.0 million of operating cash flow for the three months ended May 5, 2001. This was decreased by $17.1 million representing an increase in inventories net of an increase in accounts payable. Other changes in working capital assets and liabilities used $6.4 million. Earnings before interest, taxes, depreciation and amortization (EBITDA) for the quarter of fiscal 2001 was $7.1 million.

Net cash used for capital expenditures was $9.5 million and $13.4 million for the three months ended May 5, 2001 and April 29, 2000, respectively. During the three months ended May 5, 2001, capital expenditures included $2.4 million for new stores, $0.9 million on existing stores, $2.0 million for relocation of office, warehousing and operations of our shoe business and $4.2 million for other capital expenditures.

At May 5, 2001, we had a $300 million Amended and Restated Credit Agreement (Credit Agreement), dated as of March 15, 2000. The Credit Agreement, which expires on March 15, 2003, provides for revolving and overnight loans and issuance of letters of credit. Outstanding advances are secured by a lien on assets and are subject to a monthly borrowing base of eligible inventories and receivables, as defined. Terms of the Credit Agreement require compliance with certain restrictive covenants, including limitations on dividends, the incurrence of additional debt and financial ratio tests. Additionally, the

Company has provided an unconditional guarantee of 50% of amounts outstanding on VCM, Ltd's ("VCM") VCM's $25.0 million revolving line of credit. At May 5, 2001, $17.5 million was available under the Credit Agreement. The Credit Agreement provides for various borrowing rates, currently equal to 275 basis points over LIBOR. The LIBOR rate on $40.0 million has been locked in at a fixed annual rate of 5.895% through May 2001 under a swap agreement. In addition, the LIBOR rate on $35 million has been locked in at a fixed annual rate of 6.99% through April 2002 under a swap agreement.

To supplement operating cash requirements the Company has a $50.0 million Subordinated Secured Credit Facility with Schottenstein Stores Corp. ("SSC Facility"). Outstanding advances under the agreement are subordinated to the bank credit facility and are subject to a junior lien on assets securing the bank credit facility. At February 3, 2001, $20.0 million was outstanding. The interest rate and terms of the $50.0 million facility are generally the same as the Credit Agreement.

The Company entered into a $75.0 million Senior Subordinated Convertible Loan Agreement (Senior Facility), dated as of March 15, 2000. The Senior Facility bears interest at various rates, currently equal to 250 basis points over LIBOR. The interest rate increases an additional 50 basis points every 90 days after the first anniversary date. The Senior Facility is due in September 2003. In December 2000, pursuant to terms of the Senior Facility, as amended, SSC purchased the outstanding balance under the same continuing terms. The terms provide that if prior

to August 5, 2001, the balance outstanding thereunder is not repaid from the proceeds of an equity offering or other subordinated debt acceptable to lenders under the Credit Agreement, then after that date SSC, as the lender, has the right to convert the debt into common stock at a price equal to 95% of the 20-day average of high and low sales prices reported on the New York Stock Exchange at the time of conversion. We paid SSC a one time fee of 200 basis points, or $1.5 million, in December 2000 as consideration for entering into a Put Agreement associated with the Senior Facility.

Although management believes that cash generated by operations, along with the available proceeds from our Credit Agreement, SSC Facility and other sources of financing will be sufficient to meet our obligations for working capital, capital expenditures, and debt service requirements there is no assurance that we will be able to meet our projections. Further, there is no assurance that extended financing will be available to us in the future if we fail to meet our projections.

Our sales results in the first four fiscal months of 2001 were below plan principally as a result of unusually extended cold and wet weather patterns in most our market areas combined with the effect of increased heating and fuel prices which affected the retail industry in general. Achievement of expected cash flows from operations and compliance with our Credit Agreement covenants are dependent upon a number of factors, including the attainment of sales, gross profit, expense budgets, vendor relations, and flow of merchandise that are consistent with our financial projections, particularly for the balance of the Spring season and into the Fall season.

A major factor has reduced our availability of credit and has indicated that we need to strengthen our liquidity and increase our credit availability from other sources.

VALUE CITY DEPARTMENT STORES, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS.

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ADOPTION OF ACCOUNTING STANDARDS

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The Company utilizes interest rate swap agreements to manage its interest rate risks on borrowings under its $300 million variable rate credit agreement. The Company does not hold or issue derivative financial instruments for trading purposes. The Company does not have derivative financial instruments that are held or issued and accounted for as hedges of anticipated transactions.

INCOME TAXES

The effective tax rate for fiscal 2001 is 41.5% versus 40.2% for fiscal 2000. The increase is due primarily to the allocation of taxable income to the various taxing jurisdictions.

INFLATION

The results of operations and financial condition are presented based upon historical cost. While it is difficult to accurately measure the impact of inflation because of the nature of the estimates required, management believes the effect of inflation, if any, on the results of operations and financial condition has been minor.

RISK FACTORS AND SAFE HARBOR STATEMENT

We caution that any forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) contained in this Report, other filings with the Securities and Exchange Commission or made by our management involve risks and uncertainties, and are subject to change based on various important factors. The following factors, among others, in some cases have affected and in the future could affect our financial performance and actual results and could cause actual results for 2001 and beyond to differ materially from those expressed or implied in any such forward-looking statements: decline in demand for our merchandise, our ability to attain our fiscal 2001 business plan, expected cash from operations, vendor and their factor relations, flow of merchandise, compliance with the credit agreement, our ability to strengthen our liquidity and increase our credit availability, the availability of desirable store locations on suitable terms, changes in consumer spending patterns, consumer preferences and overall economic conditions, the impact of competition and pricing, changes in weather patterns, changes in existing or potential duties, tariffs or quotas, paper and printing costs, and the ability to hire and train associates.

Historically, our operations have been seasonal, with a disproportionate amount of sales and a majority of net income occurring in the back-to-school and Christmas selling seasons. As a result of this seasonality, any factors negatively affecting us during this period, including adverse weather, the timing and level of markdowns or unfavorable economic conditions, could have a material adverse effect on our financial condition and results of operations for the entire year.

SIGNATURE

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.

VALUE CITY DEPARTMENT STORES, INC.
(Registrant)

By /s/ James A. McGrady

James A. McGrady,
Chief Financial Officer and Treasurer

Date: June 15, 2001

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* Mr. McGrady is the Principal Financial and Accounting Officer and has been duly authorized to sign on behalf of the registrant.