GENESCO INC
Form 10-Q
September 13, 2007

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Securities and Exchange Commission
Washington, D.C. 20549
Form 10-Q

(Mark One)

þ **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
For Quarter Ended August 4, 2007

o **Transition Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File No. 1-3083
Genesco Inc.
A Tennessee Corporation
I.R.S. No. 62-0211340
Genesco Park
1415 Murfreesboro Road
Nashville, Tennessee 37217-2895
Telephone 615/367-7000

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 þ No o

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 (check one:)
Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Common Shares Outstanding August 31, 2007 22,794,106

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements
Genesco Inc.
and Subsidiaries
Condensed Consolidated Balance Sheets
(In Thousands, except share amounts)

	August 4, 2007	**February 3, 2007**	**July 29, 2006**
Assets			
Current Assets			
Cash and cash equivalents	**$ 22,129**	$ 16,739	$ 19,360
Accounts receivable, net of allowances of $2,044 at August 4, 2007, $1,910 at February 3, 2007 and $2,087 at July 29, 2006	**22,154**	24,084	19,293
Inventories	**347,574**	261,037	331,439
Deferred income taxes	**12,849**	12,940	8,907
Prepaids and other current assets	**41,761**	20,266	22,406
Total current assets	**446,467**	335,066	401,405
Property and equipment:			
Land	**4,861**	4,861	4,972
Buildings and building equipment	**16,423**	17,445	14,742
Computer hardware, software and equipment	**73,292**	72,404	66,135
Furniture and fixtures	**86,703**	82,542	71,543
Construction in progress	**19,234**	12,005	13,732
Improvements to leased property	**238,301**	222,493	207,412
Property and equipment, at cost	**438,814**	411,750	378,536
Accumulated depreciation	**(202,660)**	(189,416)	(174,117)
Property and equipment, net	**236,154**	222,334	204,419
Goodwill	**107,618**	107,651	96,235
Trademarks	**51,389**	51,361	47,675
Other intangibles, net of accumulated amortization of $6,798 at August 4, 2007, $6,096 at February 3, 2007 and $5,244 at July 29, 2006	**2,114**	2,816	3,342
Other noncurrent assets	**10,827**	10,145	9,033
Total Assets	**$ 854,569**	$ 729,373	$ 762,109

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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Genesco Inc.
and Subsidiaries
Condensed Consolidated Balance Sheets
(In Thousands, except share amounts)

Liabilities and Shareholders Equity	August 4, 2007	February 3, 2007	July 29, 2006
Current Liabilities			
Accounts payable	**$ 119,727**	$ 65,083	$ 144,954
Accrued employee compensation	**13,269**	21,954	14,612
Accrued other taxes	**10,154**	9,829	9,514
Accrued income taxes	**-0-**	7,845	-0-
Other accrued liabilities	**27,380**	25,570	27,177
Provision for discontinued operations	**5,571**	4,455	3,909
Total current liabilities	**176,101**	134,736	200,166
Long-term debt	**188,220**	109,250	129,250
Pension liability	**11,786**	14,306	21,083
Deferred rent and other long-term liabilities	**72,691**	64,245	53,288
Provision for discontinued operations	**1,794**	1,610	1,802
Total liabilities	**450,592**	324,147	405,589
Commitments and contingent liabilities			
Shareholders Equity			
Non-redeemable preferred stock	**5,676**	6,602	6,648
Common shareholders equity:			
Common stock, $1 par value:			
Authorized: 80,000,000 shares			
Issued/Outstanding:			
August 4, 2007 23,277,262/22,788,798			
February 3, 2007 23,230,458/22,741,994			
July 29, 2006 23,360,219/22,871,755	**23,277**	23,230	23,360
Additional paid-in-capital	**113,510**	107,956	114,196
Retained earnings	**300,282**	306,622	255,525
Accumulated other comprehensive loss	**(20,911)**	(21,327)	(25,352)
Treasury shares, at cost	**(17,857)**	(17,857)	(17,857)
Total shareholders equity	**403,977**	405,226	356,520
Total Liabilities and Shareholders Equity	**$ 854,569**	$ 729,373	$ 762,109

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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Genesco Inc.
and Subsidiaries
Condensed Consolidated Statements of Operations
(In Thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	August 4, 2007	**July 29, 2006**	**August 4, 2007**	**July 29, 2006**
Net sales	**$ 327,977**	$ 304,301	**$ 662,628**	$ 619,319
Cost of sales	**164,358**	150,911	**327,165**	304,560
Selling and administrative expenses	**166,059**	140,619	**325,132**	282,485
Restructuring and other, net	**158**	480	**6,753**	589
(Loss) earnings from operations	**(2,598)**	12,291	**3,578**	31,685
Interest expense, net				
Interest expense	**3,059**	2,267	**5,481**	4,541
Interest income	**(59)**	(107)	**(79)**	(467)
Total interest expense, net	**3,000**	2,160	**5,402**	4,074
(Loss) earnings before income taxes from continuing operations	**(5,598)**	10,131	**(1,824)**	27,611
Income tax (benefit) provision	**(2,658)**	4,187	**(1,087)**	11,001
(Loss) earnings from continuing operations	**(2,940)**	5,944	**(737)**	16,610
Provision for discontinued operations, net	**(1,225)**	-0-	**(1,225)**	(189)
Net (Loss) Earnings	**$ (4,165)**	$ 5,944	**$ (1,962)**	$ 16,421
Basic (loss) earnings per common share:				
Continuing operations	**$ (.13)**	$ .26	**$ (.04)**	$ .72
Discontinued operations	**$ (.06)**	$ .00	**$ (.05)**	$ (.01)
Net (loss) earnings	**$ (.19)**	$ .26	**$ (.09)**	$ .71
Diluted (loss) earnings per common share:				
Continuing operations	**$ (.13)**	$ .24	**$ (.04)**	$ .65
Discontinued operations	**$ (.06)**	$ .00	**$ (.05)**	$ (.01)
Net (loss) earnings	**$ (.19)**	$ .24	**$ (.09)**	$ .64

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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Genesco Inc.
and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(In Thousands)

	Three Months Ended		Six Months Ended	
	August 4, 2007	**July 29, 2006**	**August 4, 2007**	**July 29, 2006**
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net (loss) earnings	**$ (4,165)**	$ 5,944	**$ (1,962)**	$ 16,421
Tax benefit of stock options exercised	**(33)**	-0-	**(138)**	(158)
Adjustments to reconcile net (loss)/earnings to net cash used in operating activities:				
Depreciation	**10,935**	9,827	**21,801**	19,177
Deferred income taxes	**3,520**	(446)	**3,295**	(1,325)
Provision for losses on accounts receivable	**40**	197	**23**	254
Impairment of long-lived assets	**352**	460	**6,683**	548
Share-based compensation and restricted stock	**2,053**	1,806	**4,117**	3,505
Provision for discontinued operations	**2,011**	-0-	**2,011**	311
Other	**1,064**	338	**1,551**	883
Effect on cash of changes in working capital and other assets and liabilities:				
Accounts receivable	**1,392**	3,252	**1,886**	1,624
Inventories	**(65,155)**	(83,666)	**(86,537)**	(100,791)
Prepaids and other current assets	**(14,814)**	(893)	**(21,495)**	(778)
Accounts payable	**35,877**	47,859	**64,137**	60,656
Other accrued liabilities	**4,150**	(3,231)	**(14,239)**	(29,089)
Other assets and liabilities	**(823)**	2,776	**(2,403)**	1,848
Net cash used in operating activities	**(23,596)**	(15,777)	**(21,270)**	(26,914)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Capital expenditures	**(22,385)**	(17,343)	**(43,127)**	(36,413)
Acquisitions, net of cash acquired	**-0-**	-0-	**(34)**	-0-
Proceeds from assets sales	**6**	-0-	**6**	-0-
Net cash used in investing activities	**(22,379)**	(17,343)	**(43,155)**	(36,413)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Payments of capital leases	**(43)**	-0-	**(101)**	-0-
Tax benefit of stock options exercised	**33**	-0-	**138**	158
Shares repurchased	**-0-**	(11,729)	**-0-**	(11,729)

Change in overdraft balances	**(1,646)**	6,554	**(9,493)**	10,369
Borrowings under revolving credit facility	**98,000**	30,000	**187,000**	30,000
Payments on revolving credit facility	**(42,000)**	(7,000)	**(108,000)**	(7,000)
Dividends paid on non-redeemable preferred stock	**(54)**	(64)	**(118)**	(128)
Options exercised	**85**	-0-	**389**	566
Net cash provided by financing activities	**54,375**	17,761	**69,815**	22,236
Net Increase (Decrease) in Cash and Cash Equivalents	**8,400**	(15,359)	**5,390**	(41,091)
Cash and cash equivalents at beginning of period	**13,729**	34,719	**16,739**	60,451
Cash and cash equivalents at end of period	**$ 22,129**	$ 19,360	**$ 22,129**	$ 19,360
Supplemental Cash Flow Information:				
Net cash paid for:				
Interest	**$ 3,297**	$ 2,869	**$ 4,431**	$ 4,050
Income taxes	**12,408**	14,383	**26,340**	27,267

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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Genesco Inc.
and Subsidiaries
Condensed Consolidated Statements of Shareholders Equity
(In Thousands)

	Total Non-Redeemable Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Comprehensive Income (Loss)	Total Share-holders Equity
Balance January 28, 2006	**$6,695**	**$ 23,748**	**$ 123,137**	**$ 239,232**	**$(26,204)**	**$ (17,857)**		**$ 348,751**
Net earnings	-0-	-0-	-0-	67,646	-0-	-0-	$67,646	67,646
Dividends paid on non-redeemable preferred stock	-0-	-0-	-0-	(256)	-0-	-0-	-0-	(256)
Exercise of stock options	-0-	357	6,101	-0-	-0-	-0-	-0-	6,458
Issue shares Employee Stock Purchase Plan	-0-	10	311	-0-	-0-	-0-	-0-	321
Shares repurchased	-0-	(1,062)	(31,026)	-0-	-0-	-0-	-0-	(32,088)
Employee and non-employee restricted stock	-0-	182	3,164	-0-	-0-	-0-	-0-	3,346
Share-based compensation	-0-	-0-	4,067	-0-	-0-	-0-	-0-	4,067
Tax benefit of stock options exercised	-0-	-0-	2,405	-0-	-0-	-0-	-0-	2,405
Gain on foreign currency forward contracts (net of tax of $0.6 million)	-0-	-0-	-0-	-0-	848	-0-	848	848
Loss on interest rate swaps (net of tax benefit of $0.2 million)	-0-	-0-	-0-	-0-	(218)	-0-	(218)	(218)
Pension liability adjustment (net of tax of $3.2 million)	-0-	-0-	-0-	-0-	5,094	-0-	5,094	5,094
Cumulative adjustment to adopt SFAS	-0-	-0-	-0-	-0-	(802)	-0-	-0-	(802)

No. 158 (net of tax benefit of $0.5 million)								
Foreign currency translation adjustment	-0-	-0-	-0-	-0-	(45)	-0-	(45)	(45)
Other	(93)	(5)	(203)	-0-	-0-	-0-	-0-	(301)
Comprehensive income							$73,325	
Balance February 3, 2007	**6,602**	**23,230**	**107,956**	**306,622**	**(21,327)**	**(17,857)**		**405,226**
Cumulative effect of change in accounting principle (see Note 6)	-0-	-0-	-0-	(4,260)	-0-	-0-	-0-	(4,260)
Net loss	-0-	-0-	-0-	(1,962)	-0-	-0-	$(1,962)	(1,962)
Dividends paid on non-redeemable preferred stock	-0-	-0-	-0-	(118)	-0-	-0-	-0-	(118)
Exercise of stock options	-0-	19	370	-0-	-0-	-0-	-0-	389
Employee and non-employee restricted stock	-0-	-0-	2,334	-0-	-0-	-0-	-0-	2,334
Share-based compensation	-0-	-0-	1,783	-0-	-0-	-0-	-0-	1,783
Tax benefit of stock options exercised	-0-	-0-	138	-0-	-0-	-0-	-0-	138
Conversion of Series 3 preferred stock	(321)	7	314	-0-	-0-	-0-	-0-	-0-
Conversion of Series 4 preferred stock	(560)	8	552	-0-	-0-	-0-	-0-	-0-
Gain on foreign currency forward contracts (net of tax of $0.1 million)	-0-	-0-	-0-	-0-	103	-0-	103	103
Foreign currency translation adjustment	-0-	-0-	-0-	-0-	313	-0-	313	313
Other	(45)	13	63	-0-	-0-	-0-	-0-	31
Comprehensive loss*							$(1,546)	

Balance August 4, 2007	**$5,676**	**$ 23,277**	**$ 113,510**	**$ 300,282**	**$(20,911)**	**$ (17,857)**	**$ 403,977**

* Comprehensive income (loss) was $(4.1) million and $6.2 million for the second quarter ended August 4, 2007 and July 29, 2006, respectively.

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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Genesco Inc.
and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Note 1
Summary of Significant Accounting Policies
Interim Statements
The condensed consolidated financial statements contained in this report are unaudited but reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the results for the interim periods of the fiscal year ending February 2, 2008 (Fiscal 2008) and of the fiscal year ended February 3, 2007 (Fiscal 2007). The results of operations for any interim period are not necessarily indicative of results for the full year. The interim financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K.
Nature of Operations
The Company s businesses include the design or sourcing, marketing and distribution of footwear, principally under the *Johnston & Murphy* and *Dockers* brands and the operation at August 4, 2007 of 2,111 *Journeys, Journeys Kidz, Shi by Journeys, Johnston & Murphy, Underground Station, Jarman, Hat World, Lids, Hat Shack, Hat Zone, Head Quarters, Cap Connection* and *Lids Kids* retail footwear and headwear stores.
Principles of Consolidation
All subsidiaries are consolidated in the condensed consolidated financial statements. All significant intercompany transactions and accounts have been eliminated.
Use of Estimates
The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
Significant areas requiring management estimates or judgments include the following key financial areas:
Inventory Valuation
The Company values its inventories at the lower of cost or market.
In its wholesale operations, cost is determined using the first-in, first-out (FIFO) method. Market is determined using a system of analysis which evaluates inventory at the stock number level based on factors such as inventory turn, average selling price, inventory level, and selling prices reflected in future orders. The Company provides reserves when the inventory has not been marked down to market based on current selling prices or when the inventory is not turning and is not expected to turn at levels satisfactory to the Company.

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Genesco Inc.
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Notes to Condensed Consolidated Financial Statements
Note 1
Summary of Significant Accounting Policies, Continued

In its retail operations, other than the Hat World segment, the Company employs the retail inventory method, applying average cost-to-retail ratios to the retail value of inventories. Under the retail inventory method, valuing inventory at the lower of cost or market is achieved as markdowns are taken or accrued as a reduction of the retail value of inventories.

Inherent in the retail inventory method are subjective judgments and estimates, including merchandise mark-on, markups, markdowns, and shrinkage. These judgments and estimates, coupled with the fact that the retail inventory method is an averaging process, could produce a range of cost figures. To reduce the risk of inaccuracy and to ensure consistent presentation, the Company employs the retail inventory method in multiple subclasses of inventory with similar gross margin, and analyzes markdown requirements at the stock number level based on factors such as inventory turn, average selling price, and inventory age. In addition, the Company accrues markdowns as necessary. These additional markdown accruals reflect all of the above factors as well as current agreements to return products to vendors and vendor agreements to provide markdown support. In addition to markdown provisions, the Company maintains provisions for shrinkage and damaged goods based on historical rates.

The Hat World segment employs the moving average cost method for valuing inventories and applies freight using an allocation method. The Company provides a valuation allowance for slow-moving inventory based on negative margins and estimated shrink based on historical experience and specific analysis, where appropriate.

Inherent in the analysis of both wholesale and retail inventory valuation are subjective judgments about current market conditions, fashion trends, and overall economic conditions. Failure to make appropriate conclusions regarding these factors may result in an overstatement or understatement of inventory value.

Impairment of Long-Lived Assets

The Company periodically assesses the realizability of its long-lived assets and evaluates such assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Asset impairment is determined to exist if estimated future cash flows, undiscounted and without interest charges, are less than the carrying amount. Inherent in the analysis of impairment are subjective judgments about future cash flows. Failure to make appropriate conclusions regarding these judgments may result in an overstatement or understatement of the value of long-lived assets (see Note 3).

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Genesco Inc.
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Notes to Condensed Consolidated Financial Statements
Note 1
Summary of Significant Accounting Policies, Continued
Environmental and Other Contingencies
The Company is subject to certain loss contingencies related to environmental proceedings and other legal matters, including those disclosed in Note 9 to the Company s Condensed Consolidated Financial Statements. The Company monitors these matters on an ongoing basis and, on a quarterly basis, management reviews the Company s reserves and accruals in relation to each of them, adjusting provisions as management deems necessary in view of changes in available information. Changes in estimates of liability are reported in the periods when they occur. Consequently, management believes that its reserve in relation to each proceeding is a best estimate of probable loss connected to the proceeding, or in cases in which no best estimate is possible, the minimum amount in the range of estimated losses, based upon its analysis of the facts and circumstances as of the close of the most recent fiscal quarter. However, because of uncertainties and risks inherent in litigation generally and in environmental proceedings in particular, there can be no assurance that future developments will not require additional reserves to be set aside, that some or all reserves will be adequate or that the amounts of any such additional reserves or any such inadequacy will not have a material adverse effect upon the Company s financial condition or results of operations.
Revenue Recognition
Retail sales are recorded at the point of sale and are net of estimated returns and exclude sales taxes. Catalog and internet sales are recorded at time of delivery to the customer and are net of estimated returns. Wholesale revenue is recorded net of estimated returns and allowances for markdowns, damages and miscellaneous claims when the related goods have been shipped and legal title has passed to the customer. Shipping and handling costs charged to customers are included in net sales. Estimated returns are based on historical returns and claims. Actual amounts of markdowns have not differed materially from estimates. Actual returns and claims in any future period may differ from historical experience.

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Genesco Inc.
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Notes to Condensed Consolidated Financial Statements
Note 1
Summary of Significant Accounting Policies, Continued
Income Taxes
As part of the process of preparing Condensed Consolidated Financial Statements, the Company is required to estimate its income taxes in each of the tax jurisdictions in which it operates. This process involves estimating actual current tax obligations together with assessing temporary differences resulting from differing treatment of certain items for tax and accounting purposes, such as depreciation of property and equipment and valuation of inventories. These temporary differences result in deferred tax assets and liabilities, which are included within the Condensed Consolidated Balance Sheets. The Company then assesses the likelihood that its deferred tax assets will be recovered from future taxable income. Actual results could differ from this assessment if adequate taxable income is not generated in future periods. To the extent the Company believes that recovery of an asset is at risk, valuation allowances are established. To the extent valuation allowances are established or increase the allowances in a period, the Company includes an expense within the tax provision in the Condensed Consolidated Statements of Operations. Income tax reserves are determined using the methodology established by FASB Interpretation 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement 109 (FIN 48). FIN 48, which was adopted by the Company as of February 4, 2007, requires companies to assess each income tax position taken using a two step process. A determination is first made as to whether it is more likely than not that the position will be sustained, based upon the technical merits, upon examination by the taxing authorities. If the tax position is expected to meet the more likely than not criteria, the benefit recorded for the tax position equals the largest amount that is greater than 50% likely to be realized upon ultimate settlement of the respective tax position. Uncertain tax positions require determinations and estimated liabilities to be made based on provisions of the tax law which may be subject to change or varying interpretation. If the Company s determinations and estimates prove to be inaccurate, the resulting adjustments could be material to its future financial results. See Note 6 for additional information regarding income taxes.
Postretirement Benefits Plan Accounting
Substantially all full-time employees (except employees in the Hat World segment), who also had 1,000 hours of service in Calendar 2004, are covered by a defined benefit pension plan. The Company froze the defined benefit pension plan effective January 1, 2005. The Company also provides certain former employees with limited medical and life insurance benefits. The Company funds at least the minimum amount required by the Employee Retirement Income Security Act.

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Genesco Inc.
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Notes to Condensed Consolidated Financial Statements
Note 1
Summary of Significant Accounting Policies, Continued

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS No. 158) which requires companies to recognize the overfunded or underfunded status of postretirement benefit plans as an asset or liability in its Condensed Consolidated Balance Sheets and to recognize changes in that funded status in accumulated other comprehensive loss, net of tax, in the year in which the changes occur. This statement did not change the accounting for plans required by SFAS No. 87, Employers Accounting for Pensions and it did not eliminate any of the expanded disclosures required by SFAS No. 132(R). On February 3, 2007, the Company adopted the recognition and disclosure provisions of SFAS No. 158. As a result of the adoption of SFAS No. 158, the Company recognized a $0.8 million (net of tax) cumulative adjustment in accumulated other comprehensive loss in shareholders equity for Fiscal 2007 related to the Company s post-retirement medical and life insurance benefits. SFAS No. 158 also requires companies to measure the funded status of a plan as of the date of its fiscal year end. This requirement of SFAS No. 158 is not effective for the Company until Fiscal 2009. The Company is assessing the impact the adoption of the measurement date will have on its consolidated financial position and results of operations.

The Company accounts for the defined benefit pension plans using SFAS No. 87, Employer s Accounting for Pensions (SFAS No. 87), as amended. Under SFAS No. 87, pension expense is recognized on an accrual basis over employees approximate service periods. The calculation of pension expense and the corresponding liability requires the use of a number of critical assumptions, including the expected long-term rate of return on plan assets and the assumed discount rate, as well as the recognition of actuarial gains and losses. Changes in these assumptions can result in different expense and liability amounts, and future actual experience can differ from these assumptions.

Share-Based Compensation

The Company has share-based compensation plans covering certain members of management and non-employee directors. Pursuant to SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)), adopted on the first day of Fiscal 2007, the Company recognizes compensation expense for share-based payments based on the fair value of the awards. For the second quarter and six months of Fiscal 2008 and 2007, share-based compensation and restricted stock expense was $2.0 million, $1.8 million, $4.1 million and $3.5 million, respectively. The benefits of tax deductions in excess of recognized compensation expense are reported as a financing cash flow.

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Genesco Inc.
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Notes to Condensed Consolidated Financial Statements
Note 1
Summary of Significant Accounting Policies, Continued

The Company estimates the fair value of each option award on the date of grant using a Black-Scholes option pricing model. The application of this valuation model involves assumptions that are judgmental and highly sensitive in the determination of compensation expense, including expected stock price volatility. The Company bases expected volatility on historical term structures. The Company bases the risk free rate on an interest rate for a bond with a maturity commensurate with the expected term estimate. The Company estimates the expected term of stock options using historical exercise and employee termination experience. The Company does not currently pay a dividend on common stock. The fair value of employee restricted stock is determined based on the closing price of the Company s stock on the date of the grant.

In addition to the key assumptions used in the Black-Scholes model, the estimated forfeiture rate at the time of valuation (which is based on historical experience for similar options) is a critical assumption, as it reduces expense ratably over the vesting period. Shared-based compensation expense is recorded based on a 2% expected forfeiture rate and is adjusted annually for actual forfeitures. The Company reviews the expected forfeiture rate annually to determine if that percent is still reasonable based on historical experience. The Company believes its estimates are reasonable in the context of actual (historical) experience.

The Company granted zero and 2,351 stock options for the three months and six months ended August 4, 2007, respectively, at a weighted average exercise price of $42.82 and a weighted average fair value of $16.28. There were no stock options granted for the three months and six months ended July 29, 2006. During the three months and six months ended August 4, 2007, the Company issued zero shares and 3,547 shares, respectively, of employee restricted stock which vest over a four-year term and had a grant date fair value of $42.82. There were no shares of employee restricted stock issued for the three months and six months ended July 29, 2006. For the three months and six months ended August 4, 2007 and July 29, 2006, the Company issued zero shares, 6,761 shares, zero shares and 3,022 shares, respectively, of director retainer stock at a grant date fair value of $39.62 and $37.25, respectively.

Cash and Cash Equivalents

Included in cash and cash equivalents at August 4, 2007, February 3, 2007 and July 29, 2006 are cash equivalents of $0.3 million, $0.9 million and $0.8 million, respectively. Cash equivalents are highly-liquid financial instruments having an original maturity of three months or less. The majority of payments due from banks for customer credit card transactions process within 24 48 hours and are accordingly classified as cash and cash equivalents.

At August 4, 2007, February 3, 2007 and July 29, 2006, outstanding checks drawn on zero-balance accounts at certain domestic banks exceeded book cash balances at those banks by approximately $6.3 million, $15.8 million and $27.6 million, respectively. These amounts are included in accounts payable.

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Summary of Significant Accounting Policies, Continued
Concentration of Credit Risk and Allowances on Accounts Receivable

The Company s footwear wholesaling business sells primarily to independent retailers and department stores across the United States. Receivables arising from these sales are not collateralized. Customer credit risk is affected by conditions or occurrences within the economy and the retail industry. Two customers accounted for 11% each of the Company s trade receivables balance and no other customer accounted for more than 9% of the Company s trade receivables balance as of August 4, 2007.

The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information, as well as company-specific factors. The Company also establishes allowances for sales returns, customer deductions and co-op advertising based on specific circumstances, historical trends and projected probable outcomes.

Property and Equipment

Property and equipment are recorded at cost and depreciated or amortized over the estimated useful life of related assets. Depreciation and amortization expense are computed principally by the straight-line method over the following estimated useful lives:

Buildings and building equipment	20-45 years
Computer hardware, software and equipment	3-10 years
Furniture and fixtures	10 years

Leases

Leasehold improvements and properties under capital leases are amortized on the straight-line method over the shorter of their useful lives or their related lease terms and the charge to earnings is included in selling and administrative expenses in the Condensed Consolidated Statements of Operations.

Certain leases include rent increases during the initial lease term. For these leases, the Company recognizes the related rental expense on a straight-line basis over the term of the lease (which includes any rent holidays and the pre-opening period of construction, renovation, fixturing and merchandise placement) and records the difference between the amounts charged to operations and amounts paid as a rent liability.

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The Company occasionally receives reimbursements from landlords to be used towards construction of the store the Company intends to lease. Leasehold improvements are recorded at their gross costs including items reimbursed by landlords. The reimbursements are amortized as a reduction of rent expense over the initial lease term. Tenant allowances of $24.1 million, $23.7 million and $22.0 million at August 4, 2007, February 3, 2007 and July 29, 2006, respectively, and deferred rent of $24.4 million, $22.3 million and $20.9 million at August 4, 2007, February 3, 2007 and July 29, 2006, respectively, are included in deferred rent and other long-term liabilities on the Condensed Consolidated Balance Sheets.

Goodwill and Other Intangibles

Under the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, (SFAS No. 142), goodwill and intangible assets with indefinite lives are not amortized, but tested at least annually for impairment. SFAS No. 142 also requires that intangible assets with finite lives be amortized over their respective lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144).

Intangible assets of the Company with indefinite lives are primarily goodwill and identifiable trademarks acquired in connection with the acquisition of Hat World Corporation on April 1, 2004 and Hat Shack, Inc. on January 11, 2007. The Company tests for impairment of intangible assets with an indefinite life, at a minimum on an annual basis, relying on a number of factors including operating results, business plans and projected future cash flows. The impairment test for identifiable assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying amount.

Identifiable intangible assets of the Company with finite lives are primarily leases and customer lists. They are subject to amortization based upon their estimated useful lives. Finite-lived intangible assets are evaluated for impairment using a process similar to that used to evaluate other definite-lived long-lived assets, a comparison of the fair value of the intangible asset with its carrying amount. An impairment loss is recognized for the amount by which the carrying value exceeds the fair value of the asset.

Cost of Sales

For the Company s retail operations, the cost of sales includes actual product cost, the cost of transportation to the Company s warehouses from suppliers and the cost of transportation from the Company s warehouses to the stores. Additionally, the cost of its distribution facilities allocated to its retail operations is included in cost of sales.

For the Company s wholesale operations, the cost of sales includes the actual product cost and the cost of transportation to the Company s warehouses from suppliers.

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Summary of Significant Accounting Policies, Continued

Selling and Administrative Expenses

Selling and administrative expenses include all operating costs of the Company excluding (i) those related to the transportation of products from the supplier to the warehouse, (ii) for its retail operations, those related to the transportation of products from the warehouse to the store and (iii) costs of its distribution facilities which are allocated to its retail operations. Wholesale and unallocated retail costs of distribution are included in selling and administrative expenses in the amounts of $0.8 million and $0.7 million for the second quarter of Fiscal 2008 and Fiscal 2007, respectively, and $1.5 million and $1.4 million for the first six months of Fiscal 2008 and 2007, respectively.

Gift Cards

The Company has a gift card program that began in calendar 1999 for its Hat World operations and calendar 2000 for its footwear operations. The gift cards issued to date do not expire. As such, the Company recognizes income when: (i) the gift card is redeemed by the customer; or (ii) the likelihood of the gift card being redeemed by the customer for the purchase of goods in the future is remote and there are no related escheat laws (referred to as breakage). The gift card breakage rate is based upon historical redemption patterns and income is recognized for unredeemed gift cards in proportion to those historical redemption patterns.

The Company recognized income of $0.6 million in the fourth quarter of Fiscal 2007 due to the Company s belief that it had sufficient historical information to support the recognition of gift card breakage after a review of state escheat laws in which it operates. This initial recognition of gift card breakage was included as a reduction in restructuring and other, net on the Consolidated Statements of Operations. As of February 4, 2007 gift card breakage is recognized in revenues each period.

Buying, Merchandising and Occupancy Costs

The Company records buying, merchandising and occupancy costs in selling and administrative expense. Because the Company does not include these costs in cost of sales, the Company s gross margin may not be comparable to other retailers that include these costs in the calculation of gross margin.

Shipping and Handling Costs

Shipping and handling costs related to inventory purchased from suppliers is included in the cost of inventory and is charged to cost of sales in the period that the inventory is sold. All other shipping and handling costs are charged to cost of sales in the period incurred except for wholesale and unallocated retail costs of distribution, which are included in selling and administrative expenses.

Preopening Costs

Costs associated with the opening of new stores are expensed as incurred, and are included in selling and administrative expenses on the accompanying Condensed Consolidated Statements of Operations.

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Store Closings and Exit Costs

From time to time, the Company makes strategic decisions to close stores or exit locations or activities. If stores or operating activities to be closed or exited constitute components, as defined by SFAS No. 144, and will not result in a migration of customers and cash flows, these closures will be considered discontinued operations when the related assets meet the criteria to be classified as held for sale, or at the cease-use date, whichever occurs first. The results of operations of discontinued operations are presented retroactively, net of tax, as a separate component on the Condensed Consolidated Statement of Operations, if material individually or cumulatively. To date, no store closings meeting the discontinued operations criteria have been material individually or cumulatively.

Assets related to planned store closures or other exit activities are reflected as assets held for sale and recorded at the lower of carrying value or fair value less costs to sell when the required criteria, as defined by SFAS No. 144, are satisfied. Depreciation ceases on the date that the held for sale criteria are met.

Assets related to planned store closures or other exit activities that do not meet the criteria to be classified as held for sale are evaluated for impairment in accordance with the Company s normal impairment policy, but with consideration given to revised estimates of future cash flows. In any event, the remaining depreciable useful lives are evaluated and adjusted as necessary.

Exit costs related to anticipated lease termination costs, severance benefits and other expected charges are accrued for and recognized in accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities.

Advertising Costs

Advertising costs are predominantly expensed as incurred. Advertising costs were $7.7 million and $7.2 million for the second quarter of Fiscal 2008 and 2007, respectively, and $16.3 million and $15.4 million for the first six months of Fiscal 2008 and 2007, respectively. Direct response advertising costs for catalogs are capitalized in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position No. 93-7, Reporting on Advertising Costs. Such costs are amortized over the estimated future revenues realized from such advertising, not to exceed six months. The Condensed Consolidated Balance Sheets include prepaid assets for direct response advertising costs of $1.3 million, $1.1 million and $0.9 million at August 4, 2007, February 3, 2007 and July 29, 2006, respectively.

Consideration to Resellers

The Company does not have any written buy-down programs with retailers, but the Company has provided certain retailers with markdown allowances for obsolete and slow moving products that are in the retailer s inventory. The Company estimates these allowances and provides for them as reductions to revenues at the time revenues are recorded. Markdowns are negotiated with retailers and changes are made to the estimates as agreements are reached. Actual amounts for markdowns have not differed materially from estimates.

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Note 1
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Cooperative Advertising

Cooperative advertising funds are made available to all of the Company s wholesale customers. In order for retailers to receive reimbursement under such programs, the retailer must meet specified advertising guidelines and provide appropriate documentation of expenses to be reimbursed. The Company s cooperative advertising agreements require that wholesale customers present documentation or other evidence of specific advertisements or display materials used for the Company s products by submitting the actual print advertisements presented in catalogs, newspaper inserts or other advertising circulars, or by permitting physical inspection of displays. Additionally, the Company s cooperative advertising agreements require that the amount of reimbursement requested for such advertising or materials be supported by invoices or other evidence of the actual costs incurred by the retailer. The Company accounts for these cooperative advertising costs as selling and administrative expenses, in accordance with Emerging Issues Task Force (EITF) Issue No. 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products).

Cooperative advertising costs recognized in selling and administrative expenses were $0.5 million and $0.6 million for the second quarter of Fiscal 2008 and 2007, respectively, and $1.3 million and $1.1 million for the first six months of Fiscal 2008 and 2007, respectively. During the first six months of Fiscal 2008 and 2007, the Company s cooperative advertising reimbursements paid did not exceed the fair value of the benefits received under those agreements.

Vendor Allowances

From time to time, the Company negotiates allowances from its vendors for markdowns taken or expected to be taken. These markdowns are typically negotiated on specific merchandise and for specific amounts. These specific allowances are recognized as a reduction in cost of sales in the period in which the markdowns are taken. Markdown allowances not attached to specific inventory on hand or already sold are applied to concurrent or future purchases from each respective vendor.

The Company receives support from some of its vendors in the form of reimbursements for cooperative advertising and catalog costs for the launch and promotion of certain products. The reimbursements are agreed upon with vendors and represent specific, incremental, identifiable costs incurred by the Company in selling the vendor s products. Such costs and the related reimbursements are accumulated and monitored on an individual vendor basis, pursuant to the respective cooperative advertising agreements with vendors. Such cooperative advertising reimbursements are recorded as a reduction of selling and administrative expenses in the same period in which the associated expense is incurred. If the amount of cash consideration received exceeds the costs being reimbursed, such excess amount would be recorded as a reduction of cost of sales.

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Vendor reimbursements of cooperative advertising costs recognized as a reduction of selling and administrative expenses were $1.8 million and $1.7 million for the second quarter of Fiscal 2008 and 2007, respectively, and $2.4 million and $2.3 million for the first six months of Fiscal 2008 and 2007, respectively. During the first six months of Fiscal 2008 and 2007, the Company s cooperative advertising reimbursements received were not in excess of the costs reimbursed.

Environmental Costs

Environmental expenditures relating to current operations are expensed or capitalized as appropriate. Expenditures relating to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when environmental assessments and/or remedial efforts are probable and the costs can be reasonably estimated and are evaluated independently of any future claims for recovery. Generally, the timing of these accruals coincides with completion of a feasibility study or the Company s commitment to a formal plan of action. Costs of future expenditures for environmental remediation obligations are not discounted to their present value.

Earnings Per Common Share

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities to issue common stock were exercised or converted to common stock (see Note 8).

Other Comprehensive Income

SFAS No. 130, Reporting Comprehensive Income, requires, among other things, the Company s pension liability adjustment, unrealized gains or losses on foreign currency forward contracts and foreign currency translation adjustments to be included in other comprehensive income net of tax. The cumulative adjustment to adopt SFAS No. 158 is also included in accumulated other comprehensive loss net of tax. Accumulated other comprehensive loss at August 4, 2007 consisted of $20.8 million of cumulative pension liability adjustments, net of tax, $0.8 million cumulative adjustment to adopt SFAS No. 158, net of tax, cumulative net gains of $0.3 million on foreign currency forward contracts, net of tax, and a foreign currency translation adjustment of $0.4 million.

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Summary of Significant Accounting Policies, Continued

Business Segments

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires that companies disclose operating segments based on the way management disaggregates the Company s operations for making internal operating decisions (see Note 11).

Derivative Instruments and Hedging Activities

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of SFAS No. 133, SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities and SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, (collectively SFAS No. 133) require an entity to recognize all derivatives as either assets or liabilities in the consolidated balance sheet and to measure those instruments at fair value. Under certain conditions, a derivative may be specifically designated as a fair value hedge or a cash flow hedge. The accounting for changes in the fair value of a derivative are recorded each period in current earnings or in other comprehensive income depending on the intended use of the derivative and the resulting designation.

New Accounting Principles

In March 2006, the EITF reached a consensus on EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, gross versus net presentation), (EITF No. 06-3) which allows companies to adopt a policy of presenting taxes in the income statement on either a gross or net basis. Taxes within the scope of EITF No. 06-3 would include taxes that are imposed on a revenue transaction between a seller and a customer, for example, sales taxes, use taxes, value-added taxes and some types of excise taxes. EITF No. 06-3 was adopted effective February 4, 2007. EITF No. 06-3 did not impact the method for recording and reporting these sales taxes in the Company s Consolidated Financial Statements for the three months and six months ended August 4, 2007 and will have no impact in future periods as the Company s policy is to exclude all such taxes from revenue.

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Summary of Significant Accounting Policies, Continued

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (fiscal year 2009 for the Company), and interim periods within those fiscal years. The Company is currently evaluating the impact that the adoption of SFAS No. 157 will have, if any, on its results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 allows companies to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (fiscal year 2009 for the Company). The Company is currently evaluating the impact that the adoption of SFAS No. 159 will have, if any, on its results of operations and financial position.

Note 2
Acquisitions
Hat Shack Acquisition

On January 11, 2007, Hat World acquired 100% of the outstanding stock of Hat Shack, Inc. for a purchase price of $16.6 million plus debt assumed of $2.2 million funded from cash on hand. As of August 4, 2007, there were 49 Hat Shack retail headwear stores located primarily in the southeastern United States. The Company allocated $11.4 million of the purchase price to goodwill and $3.7 million to tradenames. The goodwill related to the Hat Shack acquisition is not deductible for tax purposes.

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Note 3
Restructuring and Other Charges and Discontinued Operations
Restructuring and Other Charges
In accordance with Company policy, assets are determined to be impaired when the revised estimated future cash flows are insufficient to recover the carrying costs. Impairment charges represent the excess of the carrying value over the fair value of those assets.
Asset impairment charges are reflected as a reduction of the net carrying value of property and equipment, and in restructuring and other, net in the accompanying Condensed Consolidated Statements of Operations.
The Company recorded a pretax charge to earnings of $0.2 million ($0.1 million net of tax) in the second quarter of Fiscal 2008. The charge was primarily for retail store asset impairments offset by an excise tax refund. The Company recorded a pretax charge to earnings of $6.8 million ($4.1 million net of tax) in the first six months of Fiscal 2008. The charge included $6.7 million of charges for retail store asset impairments, primarily in the Underground Station Group, and $0.3 million for the lease termination of one Hat World store, offset by a $0.2 million excise tax refund. The asset impairments, primarily in Underground Station stores, reflected deterioration in the urban footwear market. In addition, in May of 2007, the Company announced a plan to close or convert up to 57 underperforming urban stores, including 49 Underground Station Group stores and eight Hat World stores. See Forward-Looking Statements in Management s Discussion and Analysis of Financial Condition and Results of Operations.
The Company recorded a pretax charge to earnings of $0.5 million ($0.3 million net of tax) and $0.6 million ($0.4 million net of tax) in the second quarter and first six months, respectively, of Fiscal 2007, primarily for retail store asset impairments.
Discontinued Operations
Accrued Provision for Discontinued Operations

In thousands	Facility Shutdown Costs	Other	Total
Balance January 28, 2006	$ 5,710	$ 3	$ 5,713
Additional provision Fiscal 2007	988	-0-	988
Charges and adjustments, net	(633)	(3)	(636)
Balance February 3, 2007	6,065	-0-	6,065
Additional provision Fiscal 2008	2,011	-0-	2,011
Charges and adjustments, net	(711)	-0-	(711)
Balance August 4, 2007*	7,365	-0-	7,365
Current provision for discontinued operations	5,571	-0-	5,571
Total Noncurrent Provision for Discontinued Operations	**$ 1,794**	**$ -0-**	**$ 1,794**

* Includes a $7.7 million environmental provision, including

$5.5 million in current provision, for discontinued operations.

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Note 4
Inventories

In thousands	August 4, 2007	February 3, 2007
Raw materials	**$ 199**	$ 212
Wholesale finished goods	**36,849**	29,272
Retail merchandise	**310,526**	231,553
Total Inventories	**$ 347,574**	$ 261,037

Note 5
Derivative Instruments and Hedging Activities
In order to reduce exposure to foreign currency exchange rate fluctuations in connection with inventory purchase commitments for its Johnston & Murphy division, the Company enters into foreign currency forward exchange contracts for Euros to make Euro denominated payments with a maximum hedging period of twelve months. Derivative instruments used as hedges must be effective at reducing the risk associated with the exposure being hedged. The settlement terms of the forward contracts correspond with the payment terms for the merchandise inventories. As a result, there is no hedge ineffectiveness to be reflected in earnings. The notional amount of such contracts outstanding at August 4, 2007 and February 3, 2007 was $6.4 million and $8.0 million, respectively. Forward exchange contracts have an average remaining term of approximately two months. The gain based on spot rates under these contracts at August 4, 2007 was $0.2 million and the loss based on spot rates under these contracts at February 3, 2007 was $4,000. For the six months ended August 4, 2007 and July 29, 2006, the Company recorded an unrealized gain on foreign currency forward contracts of $0.2 million and $1.4 million, respectively, in accumulated other comprehensive loss, before taxes. The Company monitors the credit quality of the major national and regional financial institutions with which it enters into such contracts.
The Company estimates that the majority of net hedging gains related to forward exchange contracts will be reclassified from accumulated other comprehensive loss into earnings through lower cost of sales over the succeeding year.

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Note 6
Accounting for Uncertainty in Income Taxes

In June 2006, the FASB issued FIN 48. This Interpretation clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes that a company should use a more-likely-than-not recognition threshold based on the technical merits of the tax position taken. Tax positions that meet the more-likely-than-not recognition threshold should be measured in order to determine the tax benefit to be recognized in the financial statements. FIN 48 is effective in fiscal years beginning after December 15, 2006.

Effective February 4, 2007, the Company adopted the provisions of FIN 48. As a result of the adoption of FIN 48, the Company recognized a $4.3 million increase in the liability for unrecognized tax benefits which, as required, was accounted for as a reduction to the February 4, 2007 balance of retained earnings. In addition, the following information required by FIN 48 is provided:

Unrecognized tax benefits were approximately $4.6 million and $8.2 million as of August 4, 2007 and February 4, 2007, respectively. Included in the unrecognized tax benefit balance was $4.6 million and $4.8 million of tax positions on August 4, 2007 and May 5, 2007, respectively, which if recognized would impact the annual effective tax rate. The change in the unrecognized tax benefit balance from February 4, 2007 to August 4, 2007, was due to the resolution of a state audit and the IRS approving the Company s filing of an application for change in accounting method. Upon approval, the Company reclassed approximately $3.4 million between unrecognized tax benefits and deferred taxes. While it is expected that the amount of unrecognized tax benefits will change in the next 12 months, we do not expect the change to have a material impact on the results of operations or the financial position of the Company.

The Company recognizes interest expense and penalties related to the above unrecognized tax benefits within income tax expense. The Company had accrued interest and penalties of approximately $1.1 million and $0.7 million, respectively, as of August 4, 2007 and approximately $1.7 million and $0.7 million, respectively, as of May 5, 2007. The approved change in accounting method described above resulted in an approximately $0.6 million decrease in accrued interest.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, many state jurisdictions and foreign jurisdictions. With a few exceptions, the Company s U.S. Federal and State and Local income tax returns for tax years 2004 and beyond remain subject to examination. In addition, the Company has subsidiaries in various foreign jurisdictions that have statutes of limitation generally ranging from three to six years.

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Note 6

Accounting for Uncertainty in Income Taxes, Continued

The provision for income taxes resulted in an effective tax rate for continuing operations of 59.6% for the first six months ended August 4, 2007, compared with an effective tax rate of 39.8% for the first six months ended July 29, 2006. The increase in the effective tax rate for the first six months of Fiscal 2008 was primarily attributable to non-deductible expenses incurred in connection with the proposed merger with a subsidiary of The Finish Line, Inc. and the accounting for uncertain tax positions (FIN 48) including but not limited to the approved change in accounting method.

Note 7

Defined Benefit Pension Plans and Other Benefit Plans

Components of Net Periodic Benefit Cost

	Pension Benefits Three Months Ended		Other Benefits Three Months Ended	
In thousands	**August 4, 2007**	July 29, 2006	**August 4, 2007**	July 29, 2006
Service cost	**$ 62**	$ 63	**$ 57**	$ 54
Interest cost	**1,612**	1,605	**52**	50
Expected return on plan assets	**(2,006)**	(1,944)	**-0-**	-0-
Amortization:				
Prior service cost	**2**	-0-	**-0-**	-0-
Losses	**1,171**	1,105	**18**	22
Net amortization	**1,173**	1,105	**18**	22
Net Periodic Benefit Cost	**$ 841**	$ 829	**$ 127**	$ 126

	Pension Benefits Six Months Ended		Other Benefits Six Months Ended	
In thousands	**August 4, 2007**	July 29, 2006	**August 4, 2007**	July 29, 2006
Service cost	**$ 125**	$ 126	**$ 114**	$ 108
Interest cost	**3,227**	3,213	**104**	100
Expected return on plan assets	**(4,012)**	(3,892)	**-0-**	-0-
Amortization:				
Prior service cost	**4**	-0-	**-0-**	-0-
Losses	**2,076**	2,270	**36**	44
Net amortization	**2,080**	2,270	**36**	44
Net Periodic Benefit Cost	**$ 1,420**	$ 1,717	**$ 254**	$ 252

While there was no cash requirement projected for the plan in 2007, the Company made a $4.0 million contribution to the Plan in March 2007.

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Note 8
Earnings Per Share

	For the Three Months Ended August 4, 2007			For the Three Months Ended July 29, 2006		
(In thousands, except per share amounts)	**Income (Numerator)**	**Shares (Denominator)**	**Per-Share Amount**	**Income (Numerator)**	**Shares (Denominator)**	**Per-Share Amount**
(Loss) earnings from continuing operations	**$ (2,940)**			$ 5,944		
Less: Preferred stock dividends	**(54)**			(64)		
Basic EPS						
(Loss) income available to common shareholders	**(2,994)**	**22,415**	**$ (.13)**	5,880	22,988	$ .26
Effect of Dilutive Securities						
Options		**-0-**			393	
Convertible preferred stock[1]	**-0-**	**-0-**		-0-	-0-	
4 1/8% Convertible Subordinated Debentures	**-0-**	**-0-**		604	3,899	
Employees preferred stock[2]		**-0-**			60	
Diluted EPS						
(Loss) income available to common shareholders plus assumed conversions	**$ (2,994)**	**22,415**	**$ (.13)**	$ 6,484	27,340	$ .24

(1) The amount of the dividend on the convertible preferred stock per common share obtainable on conversion of the convertible preferred stock is higher than

basic earnings per share for all periods presented. Therefore, conversion of the convertible preferred stock is not reflected in diluted earnings per share, because it would have been antidilutive. The shares convertible to common stock for Series 1, 3 and 4 preferred stock would have been 29,161, 30,483 and 5,440, respectively.

(2) The Company s Employees Subordinated Convertible Preferred Stock is convertible one for one to the Company s common stock. Because there are no dividends paid on this stock, these shares are assumed to be converted.

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Note 8
Earnings Per Share, Continued

	For the Six Months Ended August 4, 2007			For the Six Months Ended July 29, 2006		
(In thousands, except per share amounts)	Income (Numerator)	Shares (Denominator)	Per-Share Amount	Income (Numerator)	Shares (Denominator)	Per-Share Amount
(Loss) earnings from continuing operations	**$ (737)**			$ 16,610		
Less: Preferred stock dividends	**(118)**			(128)		
Basic EPS						
(Loss) income available to common shareholders	**(855)**	**22,403**	**$ (.04)**	16,482	23,015	$ .72
Effect of Dilutive Securities						
Options		**-0-**			414	
Convertible preferred stock[1]	**-0-**	**-0-**		-0-	-0-	
4 1/8% Convertible Subordinated Debentures	**-0-**	**-0-**		1,207	3,899	
Employees preferred stock[2]		**-0-**			60	
Diluted EPS						
(Loss) income available to common shareholders plus assumed conversions	**$ (855)**	**22,403**	**$ (.04)**	$ 17,689	27,388	$ .65

(1) The amount of the dividend on the convertible preferred stock per common share obtainable on conversion of the convertible preferred stock is higher than

basic earnings per share for all periods presented. Therefore, conversion of the convertible preferred stock is not reflected in diluted earnings per share, because it would have been antidilutive. The shares convertible to common stock for Series 1, 3 and 4 preferred stock would have been 29,161, 30,483 and 5,440, respectively.

(2) The Company s Employees Subordinated Convertible Preferred Stock is convertible one for one to the Company s common stock. Because there are no dividends paid on this stock, these shares are assumed to be converted.

The weighted shares outstanding reflects the effect of stock buy back programs. In a series of authorizations from Fiscal 1999-2003, the Company s board of directors authorized the repurchase of up to 7.5 million shares. In June 2006, the board authorized an additional $20.0 million in stock repurchases. In August 2006, the board authorized an additional $30.0 million in stock repurchases. The Company repurchased 1,062,400 shares at a cost of $32.1 million during Fiscal 2007. The Company did not repurchase any shares during the six months ended August 4, 2007. In total, the Company has repurchased 8.2 million shares at a cost of $103.4 million from all authorizations from Fiscal 1999 to August 4, 2007.

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Environmental Matters
New York State Environmental Matters
In August 1997, the New York State Department of Environmental Conservation (NYSDEC) and the Company entered into a consent order whereby the Company assumed responsibility for conducting a remedial investigation and feasibility study (RIFS) and implementing an interim remediation measure (IRM) with regard to the site of a knitting mill operated by a former subsidiary of the Company from 1965 to 1969. The Company undertook the IRM and RIFS voluntarily, without admitting liability or accepting responsibility for any future remediation of the site. The Company has concluded the IRM and the RIFS. In the course of preparing the RIFS, the Company identified remedial alternatives with estimated undiscounted costs ranging from $-0- to $24.0 million, excluding amounts previously expended or provided for by the Company, as described in this footnote. The United States Environmental Protection Agency (EPA), which has assumed primary regulatory responsibility for the site from NYSDEC, adopted a Proposed Remedial Action Plan (PRAP) in February 2007. The PRAP, which is subject to modification, recommends a combination of groundwater extraction and treatment and in-site chemical oxidation at an estimated present worth cost of approximately $10.7 million.
The Company has not ascertained what responsibility, if any, it has for any contamination in connection with the facility or what other parties may be liable in that connection and is unable to predict the extent of its liability, if any, beyond that voluntarily assumed by the consent order. The Company s voluntary assumption of certain responsibility to date was based upon its judgment that such action was preferable to litigation to determine its liability, if any, for contamination related to the site. The Company intends to continue to evaluate the costs of further voluntary remediation versus the costs and uncertainty of litigation.
As part of its analysis of whether to undertake further voluntary action, the Company has assessed various methods of preventing potential future impact of contamination from the site on two public wells that are in the expected future path of the groundwater plume from the site. The Village of Garden City has proposed the installation at the supply wells of enhanced treatment measures at an estimated cost of approximately $2.6 million, with estimated future costs of up to $2.0 million. In the third quarter of Fiscal 2005, the Company provided for the estimated cost of a remedial alternative it considers adequate to prevent such impact and which it would be willing to implement voluntarily. The Village of Garden City has also asserted that the Company is liable for historical costs of treatment at the wells totaling approximately $3.4 million. Because of evidence with regard to when contaminants from the site of the Company s former operations first reached the wells, the Company believes it should have no liability with respect to such historical costs.

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In December 2005, the EPA notified the Company that it considers the Company a potentially responsible party (PRP) with respect to contamination at two Superfund sites in New York State. The sites were used as landfills for process wastes generated by a glue manufacturer, which acquired tannery wastes from several tanners, allegedly including the Company s Whitehall tannery, for use as raw materials in the gluemaking process. The Company has no records indicating that it ever provided raw materials to the gluemaking operation and has not been able to establish whether EPA s substantive allegations are accurate. The Company has joined a joint defense group with other tannery PRP s with respect to one of the two sites. The joint defense group has developed an estimated cost of remediation for the site and proposed an allocation of liabilities among the PRP s that, if accepted, is estimated to result in liability to the Company of approximately $100,000 with respect to the site. There is no assurance that the proposed allocation will be accepted or that the actual cost of remediation will not exceed the estimate. While the Company presently cannot predict with assurance its liability, if any, with respect to the second site associated with the glue manufacturer s waste disposal, it does not presently expect that its aggregate exposure with respect to the two landfill sites will have a material adverse effect on its financial condition or results of operations.

Whitehall Environmental Matters

The Company has performed sampling and analysis of soil, sediments, surface water, groundwater and waste management areas at the Company s former Volunteer Leather Company facility in Whitehall, Michigan.

The Company has submitted to the Michigan Department of Environmental Quality (MDEQ) and provided for certain costs associated with a remedial action plan (the Plan) designed to bring the property into compliance with regulatory standards for non-industrial uses and has subsequently engaged in negotiations regarding the scope of the Plan. The Company estimates that the costs of resolving environmental contingencies related to the Whitehall property range from $4.6 million to $5.1 million, and considers the cost of implementing the Plan, as it is modified in the course of negotiations with MDEQ, to be the most likely cost within that range. Until the Plan is finally approved by MDEQ, management cannot provide assurances that no further remediation will be required or that its estimate of the range of possible costs or of the most likely cost of remediation will prove accurate.

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Accrual for Environmental Contingences
Related to all outstanding environmental contingencies, the Company had accrued $7.7 million as of August 4, 2007, $5.8 million as of February 3, 2007 and $5.5 million as of July 29, 2006. All such provisions reflect the Company s estimates of the most likely cost (undiscounted, including both current and noncurrent portions) of resolving the contingencies, based on facts and circumstances as of the time they were made. There is no assurance that relevant facts and circumstances will not change, necessitating future changes to the provisions. Such contingent liabilities are included in the liability arising from provision for discontinued operations on the accompanying Condensed Consolidated Balance Sheets.
Other Matters
California Employment Matters
On November 4, 2005, a former employee gave notice to the California Labor Work Force Development Agency (LWDA) of a claim against the Company for allegedly failing to provide a payroll check that is negotiable and payable in cash, on demand, without discount, at an established place of business in California, as required by the California Labor Code. On May 18, 2006, the same claimant filed a putative class, representative and private attorney general action alleging the same violations of the Labor Code in the Superior Court of California, Alameda County, seeking statutory penalties, damages, restitution, and injunctive relief. The Company disputes the material allegations of the complaint and will continue to defend the matter vigorously.
Tennessee Shareholder Suit
On April 24, 2007, a putative class action, *Maxine Phillips, on Behalf of Herself and All Others Similarly Situated vs. Genesco Inc., et al.,* was filed in the Tennessee Chancery Court in Nashville. The complaint alleges, among other things, that the individual defendants (officers and directors of the Company) refused to consider properly the proposal by Foot Locker, Inc. to acquire the Company. The complaint seeks class certification, a declaration that defendants have breached their fiduciary and other duties, an order requiring defendants to implement a process to obtain the highest possible price for shareholders shares, and an award of costs and attorney s fees. The defendants have not filed a response to the complaint as of the date of this report. Following the execution of the merger agreement with The Finish Line Inc. (Finish Line), plaintiff s counsel indicated, and continues to indicate, that plaintiff intends to file an amended complaint alleging breach of fiduciary duties by the individual defendants in connection with the board of directors approval of the merger agreement and the disclosures made in the preliminary proxy statement related to the merger and seeking injunctive relief. The Company and the individual defendants reached an agreement with plaintiff under which the Company agreed to include certain additional disclosures in its definitive proxy statement related to the merger which was filed on August 13, 2007. The parties are seeking to finalize and execute a Memorandum of Understanding to formalize the settlement. Under the terms of the Memorandum, the Company would pay $450,000 in attorneys fees and expenses if the settlement and payment of fees are approved by the Court and certain other conditions, including the consummation of the merger with Finish Line, Inc., occur.

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Patent Action
The Company is named as a defendant in *Paul Ware and Financial Systems Innovation, L.L.C. v. Abercrombie & Fitch Stores, Inc., et al.,* filed on June 19, 2007, in the United States District Court for the Northern District of Georgia, against more than 100 retailers. The suit alleges that the defendants have infringed U.S. Patent No. 4,707,592 by using a feature of their retail point of sale registers to generate transaction numbers for credit card purchases. The complaint seeks treble damages in an unspecified amount and attorneys fees. The Company has not yet been served with the complaint and has not reached a conclusion as to the allegations in the complaint or what, if any, liability it may have in connection with the matter.
Note 10
Proposed Merger Agreement
The Company announced in June 2007 that the boards of directors of both Genesco and Finish Line had unanimously approved a definitive merger agreement under which The Finish Line, Inc. would acquire all of the outstanding common shares of Genesco for $54.50 per share in cash. The total transaction value is approximately $1.5 billion (the Proposed Merger). The Proposed Merger is subject to customary closing conditions, including approval by Genesco shareholders. A special meeting of shareholders to consider approval of the Proposed Merger and related matters is scheduled for September 17, 2007. During t