

CHARLOTTE RUSSE HOLDING INC

Form 10-Q

July 30, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**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 JUNE 30, 2007**

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

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COMMISSION FILE NUMBER 000-27677

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**CHARLOTTE RUSSE HOLDING, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**DELAWARE**  
(State or Other Jurisdiction of Incorporation)

**33-0724325**  
(I.R.S. Employer Identification No.)

**4645 MORENA BOULEVARD**

**SAN DIEGO, CA**  
(Address of Principal Executive Offices)

**92117**  
(Zip Code)

**(858) 587-1500**

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(Registrant's Telephone Number, Including Area Code)

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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 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  Accelerated filer  Non-accelerated filer

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

As of July 26, 2007, the registrant had 25,350,238 shares of common stock outstanding.

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**CHARLOTTE RUSSE HOLDING, INC.**

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	June 30,	September 30,	June 24,
	2007	2006	2006
	(Unaudited)	(Audited)	(Unaudited)
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 87,513,806	\$ 90,229,040	\$ 65,530,657
Inventories	53,509,082	44,864,617	51,487,563
Landlord allowances receivable	5,763,883	8,183,959	3,372,516
Prepaid rent expense	10,144,846		
Other current assets	7,945,701	3,196,891	3,046,230
Deferred tax assets	6,120,000	6,010,000	15,700,000
Current assets of discontinued operations			3,281,185
<b>Total current assets</b>	<b>170,997,318</b>	<b>152,484,507</b>	<b>142,418,151</b>
Fixed assets, net	205,832,074	177,577,999	163,454,046
Goodwill	28,790,000	28,790,000	28,790,000
Other assets	660,023	666,216	529,187
<b>Total assets</b>	<b>\$ 406,279,415</b>	<b>\$ 359,518,722</b>	<b>\$ 335,191,384</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
Current liabilities:			
Accounts payable, trade	\$ 36,231,939	\$ 24,418,975	\$ 26,706,774
Accounts payable, other	8,742,733	8,162,766	6,019,287
Accrued payroll and related expense	4,740,222	6,908,204	6,411,132
Income and sales taxes payable	2,736,646	5,648,541	3,996,619
Other current liabilities	7,361,671	10,002,442	7,513,164
Current liabilities of discontinued operations			16,318,324
<b>Total current liabilities</b>	<b>59,813,211</b>	<b>55,140,928</b>	<b>66,965,300</b>
Deferred rent	100,512,165	97,773,445	92,514,423
Other liabilities			43,705
Deferred tax liabilities	140,000	150,000	1,060,000
<b>Total liabilities</b>	<b>160,465,376</b>	<b>153,064,373</b>	<b>160,583,428</b>
Commitments and contingencies			
Stockholders equity:			
Preferred stock, \$0.01 par value, 3,000,000 shares authorized, none issued and outstanding			
Common stock, \$0.01 par value, 100,000,000 shares authorized; issued and outstanding shares 25,350,238, 24,878,050 and 22,587,114 at June 30, 2007, September 30, 2006, and June 24, 2006, respectively	253,503	248,780	225,871
Additional paid-in capital	76,378,709	64,902,477	57,332,588
Retained earnings	169,181,827	141,303,092	117,049,497

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Total stockholders' equity	245,814,039	206,454,349	174,607,956
Total liabilities and stockholders' equity	\$ 406,279,415	\$ 359,518,722	\$ 335,191,384

*See accompanying notes.*

**Table of Contents****CHARLOTTE RUSSE HOLDING, INC.****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 30, 2007</b>	<b>June 24, 2006</b>	<b>June 30, 2007</b>	<b>June 24, 2006</b>
	<b>(13 weeks)</b>	<b>(13 weeks)</b>	<b>(39 weeks)</b>	<b>(39 weeks)</b>
Net sales	\$ 180,279,697	\$ 160,745,464	\$ 550,609,996	\$ 492,949,599
Cost of goods sold, including buying, distribution and occupancy costs	126,864,339	114,710,012	397,176,377	358,363,744
Gross profit	53,415,358	46,035,452	153,433,619	134,585,855
Selling, general and administrative expenses	37,870,182	30,884,786	111,894,610	95,444,121
Operating income	15,545,176	15,150,666	41,539,009	39,141,734
Other income (expense):				
Interest income, net	1,194,104	699,038	3,729,035	1,645,829
Other charges, net		(62,499)		(191,684)
Total other income	1,194,104	636,539	3,729,035	1,454,145
Income from continuing operations before income taxes	16,739,280	15,787,205	45,268,044	40,595,879
Income taxes	6,595,276	6,267,520	17,389,309	16,116,564
Income from continuing operations	10,144,004	9,519,685	27,878,735	24,479,315
Loss on discontinued operations, net of tax (Note 2)		3,641,574		23,594,964
Net income	\$ 10,144,004	\$ 5,878,111	\$ 27,878,735	\$ 884,351
Earnings (loss) per share basic:				
Continuing operations	\$ 0.40	\$ 0.42	\$ 1.10	\$ 1.09
Discontinued operations		(0.16)		(1.05)
Basic	\$ 0.40	\$ 0.26	\$ 1.10	\$ 0.04
Earnings (loss) per share diluted:				
Continuing operations	\$ 0.40	\$ 0.38	\$ 1.09	\$ 0.99
Discontinued operations		(0.14)		(0.95)
Diluted	\$ 0.40	\$ 0.24	\$ 1.09	\$ 0.04
Weighted average shares outstanding:				
Basic	25,330,549	22,542,342	25,230,485	22,399,037
Diluted	25,541,858	24,787,745	25,489,384	24,639,658

*See accompanying notes.*

**Table of Contents****CHARLOTTE RUSSE HOLDING, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 30, 2007</b>	<b>June 24, 2006</b>	<b>June 30, 2007</b>	<b>June 24, 2006</b>
	<b>(13 weeks)</b>	<b>(13 weeks)</b>	<b>(39 weeks)</b>	<b>(39 weeks)</b>
<b>Operating Activities</b>				
Net income	\$ 10,144,004	\$ 5,878,111	\$ 27,878,735	\$ 884,351
Adjustments to reconcile net income to net cash provided by operating activities of continuing operations:				
Net loss from discontinued operations		3,641,574		23,594,964
Depreciation and amortization	9,279,115	7,912,505	26,607,962	23,560,670
Amortization of construction allowances	(3,574,464)	(2,852,297)	(9,750,733)	(8,432,191)
Landlord construction allowances	8,167,227	3,262,205	13,236,982	8,111,218
Deferred rent	33,403	941,876	(747,529)	1,494,071
Stock based compensation	568,280	492,000	1,628,000	1,428,000
Loss on disposal of assets	2,094,217	473,745	3,281,054	723,183
Deferred income taxes		(30,000)	(120,000)	302,500
Changes in operating assets and liabilities				
Inventories	(9,225,382)	(3,169,947)	(8,644,465)	(6,354,156)
Other current assets	(4,826,260)	(245,884)	(12,473,580)	4,672,225
Accounts payable, trade	3,487,414	(1,204,701)	11,812,964	(717,586)
Accounts payable, other	3,677,262	917,315	579,967	(757,476)
Accrued payroll and related expense	(1,715,458)	1,944,967	(2,167,982)	3,238,927
Income and sales taxes payable	(150,756)	1,302,246	(2,911,895)	900,809
Other current liabilities	85,211	(817,102)	(1,518,701)	(2,274,040)
Net cash provided by operating activities of continuing operations	18,043,813	18,446,613	46,690,779	50,375,469
Net cash provided by (used in) operating activities of discontinued operations		1,481,100		(1,535,052)
Net cash provided by operating activities	18,043,813	19,927,713	46,690,779	48,840,417
<b>Investing Activities</b>				
Purchases of fixed assets	(29,218,465)	(8,117,291)	(59,232,805)	(21,444,817)
Other assets	2,189	(3,883)	(26,163)	16,495
Net cash used in investing activities of continuing operations	(29,216,276)	(8,121,174)	(59,258,968)	(21,428,322)
Net cash used in investing activities of discontinued operations		(472,080)		(696,297)
Net cash used in investing activities	(29,216,276)	(8,593,254)	(59,258,968)	(22,124,619)
<b>Financing Activities</b>				
Proceeds from issuance of common stock	369,911	1,353,800	6,990,062	3,334,044
Excess tax benefits from option exercises	103,383	260,880	2,862,893	1,851,327
Net cash provided by financing activities	473,294	1,614,680	9,852,955	5,185,371



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Net (decrease) increase in cash and cash equivalents	(10,699,169)	12,949,139	(2,715,234)	31,901,169
Cash and cash equivalents at beginning of the period	98,212,975	52,581,518	90,229,040	33,629,488
Cash and cash equivalents at end of the period	\$ 87,513,806	\$ 65,530,657	\$ 87,513,806	\$ 65,530,657

*See accompanying notes.*

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**CHARLOTTE RUSSE HOLDING, INC.**

**Notes to Consolidated Financial Statements (Unaudited)**

**1. Interim Financial Statements**

The accompanying unaudited consolidated financial statements of Charlotte Russe Holding, Inc. (the Company) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures required by accounting principles generally accepted in the United States for complete financial statements have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited financial statements contain all material adjustments, including normal recurring accruals, necessary to present fairly the Company's financial position, results of operations and cash flows for the periods indicated, and have been prepared in a manner consistent with the audited financial statements for the fiscal year ended September 30, 2006.

Due to the seasonal nature of the Company's business, the results of operations for the nine month period ended June 30, 2007 are not necessarily indicative of the results of a full fiscal year.

These financial statements should be read in conjunction with the audited financial statements and the footnotes for the fiscal year ended September 30, 2006 included in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on December 13, 2006.

**2. Discontinued Operations**

The Company's efforts to reposition the Rampage stores proved unsuccessful and management determined that sufficient indicators of impairment of the Rampage long-lived assets existed as of March 25, 2006. These assets principally consisted of the store leasehold improvements, store fixtures and store equipment. As a result, a \$22.5 million non-cash impairment charge was recorded in the second quarter of fiscal 2006 to write down substantially all of the carrying value of the Rampage long-lived assets as of March 25, 2006.

During the third quarter of fiscal 2006, management completed an evaluation of the strategic alternatives for the Rampage stores. That review indicated that certain assets for a majority of the 64 Rampage stores could be sold, based upon specific interest shown by other retailers, while the remaining stores could either be closed or converted to the Charlotte Russe format. In the fourth quarter of fiscal 2006, the lease rights, store fixtures and equipment associated with 43 Rampage store locations were sold for approximately \$13.6 million. Of the remaining 21 Rampage stores in operation at the beginning of the fourth quarter, the Company converted eight stores into Charlotte Russe locations (five locations have been closed in the first nine months of fiscal 2007) and returned 13 properties back to their respective landlords prior to the end of fiscal 2006.

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As a result, operating results for all Rampage stores during fiscal 2006 have been segregated and shown as discontinued operations in the accompanying Consolidated Statements of Operations. Details of those results were as follows:

	<b>Three Months Ended</b>	<b>Nine Months Ended</b>
	<b>June 24, 2006</b>	<b>June 24, 2006</b>
	<b>(13 weeks)</b>	<b>(39 weeks)</b>
Net sales	\$ 18,578,854	\$ 58,897,637
Loss from operations	\$ 6,039,095	\$ 16,629,294
Impairment charges		22,500,000
Loss from operations	6,039,095	39,129,294
Income tax benefit	2,397,521	15,534,330
Net loss on discontinued operations	\$ 3,641,574	\$ 23,594,964

**Table of Contents****CHARLOTTE RUSSE HOLDING, INC.****Notes to Consolidated Financial Statements (Unaudited) (Continued)****2. Discontinued Operations (continued)**

In addition, the Company has segregated the assets and liabilities related to the Rampage stores and shown them as assets and liabilities of discontinued operations in the accompanying Consolidated Balance Sheets. As of September 30, 2006 and June 30, 2007, there were no assets or liabilities that required segregation.

**3. Stock Based Compensation**

Under the Company's 1999 Equity Incentive Plan (the Plan), the Company grants stock options to purchase common stock to some of its employees and non-employee directors at prices equal to the market value of the common stock on the date of grant. At June 30, 2007, there were a total of 3,250,000 shares authorized under the Plan of which 1,112,359 were outstanding and 946,600 were available for future issuance. There were 183,823 shares available for future purchase under the Company's Employee Stock Purchase Plan (ESPP) at June 30, 2007.

The Company recognized stock based compensation expense for the Plan and ESPP as follows:

	Three Months Ended		Nine Months Ended	
	June 30, 2007	June 24, 2006	June 30, 2007	June 24, 2006
	(13 weeks)	(13 weeks)	(39 weeks)	(39 weeks)
Cost of goods sold	\$ 153,400	\$ 115,522	\$ 347,900	\$ 373,122
Selling, general and administrative expenses	414,880	376,478	1,280,100	1,054,878
Compensation expense	568,280	492,000	1,628,000	1,428,000
Income tax benefit	223,902	195,324	641,432	566,916
Reduction of net income	\$ 344,378	\$ 296,676	\$ 986,568	\$ 861,084
Reduction of earnings per share:				
Basic	\$ 0.01	\$ 0.01	\$ 0.04	\$ 0.04
Diluted	\$ 0.01	\$ 0.01	\$ 0.04	\$ 0.03

**4. Net Income Per Common Share**

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Basic earnings per share is calculated based on the weighted average outstanding common shares. Diluted earnings per share is calculated based on the weighted average outstanding shares and potentially dilutive stock options and warrants. In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 128, *Earnings Per Share*, the following table reconciles net income and share amounts utilized to calculate basic and diluted net income per common share.

	Three Months Ended		Nine Months Ended	
	June 30, 2007	June 24, 2006	June 30, 2007	June 24, 2006
	(13 weeks)	(13 weeks)	(39 weeks)	(39 weeks)
Income from continuing operations	\$ 10,144,004	\$ 9,519,685	\$ 27,878,735	\$ 24,479,315
Loss on discontinued operations		(3,641,574)		(23,594,964)
Net income	\$ 10,144,004	\$ 5,878,111	\$ 27,878,735	\$ 884,351
Weighted average number of shares:				
Basic	25,330,549	22,542,342	25,230,485	22,399,037
Effect of dilutive warrants		1,871,932		1,861,679
Effect of dilutive stock options	211,309	373,471	258,899	378,942
Diluted	25,541,858	24,787,745	25,489,384	24,639,658

**Table of Contents****CHARLOTTE RUSSE HOLDING, INC.****Notes to Consolidated Financial Statements (Unaudited) (Continued)****4. Net Income Per Common Share (continued)**

The calculation of dilutive shares excludes the effect of the following options and warrants that are considered anti-dilutive:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 30, 2007</b>	<b>June 24, 2006</b>	<b>June 30, 2007</b>	<b>June 24, 2006</b>
	<b>(13 weeks)</b>	<b>(13 weeks)</b>	<b>(39 weeks)</b>	<b>(39 weeks)</b>
Anti-dilutive options and warrants	504,911	32,209	488,093	222,864

**5. Unredeemed Gift Card Income**

Sales of gift cards are recorded as a liability included within accrued expenses and other current liabilities in the Consolidated Balance Sheets. As the gift cards are redeemed for merchandise, the Company records revenue. Over time, some portion of the gift cards issued is not redeemed. Beginning with the second quarter of fiscal 2006, the liability balance is adjusted to recognize estimated unredeemed amounts under the redemptive recognition method. This method records gift card breakage as additional sales on a proportional basis over the redemption period based on historical redemption trends. Upon adoption of this method of accounting, the Company's net sales included an adjustment of \$2.0 million to reduce gift card liabilities for estimated unredeemed amounts as of the beginning of the second quarter of fiscal 2006.

**6. Recent Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is in the process of determining the impact that the adoption of FIN 48 will have on its financial position and results of operations.

In June 2006, the FASB ratified the consensus of Emerging Issues Task Force ( EITF ) Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement*. EITF Issue No. 06-3 indicates that the income statement presentation on either a gross basis or a net basis of the taxes within the scope of the issue is an accounting policy decision. The Company's accounting policy is to present the taxes within the scope of EITF Issue No. 06-3 on a net basis. The adoption of EITF Issue No. 06-3 in the first fiscal quarter of 2007 did not result in a change to the Company's accounting policy and, accordingly, did not have a material effect on

the Company's consolidated financial statements.

## **7. Commitments and Contingencies**

From time to time, the Company may be involved in litigation relating to claims arising out of its operations. As of the date of this filing, the Company is not engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on the Company's business, financial condition or results of operations.

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

**FORWARD-LOOKING STATEMENTS**

We have made statements in this quarterly report on Form 10-Q that are forward-looking statements. You can identify these statements by forward-looking words such as anticipate, believe, continue, could, estimate, expect, forecast, intend, may, possible, potential, and will, or other similar words, phrases or expressions. We have based these forward-looking statements on our current expectations and projections about future events. Statements and financial discussion and analysis contained in this quarterly report on Form 10-Q that are not historical facts are forward-looking statements. These statements discuss goals, intentions and expectations as to future trends, plans, events, results of operations or financial condition, or state other information relating to us, based on our current beliefs as well as assumptions made by us and information currently available to us. Although we believe these forward-looking statements are reasonable, they are based upon a number of assumptions concerning future conditions, any or all of which may ultimately prove to be inaccurate.

Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation: the risks described under the heading Risk Factors in this quarterly report on Form 10-Q; changes in consumer demand; changes in consumer fashion taste; and changes in business strategies and decisions. The factors identified above are believed to be important factors (but not necessarily all of the important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement. Unpredictable or unknown factors could also have material adverse effects on us. Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including shopping mall traffic and shopping patterns, timing of openings for new shopping malls or our stores, fashion trends, national or regional economic influences and weather. All forward-looking statements included in this quarterly report on Form 10-Q are expressly qualified in their entirety by the foregoing cautionary statements.

Except as required under the federal securities laws and rules and regulations of the Securities and Exchange Commission, or SEC, we undertake no obligation to update, amend or clarify forward-looking statements, whether as a result of new information, future events or otherwise.



**Table of Contents****RESULTS OF OPERATIONS**

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our Consolidated Financial Statements and Notes thereto included elsewhere in this quarterly report on Form 10-Q. The following table sets forth our operating results, expressed as a percentage of net sales, and Charlotte Russe store numbers for the periods indicated. These operating results are not necessarily indicative of the results that may be expected for any future period.

	Three Months Ended		Nine Months Ended	
	June 30, 2007	June 24, 2006	June 30, 2007	June 24, 2006
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	70.4	71.4	72.1	72.7
Gross profit	29.6	28.6	27.9	27.3
Selling, general and administrative expenses	21.0	19.2	20.4	19.4
Operating income	8.6	9.4	7.5	7.9
Interest income, net	0.7	0.4	0.7	0.3
Other charges, net				
Income from continuing operations before income taxes	9.3	9.8	8.2	8.2
Income taxes	3.7	3.9	3.1	3.2
Income from continuing operations	5.6	5.9	5.1	5.0
Loss on discontinued operations		(2.2)		(4.8)
Net income	5.6%	3.7%	5.1%	0.2%
Charlotte Russe stores open at end of period	408	360	408	360

**Three Months Ended June 30, 2007 Compared to the Three Months Ended June 24, 2006**

*Net Sales.* Our net sales increased to \$180.3 million from \$160.7 million, an increase of \$19.6 million, or 12.2%, over the same quarter last year. This increase reflects the impact of a 1.3% increase in comparable store sales which was calculated against prior year sales that have been adjusted to align with comparable weeks this year due to the 53<sup>rd</sup> week in fiscal 2006. In addition, the increase in sales reflects the contribution of additional net sales from 13 net store openings (net of 2 closures) during the quarter ended June 30, 2007, as well as other stores opened in prior fiscal periods that did not qualify as comparable stores.

*Gross Profit.* Gross profit represents net sales less cost of goods sold, which includes buying, distribution and occupancy costs. Our gross profit increased to \$53.4 million from \$46.0 million, an increase of \$7.4 million, or 16.0%, from the same quarter last year. This increase in amount was primarily the result of higher net sales. As a percentage of net sales, gross profit increased to 29.6% from 28.6%, or 1.0 percentage points, from the same quarter last year. The increase in gross profit as a percentage of net sales was principally due to a higher initial mark-up (0.5 percentage point impact), decreased markdown expense (0.9 percentage point impact) and reduced Freight expense (1.1 percentage point impact). These favorable factors were partially offset by higher store rent and occupancy costs (1.0 percentage point impact), higher shrink expense (0.3 percentage point impact) and other factors (0.2 percentage point impact).

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*Selling, General and Administrative Expenses.* Our selling, general and administrative expenses increased to \$37.9 million from \$30.9 million, an increase of \$7.0 million, or 22.6%, over the same quarter last year. This increase in amount was attributable to new store expansion and increased corporate expenses, specifically higher store payroll and operating expenses and higher central office payroll and other central office expenses. Included in selling, general and administrative expenses for the three months ended June 30, 2007 is a \$1.1 million

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expense associated with the write-off of the remaining net book value of point-of-sale assets due to the conversion to a new point-of-sale system. As a percentage of net sales, selling, general and administrative expenses increased to 21.0% from 19.2%, or 1.8 percentage points, from the same quarter last year. The increase in expenses as a percentage of net sales was principally due to increased store compensation and home office expenses, such as cost of implementation of the new point-of-sale system, minimum wage increase and training (1.4 percentage point impact), and the impact of the write-off of point-of-sale assets (0.6 percentage point impact) partially offset by other favorable factors (0.2 percentage point impact).

*Income Taxes.* Our effective tax rate of 39.4% for fiscal 2007 approximates our statutory income tax rate and is less than the 39.7% rate utilized in the same quarter last year due to the anticipation of lower state income tax rates than reflected in last year's effective rate.

*Income from Continuing Operations.* Our income from continuing operations increased to \$10.1 million from \$9.5 million, an increase of \$0.6 million, or 6.6%, from the same quarter last year. The increase was primarily due to an increase in gross profit which was partially offset by an increase in selling, general and administrative expenses.

*Loss on Discontinued Operations.* As a result of their disposition in fiscal 2006, our Ramage stores met the criteria to be classified as discontinued operations as defined by generally accepted accounting principles. We incurred a net loss of \$3.6 million in the third quarter of fiscal 2006. Due to the disposition of these stores prior to the beginning of fiscal 2007, no such losses were incurred in the third quarter of fiscal 2007.

## **Nine Months Ended June 30, 2007 Compared to the Nine Months Ended June 24, 2006**

*Net Sales.* Our net sales increased to \$550.6 million from \$492.9 million, an increase of \$57.7 million, or 11.7%, over the same period last year. This increase reflects \$46.2 million of additional net sales from 21 net store openings (net of five closures) during the first nine months of fiscal 2007 and net sales from stores opened in prior fiscal years that did not qualify as comparable stores. The increase in net sales also benefited from a 2.5% increase in comparable store sales, adjusted to align with comparable weeks last year, due to the 53<sup>rd</sup> week in fiscal 2006, which resulted in additional sales of \$11.5 million compared to the same period last year.

*Gross Profit.* Gross profit represents net sales less cost of goods sold, which includes buying, distribution and occupancy costs. Our gross profit increased to \$153.4 million from \$134.6 million, an increase of \$18.8 million, or 14.0%, over the same period last year. This increase in amount was primarily the result of higher net sales. As a percentage of net sales, gross profit increased to 27.9% from 27.3%, or 0.6 percentage points, from the same period last year. Gross profit as a percentage of net sales reflected higher initial mark-up (1.2 percentage point impact), reduced markdown expense (0.8 percentage point impact) and lower freight costs (0.2 percentage point impact). These favorable factors were offset by last year's gift card liability adjustment (0.4 percentage point impact), increased store rent and occupancy costs (0.7 percentage point impact), higher shrinkage expense (0.3 percentage point impact) and other factors (0.2 percentage point impact).

*Selling, General and Administrative Expenses.* Our selling, general and administrative expenses increased to \$111.9 million from \$95.4 million, an increase of \$16.5 million, or 17.2%, over the same period last year. This increase in amount was attributable to new store expansion and increased corporate expenses, specifically higher store payroll and operating expenses and higher central office payroll and other central office expenses. Included in selling, general and administrative expenses for the nine months ended June 30, 2007 is a \$1.8 million expense associated with the write-off of the remaining net book value of point-of-sale assets due to the conversion to a new point-of-sale system. As a percentage of net sales, selling, general and administrative expenses increased to 20.4% from 19.4%, or 1.0 percentage points, from the same period last year. The increase in expenses as a percentage of net sales was principally due to increased store compensation and home office expenses, such as cost

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of implementation of the new point-of-sale system, minimum wage increase and training (0.7 percentage point impact), and the impact of the write-off of point-of-sale assets (0.3 percentage point impact).

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*Income Taxes.* Our effective tax rate of 39.4% for fiscal 2007 approximates our statutory income tax rate and is less than the 39.7% rate utilized in the same period last year due to the anticipation of lower state income tax rates than reflected in last year's effective rate. In that regard, we made a \$0.4 million adjustment to fiscal 2007 expenses for the over-accrual of state income tax expense during fiscal 2006 that was identified upon filing our various fiscal 2006 state tax returns in fiscal 2007.

*Income from Continuing Operations.* Our income from continuing operations increased to \$27.9 million from \$24.5 million, an increase of \$3.4 million, or 13.9%, over the same period last year. The increase was primarily due to an increase in gross profit which was partially offset by an increase in selling, general and administrative expenses and income taxes.

*Loss on Discontinued Operations.* As a result of their disposition in fiscal 2006, our Rampage stores met the criteria to be classified as discontinued operations as defined by generally accepted accounting principles. We incurred a net loss of \$23.6 million in the first nine months of fiscal 2006 which included a \$22.5 million pre-tax impairment charge. Due to the disposition of these stores prior to the beginning of fiscal 2007, no such losses were incurred in the first nine months of fiscal 2007.

**LIQUIDITY AND CAPITAL RESOURCES**

Our working capital requirements vary consistent with the seasonality of our business. Our capital requirements result primarily from capital expenditures related to new store openings, remodels and information system implementations. We have historically satisfied our cash requirements principally through cash flow from operations. Due to the rapid turnover of our inventory, we generate trade payables and other accrued liabilities sufficient to offset most of our working capital requirements, and this allows us to generally operate with limited working capital investment. As of June 30, 2007, we had working capital of approximately \$111.2 million which included cash and cash equivalents of \$87.5 million.

The following table provides a summary of our sources and uses of cash during the first nine months of fiscal 2007 and 2006:

	<b>Nine Months Ended</b>	
	<b>June 30, 2007</b>	<b>June 24, 2006</b>
	<b>(39 weeks)</b>	<b>(39 weeks)</b>
Net cash provided by operating activities	\$ 46,690,779	\$ 48,840,417
Net cash used in investing activities	(59,258,968)	(22,124,619)
Net cash provided by financing activities	9,852,955	5,185,371
Change in cash position	\$ (2,715,234)	\$ 31,901,169

During the first nine months of fiscal 2007, our net cash provided by operations decreased \$2.1 million over the same period of the prior fiscal year due to a \$14.0 million increase in working capital primarily associated with increased prepaid rents and a \$0.7 million negative impact from other factors, which was partially offset by a \$3.4 million increase in income from continuing operations, a \$5.1 million increase in landlord construction allowances, a \$2.6 million increase in loss on disposal of assets and a \$1.5 million improvement in cash provided from discontinued operations as a result of disposing of the Rampage assets. Net cash used in investing activities primarily consists of capital expenditures. It increased \$37.1 million during the first nine months of fiscal year 2007 as a result of increased capital spending associated with implementation of the new point-of-sale systems to our stores, funding for 23 remodeled stores (compared to 3 remodeled stores in the same period of the prior

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fiscal year) opening of 26 new stores (compared to 21 new stores in the same period of the prior fiscal year), and increased investments in our information systems and other corporate projects. Net cash provided from financing activities primarily consists of cash and income tax benefits associated with stock option exercises. It increased \$4.7 million in the first nine months of fiscal 2007 due to a greater number of stock option exercises during the period.

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We expect to continue to invest in capital expenditures to support our growth. After taking into account new store construction, existing store remodeling and other corporate capital projects, total capital expenditures for fiscal 2007 are projected to be approximately \$80.0 million.

We currently have a \$40.0 million secured revolving credit facility, referred to as the Credit Facility, with Bank of America, N.A., which expires on June 30, 2010. Under the terms of the Credit Facility, we may borrow up to the maximum borrowing limit of \$40.0 million less any outstanding letters of credit, and we have set the initial loan ceiling amount at \$30.0 million. Interest on the Credit Facility is payable quarterly, at our option, at either (i) the Bank's prime rate plus 0.50% to 1.00% or (ii) 1.00% to 1.50% over the average interest settlement rate for deposits in the London interbank market banks subject to certain adjustments. Our ability to receive loan advances under the Credit Facility is subject to our continued compliance with various covenants, representations and warranties and conditions, including but not limited to negative covenants against the incurrence of debt or liens. The Credit Facility also contains events of default customary for facilities of this type and provides that, upon the occurrence of an event of default, payment of all outstanding loans may be accelerated and/or the lenders' commitments may be terminated. Pursuant to this agreement, we and our wholly-owned subsidiaries have (i) provided an unconditional guarantee of the full and punctual payment of obligations under the Credit Facility, (ii) pledged certain of our securities to the collateral agent as security for the full payment and performance of our obligations under the Credit Facility and (iii) granted a security interest in essentially all of our personal property as security for the full payment and performance of our obligations under the Credit Facility. At June 30, 2007, there was no outstanding debt under the Credit Facility and we were in compliance with the terms of the bank credit agreement. As of June 30, 2007, we had \$24.7 million of borrowing availability under the Credit Facility.

We believe that our cash flows from operations, our current cash balance and the funds available under our Credit Facility will be sufficient to meet our working capital needs and contemplated capital expenditure requirements through fiscal 2007. If our cash flow from operations should decline significantly, it may be necessary for us to seek additional sources of capital or to reduce planned new store openings.

**LETTERS OF CREDIT**

Pursuant to the terms of the Credit Facility, we can issue up to \$20.0 million of documentary or standby letters of credit. The outstanding commitments under the Credit Facility at June 30, 2007 totaled approximately \$5.3 million, including \$2.2 million in standby letters of credit.

**CONTRACTUAL AND COMMERCIAL OBLIGATIONS**

Our commitment to make future payments under long-term contractual obligations and commercial obligations as of June 30, 2007 was as follows:

	Total	Less Than			After
		1 Year	1-3 Years	3-5 Years	5 Years
(in thousands)					
<b>Contractual Obligations</b>					
Operating leases	\$ 473,934	\$ 71,732	\$ 146,715	\$ 113,963	\$ 141,524
Other obligations	41,087	41,087			
	\$ 515,021	\$ 112,819	\$ 146,715	\$ 113,963	\$ 141,524

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**Commercial Obligations**

Documentary letters of credit	\$ 3,052	\$ 3,052	\$	\$	\$
Standby letters of credit	2,222	2,222			
	\$ 5,274	\$ 5,274	\$	\$	\$



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During fiscal 2006, we sold lease rights for 43 locations that were formerly operated as Rampage stores to Forever 21 Retail, Inc., and its parent company guaranteed its obligations under the leases it assumed. In the event of default by Forever 21 Retail, Inc. or its parent company, we could be liable for obligations associated with 39 real estate leases which have future lease payments (undiscounted) of approximately \$50.8 million through the end of fiscal 2016 which are not reflected in the tables above. The scheduled future minimum rentals for these leases over fiscal years 2007, 2008, 2009, 2010, 2011 and thereafter are \$9.1 million, \$8.5 million, \$8.6 million, \$8.2 million, \$7.1 million and \$9.3 million, respectively. We believe that the likelihood of material liability being triggered under these leases is remote, and no liability has been accrued for these contingent lease obligations as of June 30, 2007.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, as well as revenues and expenses during the reported periods.

As a retailer of women's apparel and accessories, our financial statements are affected by several critical accounting policies, many of which affect management's use of estimates and judgments, as described in the Notes to our Consolidated Financial Statements.

On an on-going basis, management evaluates its estimates and judgments regarding revenues, inventories, long-lived assets, intangible assets, accrued liabilities, stock based compensation, self-insurance programs, income taxes and contingencies and litigation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. The results from this evaluation form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Under different assumptions or conditions, alternative estimates and judgments could be derived which would differ from the estimates being used by management. Actual results could differ from any or all of these estimates.

### **Revenue**

We sell merchandise directly to retail customers and recognize revenue at the point of sale. Customers have the right to return merchandise to us, and we maintain a reserve for the financial impact of returns which occur subsequent to the current reporting period.

Our policy with respect to gift cards is to record revenue as the gift cards are redeemed for merchandise. Prior to their redemption, unredeemed gift cards are recorded as a liability and are included within other current liabilities. Beginning with the second quarter of fiscal 2006, we adjust the gift card liability balances on a quarterly basis to recognize estimated unredeemed amounts under the redemptive recognition method. This method records gift card breakage as additional sales on a proportional basis over the redemption period based on historical redemption trends. Such adjustments are included in net sales and operating income.

### **Inventory**

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Our merchandise is initially offered for sale at a regular price, but is often marked down prior to the ultimate sale of all units that were purchased. We utilize the retail method of accounting for our inventory valuation, which inherently reduces the inventories' carrying value as permanent markdowns are initiated. In addition, we maintain a reserve for the financial impact of markdowns that we believe are likely to be encountered in the future. If actual demand or market conditions are more or less favorable than those projected by management, the level of the reserve for future markdowns would be subject to change in subsequent reporting periods.

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We also provide for estimated inventory losses for damaged, lost or stolen inventory for the period from the last physical inventory to the financial statement date. These estimates are based on historical experience and other factors.

We receive certain allowances from our vendors primarily related to distribution center handling expenses or defective merchandise. These allowances are reflected as a reduction of merchandise inventory in the period they are received and allocated to cost of goods sold during the period in which the items were sold.

## **Goodwill and Long-lived Assets**

We have recorded a goodwill asset of \$32.9 million that arose from the acquisition of our business in September 1996. Subsequent amortization of \$4.1 million reduced its carrying value to \$28.8 million. This asset is tested for possible impairment on at least an annual basis in accordance with Statement of Financial Accounting Standards, or SFAS, No. 142, *Goodwill and Other Intangibles*, utilizing discounted cash flow valuation techniques and reference to the market value of our outstanding common stock. No impairment adjustments have been required to date. In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*, we assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important that could trigger an impairment review include a significant underperformance relative to historical or projected future operating results, a significant change in the manner of the use of the asset or a significant negative industry or economic trend. Upon determining that the carrying value of long-lived assets may not be recoverable based upon the existence of one or more of the above indicators of impairment, we estimate the future cash flows expected to result from the use of the assets.

## **Operating Leases**

We record rent expense on noncancellable leases containing known future scheduled rent increases on a straight-line basis over the respective leases beginning when we receive possession of the leased property for construction purposes. The difference between rent expense and rent paid is accounted for as deferred rent. Landlord construction allowances and other such lease incentives are recorded as deferred lease credits, and are amortized on a straight-line basis over the life of the lease as a reduction to rent expense.

## **Stock Based Compensation**

We estimate the fair value of stock options granted using the Black-Scholes option-pricing formula and a multiple option award approach. This fair value is then amortized over the requisite service periods of the awards. This option-pricing model requires the input of highly subjective assumptions, including the option's expected life, price volatility of the underlying stock, risk free interest rate and expected dividend rate. As stock-based compensation expense is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R), *Share-Based Payment*, requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

## **Self-Insurance Liabilities**

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Based on our assessment of risk and cost efficiency, we self-insure and purchase insurance policies to provide for workers' compensation, employee group medical benefits, general liability, property losses and director's and officer's liability. We estimate risks and record a liability based upon historical claim experience, insurance deductibles, severity factors and other actuarial assumptions. While we believe that our risk assessments are appropriate, to the extent that future occurrences and claims differ from our historical experience, additional charges for insurance may be recorded in future periods.

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### **Income Taxes**

We account for income taxes using the liability method as prescribed by SFAS No. 109, Accounting for Income Taxes. Deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying value of existing assets and liabilities and their respective tax bases. Inherent in the measurement of these deferred balances are certain judgments and interpretations of existing tax law and other published guidance. No valuation allowance has been provided for deferred tax assets, since we anticipate that the full amount of these assets should be realized in the future. Our effective tax rate considers our judgment of expected tax liabilities in the various taxing jurisdictions within which we are subject to tax. The recorded amounts of income tax are subject to adjustment upon audit, changes in interpretation and changes in judgment utilized in determining estimates.

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

As of June 30, 2007, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

Information with respect to recent accounting pronouncements is incorporated by reference to Note 6 to our Consolidated Financial Statements for the period ended June 30, 2007, on page 8.

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

Our market risks relate primarily to changes in interest rates. We bear this risk in two specific ways. First, the Credit Facility carries a variable interest rate that is tied to market indices and, therefore, our statements of operations and our cash flows will be exposed to changes in interest rates. As of June 30, 2007, we had no borrowings against the Credit Facility. However, we may borrow funds under the Credit Facility as needed.

The second component of interest rate risk involves the short-term investment of excess cash in short-term, investment-grade interest-bearing securities. These investments are considered to be cash equivalents and are shown that way on our balance sheet. If there are changes in interest rates, those changes would affect the investment income we earn on these investments and, therefore, impact our cash flows and results of operations.

We believe our market risk exposure is minimal.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosures Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures as such item is defined under Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2007 to provide reasonable assurance that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized

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and reported within the time periods specified in the SEC rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting**

We completed the implementation of new point-of-sale systems at all Charlotte Russe store locations during our fiscal quarter ended June 30, 2007 which did not result in any change to our internal control over financial reporting. There has been no change in our internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

From time to time, we may be involved in litigation relating to claims arising out of our operations. As of the date of this filing, we are not engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or results of operations.

**ITEM 1A. RISK FACTORS**

You should consider carefully the following information about the risks described below, together with the other information contained in this quarterly report on Form 10-Q and in our other filings with the SEC, before you decide to buy or maintain an investment in our common stock. We believe the risks described below are the risks that are material to us as of the date of this quarterly report. If any of the following risks actually occur, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock could decline, and you may lose all or part of the money you paid to buy our common stock. The risks set forth below with an asterisk (\*) next to the title include certain substantive revisions to the risks set forth in our annual report on Form 10-K for the fiscal year ended September 30, 2006 and our subsequent filings with the SEC.

**RISKS RELATING TO OUR BUSINESS**

*Our success depends on our ability to identify and rapidly respond to consumer fashion tastes.*

The fashion retail industry is subject to rapidly evolving fashion trends and shifting consumer demands. Accordingly, our success is heavily dependent both on the priority our target customers place on fashion and on our ability to anticipate, identify and capitalize upon emerging fashion trends in a timely manner. Current fashion tastes place significant emphasis on a fashionable look. In the past this emphasis has increased and decreased through fashion cycles and decreased emphasis has adversely affected our results. If we do not anticipate, identify or react appropriately and timely to changes in styles, trends, desired images or brand preferences, it may lead to, among other things, excess inventories and higher markdowns, as well as decreased appeal of our Charlotte Russe brand.

*We intend to continue to open new stores, which could strain our resources and cause us to operate our business less effectively. (\*)*

Our growth will largely depend on successfully opening and operating new stores. During nine months of fiscal 2007, we opened 26 new Charlotte Russe stores, and we are scheduled to open approximately 24 additional stores in the fourth quarter of fiscal 2007 for a total of approximately 50 new stores for fiscal 2007. We intend to continue to increase our number of stores for at least the next several years.

In order to support our planned expansion we will need to continually monitor and upgrade our management information and other systems. This expansion also will place increased demand on our managerial, operational, and administrative resources. These increased demands and operating complexities could cause us to operate our business less effectively, which in turn could cause deterioration in the financial



performance of our individual stores and our company as a whole and slow our new store growth.

*Our planned expansion involves a number of risks that could prevent or delay the successful opening of new stores as well as impact the performance of our existing stores.*

Our ability to open and operate new stores successfully depends on many factors, including, among others, our ability to:

identify suitable store locations, the availability of which is outside of our control;

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negotiate acceptable lease terms, including desired tenant improvement allowances;

source sufficient levels of inventory to meet the needs of new stores;

hire, train and retain store personnel;

successfully integrate new stores into our existing operations; and

identify and satisfy the fashion preferences of new geographic areas.

In addition, some of our new stores will be opened in regions of the United States in which we currently have few or no stores. The expansion into new markets may present competitive, merchandising and distribution challenges that are different from those currently encountered in our existing markets. Any of these challenges could adversely affect our business and results of operations. In addition, to the extent our new store openings are in existing markets, we may experience reduced net sales volumes in existing stores in those markets.

***A decline in general economic conditions may lead to reduced consumer demand for our apparel and accessories.***

Consumer spending habits, including spending for the fashionable apparel and related accessories that we sell, are affected by, among other things, prevailing economic conditions, levels of employment, salaries and wage rates, consumer confidence and consumer perception of economic conditions. A general slowdown in the United States economy and an uncertain economic outlook could adversely affect consumer spending habits and mall traffic, which could result in lower net sales than expected and could cause us to slow our expansion plans.

***Our stores are heavily dependent on the customer traffic generated by shopping malls.***

Most of our store locations are not sufficiently concentrated to make significant marketing expenditures cost effective. As a result, we depend heavily on locating our stores in prominent locations within successful shopping malls in order to generate customer traffic. We cannot control the development of new shopping malls, the availability or cost of appropriate locations within existing or new shopping malls or the success of individual shopping malls.

***Our market share may be adversely impacted at any time by a significant number of competitors.***

We operate in a highly competitive environment characterized by low barriers to entry. We compete against a diverse group of retailers, including national and local specialty retail stores, regional retail chains, traditional department stores and, to a lesser extent, mass merchandisers. Our market share and results of operations may be adversely impacted by this significant number of competitors. Many of our competitors also are larger and have substantially greater resources than we do.

*We rely on our good relationships with vendors to implement our business strategy successfully.*

Our business is dependent on continued good relations with our vendors. In particular, we believe that we generally are able to obtain attractive pricing and other terms from vendors because we are perceived as a desirable customer. Our merchandise strategy also relies in large part on our ability to obtain much of our merchandise from our vendors within one to two months from the date of order. Our failure to maintain good relations with our vendors could increase our exposure to changing fashion cycles, which may in turn lead to increased inventory markdown rates.

*If at any time our comparable store sales and quarterly results of operations decline or do not meet the expectations of research analysts, the price of our common stock could decline substantially. (\*)*

Our quarterly results of operations for our stores have fluctuated in the past and can be expected to continue to fluctuate in the future. For instance, our quarterly comparable store sales percentages have ranged as high as positive 21.0% and as low as negative 6.6% over the last 11 fiscal quarters and we expect a flat comparable store

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sales percentage increase during the fourth quarter of fiscal 2007. Our comparable store sales and quarterly results of operations are affected by a variety of factors, including:

the timing of new store openings and the relative proportion of new stores to mature stores;

fashion trends;

calendar shifts of holiday or seasonal periods;

our ability to maintain appropriate inventory levels;

changes in our merchandise mix;

timing of promotional events;

general economic conditions and, in particular, the retail sales environment;

actions by competitors or mall anchor tenants; and

weather conditions.

***We rely on our management team to implement our business strategy successfully.***

Our success depends to a significant extent upon the continued services of our key personnel, including senior management, who are at will employees and have made a significant contribution to our business. If any of our key personnel were to leave us, such a loss could reduce future sales, increase costs or both. Our success in the future will also depend upon our ability to attract, train and retain talented and qualified personnel.

***The failure to efficiently complete any upgrades or enhancements to certain of our technology and information systems could negatively impact our business. (\*)***

The efficient operation of our business is heavily dependent on information systems. In particular, we rely upon technology and information systems for inventory control, point-of-sale processing and other critical information. We periodically review, improve and, under certain circumstances, replace information systems to provide enhanced support to all operating areas. If such upgrades and enhancements are not successfully implemented, then the current systems may not be able to continue to adequately support our information requirements.

*The loss of, or disruption of operations in, either of our two distribution centers could negatively impact our business.*

Our merchandise is distributed through two facilities that use automated systems for sorting apparel and shipping merchandise. We depend on the orderly operation of our facilities and distribution processes, as well as sufficient shipping resources. Disruptions in these operations due to fire, earthquake or other catastrophic events, employee matters, shipping problems or other events could result in delays in the delivery of merchandise to our stores.

*The effects of war or acts of terrorism could adversely affect our business.*

The continued threat of terrorism, heightened security measures and military action in response to acts of terrorism has disrupted commerce and has intensified concerns regarding the United States economy. Any further acts of terrorism, particularly directed at malls, or new or extended hostilities may disrupt commerce and undermine consumer confidence, which could negatively impact our sales by causing mall traffic or consumer spending to decline.

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### ***Failure of our suppliers to use acceptable ethical business practices could negatively impact our business.***

We require our suppliers to operate in compliance with applicable laws, rules and regulations regarding working conditions, employment practices, environmental compliance and trademark and copyright licensing. However, we do not control their labor and other business practices. If one of our suppliers violate labor or other laws or implements labor or other business practices that are regarded as unethical, the shipment of finished products to us could be interrupted, orders could be canceled, relationships could be terminated and our reputation could be damaged. If one of our suppliers fails to procure necessary license rights to trademarks, copyrights or patents, legal action could be taken against us that could impact the salability of our inventory and expose us to financial obligations to a third party. Any of these events could have a material adverse effect on our sales and results of operations.

### ***Our business could be adversely impacted by unfavorable international conditions.***

We receive apparel and other merchandise from foreign sources, both purchased directly in foreign markets and indirectly through domestic vendors with foreign sources. To the extent that any of our vendors are located overseas or rely on overseas sources for a large portion of their products, any event causing a disruption of imports, including the imposition of import restrictions, could harm our ability to source product. This disruption could materially limit the merchandise that we would have available for sale and reduce our revenues and earnings. The flow of merchandise from our vendors could also be adversely affected by financial or political instability, or war, in or affecting any of the countries in which the goods we purchase are manufactured or through which they flow.

Trade restrictions in the form of tariffs or quotas, or both, that are applicable to the products that we sell also could affect the import of those products and could increase the cost and reduce the supply of products available to us. Any material increase in tariff levels, or any material decrease in quota levels or available quota allocation, could negatively impact our business. Further, changes in tariffs or quotas for merchandise imported from individual foreign countries could lead us to shift our sources of supply among various countries. Any shift we might undertake in the future could result in a disruption of our sources of supply and lead to a reduction in our revenues and earnings. Supply chain security initiatives undertaken by the United States government that impede the normal flow of product could also negatively impact our business.

### ***We may be liable for any defaults with respect to the leases for our Rampage stores disposed of in fiscal 2006.***

In fiscal 2006, we sold the lease rights, store fixtures and equipment for 43 Rampage store locations to Forever 21 Retail, Inc., and Forever 21, Inc., the parent company of Forever 21 Retail, guaranteed Forever 21 Retail's obligations under the leases that it assumed in connection with the transaction. In the event Forever 21 Retail or Forever 21 defaults on their obligations under certain of these leases or the guarantee, we may be liable for any damages or costs associated with such a default, which could adversely impact our future results.

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not applicable.

## **Dividends**

We have never declared nor paid dividends on our common stock and we do not intend to pay any dividends on our common stock in the foreseeable future. We currently intend to retain earnings to finance future operations and expansion. Moreover, under the terms of the Credit Facility, stock dividends and distributions are restricted.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

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**ITEM 4. SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.



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**ITEM 6. EXHIBITS**

- 10.1 Employment Agreement by and between Charlotte Russe Holding, Inc. and Patricia K. Johnson dated April 20, 2007
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this quarterly report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Diego, State of California, on the 30<sup>th</sup> day of July, 2007.

CHARLOTTE RUSSE HOLDING, INC.

By: /s/ **PATRICIA K. JOHNSON**  
**Patricia K. Johnson**

**Executive Vice President and**

**Chief Financial Officer**