

A.C. Moore Arts & Crafts, Inc.

Form 10-Q

May 11, 2011

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

**For The Quarterly Period Ended April 2, 2011
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: 000-23157

A.C. MOORE ARTS & CRAFTS, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania

(State or other jurisdiction of incorporation or organization)

22-3527763

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

130 A.C. Moore Drive, Berlin, NJ 08009

(Address of principal executive offices) (Zip Code)

(856) 768-4930

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

Common Stock, no par value

Outstanding at May 3, 2011
25,394,412

**A.C. MOORE ARTS & CRAFTS, INC.
TABLE OF CONTENTS**

| | Page |
|--|------|
| <u>PART I: FINANCIAL INFORMATION</u> | 3 |
| <u>Item 1. Financial Statements (unaudited)</u> | 3 |
| <u>Consolidated Balance Sheets as of April 2, 2011, January 1, 2011 and April 3, 2010</u> | 3 |
| <u>Consolidated Statements of Operations for the Three Month Periods Ended April 2, 2011 and April 3, 2010</u> | 4 |
| <u>Consolidated Statements of Cash Flows for the Three Month Periods Ended April 2, 2011 and April 3, 2010</u> | 5 |
| <u>Notes to Consolidated Financial Statements</u> | 6 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 10 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 16 |
| <u>Item 4. Controls and Procedures</u> | 16 |
| <u>PART II: OTHER INFORMATION</u> | 17 |
| <u>Item 1. Legal Proceedings</u> | 17 |
| <u>Item 1A. Risk Factors</u> | 17 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 17 |
| <u>Item 3. Defaults Upon Senior Securities</u> | 17 |
| <u>Item 4. Removed and Reserved</u> | 17 |
| <u>Item 5. Other Information</u> | 17 |
| <u>Item 6. Exhibits</u> | 17 |
| <u>SIGNATURES</u> | 18 |
| <u>Exhibit 31.1</u> | |
| <u>Exhibit 31.2</u> | |
| <u>Exhibit 32.1</u> | |
| <u>Exhibit 32.2</u> | |

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED BALANCE SHEETS**(In thousands except share data)
(unaudited)

| | April 2, 2011 | January 1, 2011 | April 3, 2010 |
|--|--------------------------|----------------------------|--------------------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 26,654 | \$ 39,970 | \$ 31,929 |
| Inventories | 115,707 | 111,266 | 121,985 |
| Prepaid expenses and other current assets | 7,741 | 9,104 | 8,541 |
| Prepaid and receivable income taxes | | | 188 |
| Deferred tax assets | 1,809 | 2,153 | 3,226 |
| | 151,911 | 162,493 | 165,869 |
| Non-current assets: | | | |
| Property and equipment, net | 71,760 | 73,771 | 80,679 |
| Other assets | 1,366 | 1,192 | 1,989 |
| | \$ 225,037 | \$ 237,456 | \$ 248,537 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | | |
| Current liabilities: | | | |
| Short-term debt | \$ 19,000 | \$ 19,000 | \$ 19,000 |
| Trade accounts payable | 38,362 | 43,131 | 29,461 |
| Accrued payroll and payroll taxes | 3,067 | 2,224 | 2,281 |
| Accrued expenses | 22,069 | 22,815 | 23,036 |
| Accrued lease liability | 2,336 | 2,478 | 2,030 |
| | 84,834 | 89,648 | 75,807 |
| Non-current liabilities: | | | |
| Deferred tax liability and other | 1,574 | 1,920 | 2,993 |
| Accrued lease liability | 14,108 | 14,475 | 16,789 |
| | 15,682 | 16,395 | 19,782 |
| | 100,516 | 106,043 | 95,589 |
| Commitments and contingencies | | | |

Shareholders' equity:

Preferred stock, no par value, 10,000,000 shares authorized; none issued

Common stock, no par value, 40,000,000 shares authorized; shares issued and outstanding 25,394,412; 25,346,412; and 24,960,946 at April 2, 2011, January 1, 2011 and April 3, 2010, respectively

Retained earnings (deficit)

| | | |
|-------------------|-------------------|-------------------|
| 138,651 | 138,105 | 137,023 |
| (14,130) | (6,692) | 15,925 |
| 124,521 | 131,413 | 152,948 |
| \$ 225,037 | \$ 237,456 | \$ 248,537 |

See accompanying notes to financial statements.

Table of Contents

A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share data)

(unaudited)

| | Quarter Ended | |
|---|--------------------------|--------------------------|
| | April 2, 2011 | April 3, 2010 |
| Net sales | \$ 102,724 | \$ 105,369 |
| Cost of sales (including buying and distribution costs) | 58,622 | 60,300 |
| Gross margin | 44,102 | 45,069 |
| Selling, general and administrative expenses | 50,661 | 52,268 |
| Store pre-opening and closing expenses | 629 | 113 |
| Loss from operations | (7,188) | (7,312) |
| Interest expense | 239 | 231 |
| Interest (income) | (9) | (4) |
| Loss before income taxes | (7,418) | (7,539) |
| Provision for income taxes | 20 | 24 |
| Net loss | \$ (7,438) | \$ (7,563) |
| Basic net loss per share | \$ (0.30) | \$ (0.31) |
| Diluted net loss per share | \$ (0.30) | \$ (0.31) |
| Basic weighted average shares outstanding | 24,570 | 24,342 |
| Diluted weighted average shares outstanding | 24,570 | 24,342 |

See accompanying notes to financial statements.

Table of Contents

A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

| | Quarter Ended | |
|---|--------------------------|--------------------------|
| | April 2, 2011 | April 3, 2010 |
| Cash flows from operating activities: | | |
| Net loss | \$ (7,438) | \$ (7,563) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,008 | 3,684 |
| Stock based compensation expense | 546 | 437 |
| Changes in assets and liabilities: | | |
| Inventories | (4,441) | 73 |
| Prepaid expenses and other current assets | 1,363 | 982 |
| Accounts payable | (4,770) | (7,586) |
| Accrued payroll, payroll taxes and accrued expenses | 96 | (1,237) |
| Accrued lease liability | (509) | (632) |
| Other | (175) | 244 |
| Net cash (used in) operating activities | (11,320) | (11,598) |
| Cash flows from investing activities: | | |
| Capital expenditures | (1,996) | (2,425) |
| Net cash (used in) investing activities | (1,996) | (2,425) |
| Cash flows from financing activities: | | |
| Net cash (used in) financing activities | | |
| Net decrease in cash and cash equivalents | (13,316) | (14,023) |
| Cash and cash equivalents at beginning of period | 39,970 | 45,952 |
| Cash and cash equivalents at end of period | \$ 26,654 | \$ 31,929 |

See accompanying notes to financial statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Basis of Presentation

The consolidated financial statements included herein include the accounts of A.C. Moore Arts & Crafts, Inc. and its wholly owned subsidiaries. As used herein, unless the context otherwise requires, all references to A.C. Moore, the Company, we, our, us and similar terms in this report refer to A.C. Moore Arts & Crafts, Inc. together with its subsidiaries. The Company is a specialty retailer of arts, crafts and floral merchandise for a wide range of customers. As of April 2, 2011, the Company operated a chain of 135 stores. The stores are located in the Eastern United States. The Company also serves customers nationally via its e-commerce site, www.acmoore.com.

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reported period and related disclosures. Significant estimates made as of and for the three month periods ended April 2, 2011 and April 3, 2010 include, among others, provisions for shrinkage, capitalized buying, freight, warehousing and distribution costs related to inventory, the net realizable value of merchandise designated for clearance or slow-moving merchandise, the future rental obligations and carrying costs of closed stores and the liability for workers compensation, general liability and health insurance claims. Actual results could differ materially from those estimates. Certain prior year amounts have been reclassified to correspond to current year presentation. These financial statements have been prepared by management without audit and should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended January 1, 2011 (fiscal 2010). The current fiscal year will end on December 31, 2011 (fiscal 2011). Due to the seasonality of the Company's business, the results for the interim periods are not necessarily indicative of the results for the year. The Company has included its balance sheet as of April 3, 2010 to assist in viewing the Company on a full-year basis. The accompanying consolidated financial statements reflect, in the opinion of management, all adjustments necessary for a fair statement of the interim financial statements. In the opinion of management, all such adjustments are of a normal and recurring nature.

(2) Fair Value Measurement

Accounting standards require disclosure of the fair value of certain assets and liabilities including information about how their fair value was determined. The determination of fair value has been grouped into three broad categories referred to as levels 1, 2 and 3. The fair market value of level 1 can be determined from quoted market prices for identical assets on an active market, level 2 from quoted prices for similar assets on an active market and for level 3 from assumptions that management makes based on the best available information.

Table of Contents

The following tables provide the assets and liabilities carried at fair value measured on a recurring basis as of April 2, 2011, January 1, 2011 and April 3, 2010:

| | Fair Value Measurements Using | | | | |
|-----------------------------------|----------------------------------|---|-------------------------------------|----|----------------------------|
| | Total Carrying Value | Quoted Prices in Active Markets (Level 1) | Significant Other | | Total Gains (Losses) |
| Observable Inputs (Level 2) | | | Unobservable Inputs (Level 3) | | |
| Recurring | | | | | |
| As of April 2, 2011 | | | | | |
| Cash Equivalents | \$ 26,654 | \$ 26,654 | \$ | \$ | |
| As of January 1, 2011 | | | | | |
| Cash Equivalents | \$ 39,970 | \$ 39,970 | \$ | \$ | |
| As of April 3, 2010 | | | | | |
| Cash Equivalents | \$ 31,929 | \$ 31,929 | \$ | \$ | |

Nonrecurring**As of January 1, 2011**

Long-lived assets held and used (1)

| | | | | |
|--------|----|----|--------|----------|
| \$ 180 | \$ | \$ | \$ 180 | \$ (905) |
|--------|----|----|--------|----------|

(1) Represents retail store fixed assets written down to their fair value, resulting in an impairment charge which was included in earnings for the period ended January 1, 2011.

Cash and cash equivalents, principally money market mutual funds, are measured at fair value using quoted market prices and are classified within Level 1 of the valuation hierarchy. The nonrecurring remeasurement of long-lived assets represents store assets written down to fair value using a discounted cash flow model. The loss is the amount by which the carrying amount of the assets exceeds its fair value. Key management judgments and estimates in the valuation include sales and profitability for current and future years, and rates at which to discount projected future cash flows. The fair value measurement is classified within Level 3 of the valuation hierarchy as the valuation model inputs are not observable based on readily available market data.

(3) Inventories

The Company values its inventory at the lower of cost or market, with cost determined using a weighted average method based upon the purchase order cost of the merchandise at time of receipt. In addition, management includes the cost of purchasing, warehousing, and transportation in the cost of inventory. Vendor allowances, which primarily represent volume discounts and cooperative advertising funds, are recorded as a reduction in the cost of merchandise inventories. For merchandise where we are the direct importer, ocean freight and duty are included as inventory costs. These additional costs and cost adjustments are not assigned to specific units of inventory. Management uses all available information to determine the appropriate amount of net inventory costs to be recognized and deferred in each reporting period.

Perpetual inventory records are used to value store and warehouse inventories. A full physical inventory is taken at every location at least once per year and the perpetual records are adjusted to the physical counts. Estimates for inventory shrinkage from the date of the most recent physical inventory through the end of each reporting period are based on results from physical inventories and shrink trends. These estimates are updated to actual at the time of the physical inventory. Our inventory valuation methodology also requires other management estimates and judgments,

such as the net realizable value of merchandise designated for clearance or slow-moving merchandise. Our adjustments to inventory cost for clearance and slow-moving merchandise is based on several factors including the quantity of merchandise on hand, sales trends and future advertising and merchandising plans. The accuracy of these estimates can be impacted by many factors, some of which are outside of management's control, including changes in economic conditions and consumer buying trends. Based on prior experience we do not believe the assumptions used in these estimates will change significantly.

Table of Contents**(4) Shareholders Equity**

During the first quarter of fiscal 2011, shareholders equity changed as follows:

| In thousands, except share data | Number of Shares | Common Stock | Retained Earnings | Total |
|----------------------------------|---------------------|-----------------|----------------------|------------|
| Balance, January 1, 2011 | 25,346,412 | \$ 138,105 | \$ (6,692) | \$ 131,413 |
| Net loss | | | (7,438) | (7,438) |
| Total comprehensive loss | | | | \$ (7,438) |
| Stock-based compensation expense | | 546 | | 546 |
| Restricted shares net | 48,000 | | | |
| Balance, April 2, 2011 | 25,394,412 | \$ 138,651 | \$ (14,130) | \$ 124,521 |

(5) Financing Agreement

On January 15, 2009, the Company entered into a credit agreement (the "WFRF loan agreement") with Wells Fargo Retail Finance, LLC ("WFRF") for a three-year term. On March 4, 2011, the parties amended the agreement (the "WFRF amendment") for an additional five-year term through March 4, 2016.

The WFRF loan agreement, as amended, is an asset-based senior secured revolving credit facility in an aggregate principal amount of up to \$60.0 million, with a \$15.0 million sub-limit for letters of credit. Prior to the WFRF amendment, interest was calculated at either adjusted LIBOR or WFRF's base rate plus a margin of between 1.75 and 2.50 percent per annum, depending upon the level of excess availability as defined in the loan agreement. In addition, the Company paid an annual fee of between 0.25 and 0.50 percent per annum on the amount of unused availability, also dependent on the level of excess availability. As a result of the amendment, interest is calculated at either adjusted LIBOR or WFRF's base rate plus a margin of between 2.25 and 2.75 percent per annum, depending upon the level of excess availability, and WFRF's base rate has a floor equal to the adjusted LIBOR rate plus 1.00 percent per annum. In addition, the Company will pay an annual fee between 0.375 and 0.50 percent per annum on the amount of unused availability, also dependent on the level of excess availability. At closing of the WFRF amendment, the Company paid or incurred deferred financing costs of approximately \$0.4 million that will be amortized over the term of the facility.

The agreement contains customary terms and conditions which, among other things, restrict the Company's ability to incur additional indebtedness or guaranty obligations, create liens or other encumbrances, pay dividends, redeem or issue certain equity securities or change the nature of the business. In addition, there are limitations on the type of investments, acquisitions, or dispositions the Company can make. As defined in the agreement, the Company is also required to maintain greater than \$90.0 million in book value of inventory and have excess availability of more than 10 percent of the borrowing base or \$6.0 million, whichever is less.

The WFRF loan agreement defines various events of default which include, without limitation, a material adverse effect (as defined in the agreement), failure to pay amounts when due, cross-default provisions, material liens or judgments, insolvency, bankruptcy or a change of control. The WFRF amendment modified certain provisions of the agreement in order to permit the Company to enter into, and perform its obligations under, contracts to effect a strategic alternatives transaction (as defined in the WFRF amendment). However, in order to consummate a strategic alternatives transaction, the Company will need to either payoff and terminate the credit facility or obtain WFRF's consent.

Table of Contents

As of April 2, 2011 there was \$19.0 million borrowed under the line of credit, \$3.2 million of outstanding stand-by letters of credit and availability of \$37.8 million. Subject to availability, there is no debt service requirement during the term of this agreement.

(6) Income Taxes

The Company uses the asset and liability method of accounting for income taxes. The Company does business in various jurisdictions that impose income taxes. Management determines the aggregate amount of income tax expense to accrue and the amount currently payable based upon the tax statutes of each jurisdiction. This process includes adjusting income determined using generally accepted accounting principles for items that are treated differently by the applicable taxing authorities. Deferred taxes are reflected on the Company's balance sheet for temporary differences that will reverse in subsequent years. A change in tax rates is recognized as income or expense in the period in which the change becomes effective. Valuation allowances are recorded to reduce the carrying amount of deferred tax assets when it is more likely than not that such assets will not be realized. The Company has determined that it is necessary to record a valuation allowance against its net deferred tax assets due to, among other factors, the Company's cumulative three-year loss position. Based on its historical and continuing operating losses, the Company has recorded a 100% valuation allowance against its net deferred tax assets and expects to continue to do so during fiscal 2011. As of April 2, 2011 the valuation allowance was \$34.9 million. The expiration of statutes and closing of audits in fiscal 2011 may reduce the amount of unrecognized tax benefits by approximately \$0.3 million which would result in a current tax benefit.

Table of Contents**(7) Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share:

| (In thousands, except per share data) | Quarter Ended | |
|--|------------------|------------------|
| | April 2, 2011 | April 3, 2010 |
| Net loss | \$ (7,438) | \$ (7,563) |
| Weighted average shares: | | |
| Basic | 24,570 | 24,342 |
| Incremental shares from assumed exercise of stock options and stock appreciation rights | | |
| Diluted | 24,570 | 24,342 |
| Basic net loss per share | \$ (0.30) | \$ (0.31) |
| Diluted net loss per share | \$ (0.30) | \$ (0.31) |
| Stock options and stock appreciation rights excluded from calculation because exercise price was greater than average market price | 1,953 | 2,624 |
| Potentially dilutive shares excluded from the calculation as the result would be anti-dilutive | 1,856 | 907 |

(8) Commitments and Contingencies

The Company is involved in legal proceedings from time to time in the ordinary course of business. Management believes that none of these legal proceedings will have a materially adverse effect on the Company's financial condition or results of operations. However, there can be no assurance that future costs of such litigation would not be material to the Company's financial condition, results of operations or cash flows.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**Cautionary Statement Relating to Forward-looking Statements**

Certain oral statements made by our management from time to time and certain statements contained herein or in other reports filed by us with the Securities and Exchange Commission (SEC) or incorporated by reference herein or therein are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to our results of operations and our business. All such statements, other than statements of historical facts, including those regarding market trends, our financial position and results of operations, business strategy, projected costs, and plans and objectives of management for future operations, are forward-looking statements. In general, such statements are identified by the use of forward-looking words or phrases including, but not limited to, intended, will, should, may, believes, expects, expected, anticipates and anticipated or the negative thereof or variations

thereon or similar terminology. These forward-looking statements are based on our current expectations. Although we believe that the expectations reflected in forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. These forward-looking statements represent our current judgment. We disclaim any intent or obligation to update our forward-looking statements. Because forward-looking statements involve risks and uncertainties, our actual results could differ materially. For additional information concerning factors that could cause actual results to differ materially from the information contained herein, reference is made to the information under Part II, Item 1A. Risk Factors as set forth below and in our annual report on Form 10-K for the fiscal year ended January 1, 2011 as filed with the SEC. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this Cautionary Statement.

Table of Contents

Overview

General

We are a specialty retailer of arts, crafts and floral merchandise for a wide range of customers. Our first store opened in Moorestown, New Jersey in 1985. As of April 2, 2011, we operated 135 stores in the Eastern United States. Our stores typically range from 20,000 to 25,000 square feet with an average of 22,800 square feet. We also serve customers nationally through our e-commerce site, www.acmoore.com.

Due to the importance of our peak selling season, which includes the Fall and Winter holiday seasons, the fourth quarter has historically contributed, and is expected to continue to contribute, a significant portion of our operating results for the entire year. As a result, any factors negatively affecting us during the fourth quarter of any year, including adverse weather and unfavorable economic conditions, would have a material adverse effect on our results of operations for the entire year.

Our quarterly results of operations also may fluctuate based upon such factors as the length of holiday seasons, the date on which holidays fall, the number and timing of new store openings, the amount of store pre-opening expenses, the amount of net sales contributed by new and existing stores, the mix of products sold, the amount of sales returns, the timing and level of markdowns and other competitive factors.

For the three months ended April 2, 2011, comparable store sales decreased by 2.6 percent, while gross margin as a percent to sales increased 0.1 percentage points for the quarter. The decline in comparable store sales was primarily due to weak sales in seasonal and home decor. Seasonal sales were negatively impacted due to the Easter holiday occurring later in fiscal 2011 than in fiscal 2010. The increase in gross margin was primarily the result of supply chain efficiencies and improvements in inventory control and security partially offset by a decline in merchandise gross margin. We remain focused on margin enhancement opportunities in 2011 by continuing our everyday shelf pricing and promotional price optimization initiatives, along with continued improvements in inventory control and security. However, competitive pressure and further deterioration in an already weakened retail environment could result in additional downward pressure on comparable store sales or cause us to be more promotional than we currently expect, which would have a negative impact on margin.

Business and Operating Strategy

We have experienced net losses in each of the last three years. These losses have primarily been the result of declines in same store sales for each of the past four years. In the first quarter of fiscal 2011 same store sales declined 2.6 percent and we had a net loss of \$7.4 million. We anticipate a net loss in fiscal 2011. Management's primary business and operating initiatives, as discussed below, are designed to address what we believe to be opportunities to improve our results. These initiatives support our focus on driving sales, improving store profitability and increasing gross margin.

Table of Contents

Drive sales. We continue to be focused on driving sales through better execution in customer service; a broad and differentiated merchandise assortment; a high in-stock position, especially in basic craft components; and increased productivity of our integrated marketing/advertising programs.

Customer insight. Understanding our customers' expectations of A.C. Moore, along with product trends and customer interests, is core to our ability to develop stronger relationships and be our customers' store of choice. We primarily utilize our social networking sites and our REWARDS loyalty program to gain consumer insight, supplemented by other studies from time to time.

Differentiated merchandise assortment. We continually seek to identify new and unique product lines and merchandise assortments that differentiate us from our competitors. We regularly review our supplier base and product assortment to ensure that we are offering newness to our customers and enhancing the overall shopping experience.

Improved in-stock position. A high in-stock position is critical to maximizing our sales potential and enhancing customer loyalty. Since 2007, we have invested significant resources in supply chain and inventory management systems. We continue to refine our inventory management processes to ensure we maintain high in-stock levels, especially on basic craft components that are meaningful to our customers.

Integrated marketing/advertising program. We continue to enhance and diversify our marketing and advertising mix based on our customer and craft consumer preferences. Our marketing mix is designed to allow us to reach both current and prospective customers in an efficient manner. Diversified marketing vehicles allow us to market more efficiently based on our customer product preferences. Through these different vehicles, we can target our marketing of promotional items, new products and programs, creating both sales and margin enhancements.

Promotional strategies. We continue to test new advertising and marketing vehicles to enhance both sales and margin. While print advertising remains an important vehicle for us, we continue to build our direct marketing capabilities to drive profitable sales and traffic from both existing and prospective customers. We also continue to test other vehicles based on insight on how our customers and crafters use media.

A.C. Moore Rewards program. In July 2009, we launched our REWARDS customer loyalty program throughout the chain. We utilize this powerful tool to interact with our customers based on their purchase history and product preferences, delivering targeted product information and promotions. We believe this initiative will increase our share of wallet with our existing customers and enable us to differentiate ourselves from our competition.

Improve store profitability. We continue to strive to improve our store profitability. During 2011, we will continue to focus on improving store profitability using the following tactics:

Real estate portfolio strategy. Management continually reviews opportunities to open stores in new and existing markets and to relocate or remodel existing stores where strategically prudent and economically viable. Existing stores are reviewed on a periodic basis to identify underperforming locations for potential relocation, remodeling or closure. During 2011, we expect to open two new stores, each of which opened in the first fiscal quarter, remodel four to six stores, and close two stores through lease expirations. We also continue to renegotiate existing leases with the goal of lowering the cost of occupancy in these stores.

Table of Contents

Store operations leadership. In fiscal 2010, we reorganized our store operations leadership team to provide more training and development capabilities within our field organization. We believe this structure will enhance our ability to improve store profitability.

Increase gross margin. We are focused on increasing gross margin through implementation of a category management process where we regularly review our product mix, and optimize our regular and promotional prices and supply chain.

Category management. The category management process leverages merchandise assortment planning tools, the use of a merchandise planning calendar and an open-to-buy process focused on sales and inventory productivity.

Price optimization. We believe we have significant opportunities to increase our gross margin by optimizing our regular shelf prices and employing our market basket tools to improve the profitability and sales of promotional products. We believe that we offer competitive pricing, but there are opportunities to strategically improve margins while focusing on growing market share.

Supply chain optimization. In addition to our ongoing supply chain initiatives, which include improving in-stock positions, optimizing inventory levels, increasing merchandise turns and improving distribution efficiencies, in fiscal 2010 we completed two significant projects: automated replenishment and cross-docking.

Results of Operations

The following table sets forth, for the periods indicated selected statement of operations data expressed as a percentage of net sales and the number of stores open at the end of each such period:

| | Quarter Ended | |
|--|--------------------------|--------------------------|
| | April 2, 2011 | April 3, 2010 |
| Net sales | 100.0% | 100.0% |
| Cost of sales | 57.1 | 57.2 |
| Gross margin | 42.9 | 42.8 |
| Selling, general and administrative expenses | 49.3 | 49.6 |
| Store pre-opening and closing expenses | 0.6 | 0.1 |
| Loss from operations | (7.0) | (6.9) |
| Interest expense (income), net | 0.2 | 0.2 |
| Loss before income taxes | (7.2) | (7.1) |
| Provision for (benefit of) income taxes | 0.0 | 0.0 |
| Net loss | (7.2)% | (7.1)% |
| Number of stores open at end of period | 135 | 136 |

Table of Contents***Three Months Ended April 2, 2011 Compared to Three Months Ended April 3, 2010***

Net Sales. Net sales decreased \$2.6 million, or 2.5 percent, to \$102.7 million in the three months ended April 2, 2011 from \$105.4 million during the three months ended April 3, 2010. This decrease is comprised of (i) a comparable store sales decrease of \$2.6 million, or 2.6 percent, (ii) a net increase of \$1.7 million from new stores not included in the comparable store base and e-commerce sales, and (iii) a decrease in sales of \$1.7 million from stores closed since April 3, 2010. The decline in comparable store sales was primarily due to weak sales in seasonal and home decor. Seasonal sales were negatively impacted due to the Easter holiday occurring later in fiscal 2011 than in fiscal 2010. Categories that had an increase in comparable store sales for the quarter include celebrations, checkout/ impulse and everyday floral. Stores are added to the comparable store base at the beginning of the fourteenth full month of operation. Comparable stores that are relocated or remodeled remain in the comparable store base. Stores that close are removed from the comparable store base as of the beginning of the month of closure.

Gross Margin. Gross margin is net sales minus the cost of merchandise which includes purchasing and receiving costs, inbound freight, duties related to import purchases, internal transfer costs and warehousing costs. Gross margin as a percent of net sales was 42.9 percent for the three months ended April 2, 2011, and 42.8 percent for the three months ended April 3, 2010. The increase in gross margin was primarily the result of supply chain efficiencies and improvements in inventory control and security partially offset by a decline in merchandise margin.

Selling, General and Administrative Expenses. Selling, general and administrative expenses include (a) direct store level expenses, including rent and related operating costs, payroll, advertising, depreciation and other direct costs, and (b) corporate level costs not directly associated with or allocable to cost of sales, including executive salaries, accounting and finance, corporate information systems, office facilities, stock-based compensation and other corporate expenses.

Selling, general and administrative expenses were \$50.7 million in the first quarter of fiscal 2011, a decrease of \$1.6 million compared to the \$52.3 million in the first quarter of fiscal 2010. This decrease was primarily attributable to a decrease in advertising expenses and severance benefits related to the retirement of the Company's Chief Executive Officer, partially offset by an increase in store payroll. As a percent of sales, selling, general and administrative expenses decreased 0.3 percent to 49.3 percent from 49.6 percent.

Store Pre-Opening and Closing Expenses. We expense store pre-opening costs as they are incurred, which includes lease costs prior to a store opening. Store closing costs include severance, inventory liquidation costs, asset related charges, lease termination payments and the net present value of future rent obligations less estimated sub-lease income. Store pre-opening expenses of \$0.3 million include costs related to the two stores that opened in the first quarter of fiscal 2011. Store closing costs of \$0.3 million include costs related to the one store closed in the first quarter of fiscal 2011 and ongoing operating costs for stores previously closed. In the first quarter of fiscal 2010, we incurred store pre-opening expenses of \$0.1 million for the one store that opened in that quarter. There were no stores closed during the first quarter of fiscal 2010.

Interest Income and Expense. In the first quarter of fiscal 2011 and fiscal 2010, we had interest expense of \$0.2 million. Borrowings and interest rates were comparable for both periods.

Income Taxes. Based upon its historical and continuing operating losses, the Company is recording a 100 percent valuation allowances against its net deferred tax assets and expects to continue to do so for the remainder of fiscal 2011. The expiration of statutes and closing of audits in fiscal 2011 may reduce the amount of unrecognized tax benefits by approximately \$0.3 million which would result in a current tax benefit.

Liquidity and Capital Resources

We have experienced net losses in each of the past three years and anticipate a net loss in fiscal 2011. These losses are primarily the result of declines in same store sales for each of the last four years. In the first quarter of fiscal 2011 same store sales declined 2.6 percent and we had a net loss of \$7.4 million.

Table of Contents

One of our primary sources of liquidity is a \$60.0 million credit facility provided by Wells Fargo Retail Finance, LLC. Although we currently have \$37.8 million of availability and have not increased our borrowing under this credit facility since it was put in place two years ago, the agreement does contain various events of default which if triggered would allow the lender to take actions including raising the interest rate, discontinuing advances and accelerating the Company's obligations.

On January 15, 2009, the Company entered into a credit agreement (the "WFRF loan agreement") with Wells Fargo Retail Finance, LLC ("WFRF") for a three-year term. On March 4, 2011, the parties amended the agreement (the "WFRF amendment") for an additional five-year term through March 4, 2016.

The WFRF loan agreement, as amended, is an asset-based senior secured revolving credit facility in an aggregate principal amount of up to \$60.0 million, with a \$15.0 million sub-limit for letters of credit. Prior to the WFRF amendment, interest was calculated at either adjusted LIBOR or WFRF's base rate plus a margin of between 1.75 and 2.50 percent per annum, depending upon the level of excess availability as defined in the loan agreement. In addition, the Company paid an annual fee of between 0.25 and 0.50 percent per annum on the amount of unused availability, also dependent on the level of excess availability. As a result of the amendment, interest is calculated at either adjusted LIBOR or WFRF's base rate plus a margin of between 2.25 and 2.75 percent per annum, depending upon the level of excess availability, and WFRF's base rate has a floor equal to the adjusted LIBOR rate plus 1.00 percent per annum. In addition, the Company will pay an annual fee between 0.375 and 0.50 percent per annum on the amount of unused availability, also dependent on the level of excess availability. At closing of the WFRF amendment, the Company paid or incurred deferred financing costs of approximately \$0.4 million that will be amortized over the term of the facility.

The WFRF loan agreement defines various events of default which include, without limitation, a material adverse effect (as defined in the agreement), failure to pay amounts when due, cross-default provisions, material liens or judgments, insolvency, bankruptcy or a change of control. The WFRF amendment modified certain provisions of the agreement in order to permit the Company to enter into, and perform its obligations under, contracts to effect a strategic alternatives transaction (as defined in the WFRF amendment). However, in order to consummate a strategic alternatives transaction, the Company will need to either payoff and terminate the credit facility or obtain WFRF's consent.

On February 15, 2011, the Company announced that it had engaged Janney Montgomery Scott LLC to serve as financial advisor in the exploration of strategic alternatives to enhance shareholder value. These alternatives include, but are not limited to, a sale of the Company, corporate financing or capital raise. The Company has received third party expressions of interest but there can be no assurance that a transaction will result from this process.

Our capital requirements are primarily to support seasonal increases in inventory and inventory purchases for new stores, capital assets to support new, remodeled and relocated stores as well as investments in information technology infrastructure and systems. In recent years, we have financed operations and new store growth primarily with cash generated from operating activities and a \$10.0 million private placement of our common stock which occurred in May of 2009.

At April 2, 2011 and January 1, 2011, our working capital was \$67.1 million and \$72.8 million, respectively. Cash used in operations was \$11.3 million for the three months ended April 2, 2011. This was principally the result of a \$9.2 million increase in the net investment in inventory (change in inventory net of change in accounts payable). For the three months ended April 3, 2010, cash used in operations was \$11.6 million which was primarily the result of a \$7.5 million increase in the net investment in inventory.

Table of Contents

Net cash used in investing activities during the three months ended April 2, 2011 was \$2.0 million, all of which related to capital expenditures. In fiscal 2011, we expect to spend approximately \$8.0 to \$9.0 million on capital expenditures, which includes approximately \$3.5 million for new and relocated stores, \$2.6 million for store maintenance capital and the remainder used for information technology and distribution center equipment. For the three months ended April 2, 2010, we invested \$2.4 million, all of which related to capital expenditures. We believe the cash generated from operations during the year and available borrowings under the line of credit agreement will be sufficient to finance our working capital and capital expenditure requirements for at least the next 12 months.

Critical Accounting Estimates

A description of our critical accounting policies was provided in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of the fiscal 2010 Form 10-K. There were no changes in these policies during the first quarter of fiscal 2011.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We invest cash balances in excess of operating requirements primarily in money market mutual funds. The fair value of our cash and equivalents at April 2, 2011 equaled carrying value. A hypothetical decrease in interest rates of 10 percent compared to the rates in effect at April 2, 2011 would reduce our interest income by less than \$0.1 million annually.

As of April 2, 2011 we had \$19.0 million outstanding under our line of credit. The interest rate on our line of credit fluctuates with market rates and therefore the value of this financial instrument will not be impacted by a change in interest rates. A 10 percent increase in interest rates would increase our interest expense by less than \$0.1 million annually.

ITEM 4. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

We carried out an evaluation, with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures as of April 2, 2011. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of April 2, 2011, our disclosure controls and procedures, as defined in Rule 13a-15(e), were effective to ensure that (i) information required to be disclosed by the issuer in the reports that it files or submits under the Securities Exchange Act of 1934 (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is involved in legal proceedings from time to time in the ordinary course of business. Management believes that none of these legal proceedings will have a materially adverse effect on the Company's financial condition or results of operations. However, there can be no assurance that future costs of such litigation would not be material to our financial condition, results of operations or cash flows.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011 which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011.

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

Not Applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

ITEM 4. REMOVED AND RESERVED

Not Applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

- 31.1 Certification pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act).
- 31.2 Certification pursuant to Rule 13a-14(a) promulgated under the Exchange Act.
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

A.C. MOORE ARTS & CRAFTS, INC.

Date: May 10, 2011

By: /s/ Joseph A. Jeffries
Joseph A. Jeffries
Chief Executive Officer
(Principal Executive Officer)

Date: May 10, 2011

By: /s/ Rodney Schriver
Rodney Schriver
Vice President, Chief Accounting Officer and
Controller
(Principal Accounting Officer)

Table of Contents

Exhibit Index

| Exhibit No. | Description |
|-------------|--|
| 31.1 | Certification pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act). |
| 31.2 | Certification pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act). |
| 32.1 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |