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LANDS END INC
Form 10-Q
June 08, 2001

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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 Quarter Ended April 27, 2001

OR

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

For the transition period from to

Commission file number 1-9769

LANDS' END, INC.

(Exact name of registrant as specified in its charter)

DELAWARE 36-2512786
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

Lands' End Lane, Dodgeville, WI 53595
(Address of principal executive (Zip code)
offices)

Registrant's telephone number, 608-935-9341
including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of June 8, 2001:

Common stock, \$.01 par value 29,409,242 shares outstanding

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LANDS' END, INC. & SUBSIDIARIES
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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LANDS' END, INC. & SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Three months ended	
	April 27, 2001	April 28, 2000
	(Unaudited)	
Revenue		
Net merchandise sales	\$287,117	\$266,045
Shipping and handling revenue	24,003	19,795
Total revenue	311,120	285,840
Cost of sales		
Cost of merchandise sales	154,913	145,146
Shipping and handling costs	24,263	20,926
Total cost of sales	179,176	166,072
Gross profit	131,944	119,768
Selling, general and administrative expenses	121,438	118,448
Income from operations	10,506	1,320
Other income (expense):		
Interest expense	(233)	(130)
Interest income	636	719
Other	(1,536)	(1,445)
Total other expense, net	(1,133)	(856)
Income before income taxes	9,373	464
Income tax provision	3,515	172
Net income	\$ 5,858	\$ 292
Basic earnings per share	\$ 0.20	\$ 0.01
Diluted earnings per share	\$ 0.20	\$ 0.01
Basic weighted average shares outstanding	29,380	30,199
Diluted weighted average shares outstanding	29,620	30,835

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

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LANDS' END, INC. & SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands)

	April 27, 2001	January 26, 2001
	(unaudited)	
Assets		

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Current assets:		
Cash and cash equivalents	\$ 26,591	\$ 75,351
Receivables, net	17,140	19,808
Inventory	197,561	188,211
Prepaid advertising	20,801	17,627
Other prepaid expenses	8,947	9,715
Income taxes receivable	397	-
Deferred income tax benefits	10,973	10,973
Total current assets	282,410	321,685
Property, plant and equipment, at cost:		
Land and buildings	104,880	104,815
Fixtures and equipment	103,512	103,866
Computer hardware and software	105,334	99,979
Leasehold improvements	4,642	4,630
Construction in progress	7,461	4,289
Total property, plant and equipment	325,829	317,579
Less-accumulated depreciation and amortization	138,134	132,286
Property, plant and equipment, net	187,695	185,293
Intangibles, net	645	651
Total assets	\$470,750	\$507,629
Liabilities and shareholders' investment		
Current liabilities:		
Lines of credit	\$ 21,573	\$ 16,940
Accounts payable	67,152	96,168
Reserve for returns	7,287	9,061
Accrued liabilities	35,626	41,135
Accrued profit sharing	755	2,357
Income taxes payable	-	13,213
Total current liabilities	132,393	178,874
Deferred income taxes	17,251	14,567
Shareholders' investment:		
Common stock, 40,221 shares issued	402	402
Donated capital	8,400	8,400
Additional paid-in capital	32,358	31,908
Deferred compensation	(103)	(121)
Accumulated other comprehensive income	4,477	5,974
Retained earnings	494,945	489,087
Treasury stock, 10,834 and 10,945 shares at cost, respectively	(219,373)	(221,462)
Total shareholders' investment	321,106	314,188
Total liabilities and shareholders' investment	\$470,750	\$507,629

The accompanying notes to consolidated financial statements are an integral part of these consolidated balance sheets.

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LANDS' END, INC. & SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

Three Months Ended
April 27, April 28,
2001 2000
(unaudited)

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Cash flows from (used for) operating activities:		
Net income	\$ 5,858	\$ 292
Adjustments to reconcile net income to net cash flows from operating activities-		
Depreciation and amortization	6,235	5,990
Deferred compensation expense	18	32
Deferred income taxes	2,684	-
Tax benefit of stock options	450	1,832
Changes in current assets and liabilities:		
Receivables, net	2,668	612
Inventory	(9,350)	(16,950)
Prepaid advertising	(3,174)	(5,305)
Other prepaid expenses	768	(2,165)
Accounts payable	(29,016)	(1,872)
Reserve for returns	(1,774)	(1,855)
Accrued liabilities	(4,779)	(4,653)
Accrued profit sharing	(1,602)	(2,574)
Income taxes payable	(13,610)	(10,318)
Other	(1,497)	738
Net cash flows used for operating activities	(46,121)	(36,196)
Cash flows used for investing activities:		
Cash paid for capital additions	(9,361)	(5,042)
Net cash flows used for investing activities	(9,361)	(5,042)
Cash flows from (used for) financing activities:		
Proceeds from short-term debt	4,633	6,688
Purchases of treasury stock	(4)	(1,014)
Issuance of treasury stock	2,093	4,229
Net cash flows from financing activities	6,722	9,903
Net decrease in cash and cash equivalents	(48,760)	(31,335)
Beginning cash and cash equivalents	75,351	76,413
Ending cash and cash equivalents	\$ 26,591	\$ 45,078
Supplemental cash flow disclosures:		
Interest paid	\$ 233	\$ 130
Income taxes paid	17,000	8,748

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

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LANDS' END, INC. & SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Interim financial statements

The condensed consolidated financial statements included herein have been prepared by Lands' End, Inc. (the company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and in the opinion of management contain all adjustments (consisting primarily of normal recurring adjustments) necessary to present fairly the financial position. Certain information and footnote disclosures

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normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the company believes that the disclosures are adequate to make the information presented not misleading. The results of operations for the interim periods disclosed within this report are not necessarily indicative of future financial results. These consolidated financial statements are condensed and should be read in conjunction with the financial statements and the notes thereto included in the company's latest Annual Report on Form 10-K, which includes financial statements for the year ended January 26, 2001.

2. Reclassifications

Certain financial statement amounts have been reclassified to be consistent with the current presentation.

3. Foreign currency translations and transactions

Financial statements of the foreign subsidiaries and foreign-denominated assets are translated into U.S. dollars in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 52. Translation adjustments of the financial statements of the foreign subsidiaries are recorded in accumulated other comprehensive income, which is a component of stockholders' equity. Gains and losses resulting from the translation of other foreign-denominated assets and foreign currency transactions are recorded as other income and expense on the consolidated statements of operations. For the periods ended April 27, 2001 and April 28, 2000, losses of \$0.4 million and \$1.0 million were recorded as other expense on the consolidated statements of operations, respectively.

4. Derivative instruments and hedging activities

The company has adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," which establish accounting and reporting standards for forward contracts, options, other derivative instruments and related hedging activities. Statements No. 133 and No. 138 require, in part, that the company report all derivative instruments on the consolidated balance sheets as assets or liabilities at their fair value. The treatment of subsequent changes in fair value depends on whether hedge accounting is available. For the first quarter of fiscal 2002, a loss of \$0.3 million was recorded in other expense, compared with a loss of \$0.5 million in the first quarter of fiscal 2001.

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LANDS' END, INC. & SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The company currently has foreign exchange forward contracts and options that mitigate the company's exposure to the variability in future cash flows on forecasted transactions with the company's foreign subsidiaries. To reduce risk, the company enters into foreign currency forward contracts and put options with a maximum hedging period of 24 months. The company estimates that net-hedging gains of about \$3.5 million will be reclassified from accumulated other comprehensive income into earnings through lower cost of sales and other income and expense within the 12 months between April 28, 2001 and May 3, 2002.

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5. Earnings per share

The following table discloses the computation of diluted earnings per share and basic earnings per share.

	Three Months Ended	
(In thousands, except per share data)	April 27, 2001	April 28, 2000
Net income	\$ 5,858	\$ 292
Average shares of common stock outstanding	29,380	30,199
Incremental shares from assumed exercise of stock options	240	636
Diluted weighted average shares of common stock outstanding	29,620	30,835
Basic earnings per share	\$ 0.20	\$ 0.01
Diluted earnings per share	\$ 0.20	\$ 0.01

6. Comprehensive income

In accordance with Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income," the following table presents the company's comprehensive income.

	Three months ended	
(In thousands)	April 27, 2001	April 28, 2000
Net income	\$ 5,858	\$ 292
Other comprehensive income:		
Foreign currency translation adjustments	(619)	(671)
Unrealized gain (loss) on forward contracts and options	(878)	1,409
Comprehensive income	\$ 4,361	\$ 1,030

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LANDS' END, INC. & SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Segment disclosure

Segment net merchandise sales represent sales to external parties. Sales from the Internet, export sales shipped from the United States and liquidation sales are included in the respective business segments. Segment income before income taxes is net merchandise sales less direct and allocated operating expenses, which includes interest expense and interest income. Segment identifiable assets are those that are directly used in or identified with segment operations. "Other" includes currency gains and losses, corporate expenses, intercompany eliminations, and other income and expense items that are not allocated to segments.

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The following tables include pertinent financial data by operating segment for the quarters ended April 27, 2001 and April 28, 2000 (1).

(In thousands)	Quarter ended April 27, 2001				Consolidated
	Core	Specialty	Inter-national	Other	
Net merchandise sales	\$172,667	\$ 86,320	\$ 28,130	\$ -	\$287,117
Income (loss) before income taxes	8,568	3,671	(1,203)	(1,663)	9,373
Identifiable assets	274,260	135,084	61,406	-	470,750
Depreciation and amortization	3,787	1,865	583	-	6,235
Capital expenditures	6,201	3,054	106	-	9,361
Interest expense	21	10	202	-	233
Interest income	275	137	224	-	636

	Quarter ended April 28, 2000				Consolidated
	Core	Specialty	Inter-national	Other	
Net merchandise sales	\$160,598	\$ 79,027	\$ 26,420	\$ -	\$266,045
Income (loss) before income taxes	2,200	1,978	(1,858)	(1,856)	464
Identifiable assets	256,395	126,018	62,424	-	444,837
Depreciation and amortization	3,618	1,778	594	-	5,990
Capital expenditures	3,300	1,622	120	-	5,042
Interest expense	26	13	91	-	130
Interest income	475	233	11	-	719

(1) Fiscal 2001 has been restated to conform to fiscal 2002 presentation.

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Item 2.

Management's Discussion and Analysis

Results of Operations

Three Months Ended April 27, 2001, compared with
Three Months Ended April 28, 2000

Total revenue for the first quarter just ended was \$311.1 million, up 9 percent from \$285.8 million in the prior year's quarter. About two-thirds of the sales increase was due to a shift in the timing of a major clearance catalog and an additional issue of a Kids catalog. Growth in the core business segment was led by strength in the women's and coed divisions. A portion of this growth came from mailing the Lands' End core May catalog one week earlier than last year. In the specialty segment, the Kids division showed the strongest growth; Corporate Sales

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grew in the low-single digits, reflecting a slowdown in national business spending; and Coming Home, which features products for bed and bath, was relatively flat. All international businesses had double-digit sales increases when measured in their local currencies, and overall international sales in U.S. dollars were also improved.

Total revenue for the first 5 weeks of the current second quarter increased 4 percent compared with the similar period in the prior year.

Gross profit for the quarter just ended was \$132 million, or 42.4 percent of total revenue, compared with \$120 million, or 41.9 percent of total revenue in the prior year. Merchandise gross profit margin rose due to higher initial margins from improved sourcing.

Liquidation of excess inventory was 11 percent of net merchandise sales for the first quarter of both years. Inventory was \$198 million as of April 27, 2001, up 10 percent from \$179 million at the same time last year. Inventory is currently in line with the sales increase and with planned levels, and the quality of inventory is improved from the prior year.

For the first quarter this year, selling, general and administrative expenses were \$121 million, up 3 percent from \$118 million in the prior year. As a percentage of total revenue, SG&A was 39.0 percent, compared with 41.4 percent in the prior year. More than half of the improvement in the SG&A ratio was due to a reduction in national advertising expenses, bringing them more in line with historical levels of spending. In addition, higher sales productivity per page resulted in relatively lower catalog costs.

Net income for the quarter just ended was \$5.9 million, and diluted earnings per share were \$0.20, compared with net income of \$292 thousand, or \$0.01, for the same period last year.

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Segment results

The company has three business segments consisting of Core (regular monthly and prospecting catalogs, First Person and Lands' End for Men), Specialty (Kids, Corporate Sales, and Coming Home catalogs) and International (foreign-based operations in Japan, United Kingdom and Germany). "Other" includes currency gains and losses, corporate expenses, intercompany eliminations, and other income and deduction items that are not allocated to segments. (See Note 7.)

The core segment's net merchandise sales were \$172.7 million, representing 60.1 percent of the company's net merchandise sales and an increase of \$12.1 million from the prior year. The women's and coed divisions accounted for the strong growth in the core segment. The core segment's pretax income increased \$6.4 million from the prior year.

The specialty segment's net merchandise sales were \$86.3 million, which were 30.1 percent of the company's net merchandise sales and \$7.3 million above the prior year. This sales increase was principally from our Kids'

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division. The specialty segment's pretax income increased \$1.7 million from the prior year.

The international segment's net merchandise sales were \$28.1 million, which were 9.8 percent of total net merchandise sales and \$1.7 million above the prior year. The increase represented double-digit sales increases of all international businesses when measured in their local currencies. The international segment's pretax income improved by \$0.7 million from the prior year.

Segment net merchandise sales (1)
(Amounts in thousands)

Net Merchandise Sales	April 27, 2001		April 28, 2000	
	Amount	% of Net Sales	Amount	% of Net Sales
Core	\$172,667	60.1%	\$160,598	60.4%
Specialty	86,320	30.1%	79,027	29.7%
International	28,130	9.8%	26,420	9.9%
Total net sales	\$287,117	100.0%	\$266,045	100.0%

(1) Shipping and handling revenue is excluded.

Income (loss) before income taxes (2)
(Amounts in thousands)

	April 27, 2001		April 28, 2000	
	Amount	% of Revenue	Amount	% of Revenue
Core	\$ 8,568	2.7%	\$ 2,200	0.8%
Specialty	3,671	1.2%	1,978	0.8%
International	(1,203)	(0.4%)	(1,858)	(0.7%)
Other	(1,663)	(0.5%)	(1,856)	(0.7%)
Income before income taxes	\$ 9,373	3.0%	\$ 464	0.2%

(2) Percentages are based on total revenue.

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Seasonality of business

The company's business is highly seasonal. Historically, a disproportionate amount of the company's revenue and a majority of its profits have been realized during the fourth quarter. If the company's sales were materially different from seasonal norms during the fourth quarter, the company's annual operating results could be materially affected. In addition, as the company continues to refine its marketing efforts by experimenting with the timing of its catalog mailings, quarterly results may fluctuate. Accordingly, results for the individual quarters are not necessarily indicative of the results to be expected for the entire year.

Liquidity and capital resources

To date, the bulk of the company's working capital needs have been met through funds generated from operations and from short-term bank loans. The company's principal need for working capital has been to meet peak inventory requirements associated with its seasonal sales pattern. In addition, the company's resources have been used to make asset additions and purchase treasury stock.

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At April 27, 2001, the company had unsecured domestic credit facilities totaling \$200 million, of which the only reduction was about \$43 million of outstanding letters of credit. The company also maintains foreign credit lines for use in foreign operations totaling the equivalent of approximately \$43 million as of April 27, 2001, of which about 22 million was outstanding.

Since fiscal 1990, the company's board of directors has authorized the company from time to time to purchase a total of 14.7 million shares of treasury stock. As of June 8, 2001, 12.7 million shares have been purchased, and there is a balance of 2.0 million shares available to the company.

Capital investment

Capital expenditures for fiscal 2002 are currently planned to be between \$45 and \$50 million, of which about \$9.4 million had been expended through April 27, 2001. Major projects to date related primarily to investing in our information technology and in building our new Stevens Point, Wisconsin facility. The company believes that its cash flow from operations and borrowings under its current credit facilities will provide adequate resources to meet its capital requirements, operational needs and treasury stock purchases for the foreseeable future.

Possible future changes

A 1992 Supreme Court decision confirmed that the Commerce Clause of the United States Constitution prevents a state from requiring the collection of its use tax by a mail order company unless the company has a physical presence in the state. However, there continues to be uncertainty due to inconsistent application of the Supreme Court decision by state and federal courts. The company attempts to conduct its operations in compliance with its interpretation of the applicable legal standard, but there can be no assurance that such compliance will not be challenged.

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In recent challenges, various states have sought to require companies to begin collection of use taxes and/or pay taxes from previous sales. The company has not received assessments from any state. The amount of potential assessments, if any, can not be reasonably estimated.

The Supreme Court decision also established that Congress has the power to enact legislation that would permit states to require collection of use taxes by mail order companies. Congress has from time to time considered proposals for such legislation. The company anticipates that any legislative change, if adopted, would be applied only on a prospective basis.

In October 1998, The Internet Tax Freedom Act was signed into law. Among the provisions of this Act is a three-year moratorium on multiple and discriminatory taxes on electronic commerce. An Advisory Commission was appointed to study electronic commerce tax issues and submitted its final report to Congress on April 3, 2000. Among other recommendations, the majority of the Advisory Commission favored the extension of the moratorium for an additional five years, until 2006, and greater uniformity and simplification of the state sales and use tax systems. Following the Advisory Commission's final report, there have been several initiatives at the congressional and state levels to implement the recommendations of the Advisory Commission or otherwise adjust the current sales and use tax laws and policies. We continue to monitor this

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activity and its potential effect on the company's collection obligations.

Business Outlook

We continue to take a conservative approach to our business in light of the uncertainty in the U.S. economy, particularly in the retail environment. For fiscal 2002, a 53-week year that will end on February 1, 2002, the company expects that sales will increase in the single digit range, and we expect gross profit margin to show continued improvement compared to the prior year. As a result, we expect an increase in diluted earnings per share of at least 20 percent for the year as a whole.

As described later in our statement regarding forward-looking information, our business's profit level is sensitive to many factors, including changes in sales volume, which are difficult for us, like most retailers, to accurately predict.

Statement regarding forward-looking information

Statements in this report (including, but not limited to, Management's Discussion and Analysis) that are not historical, including, without limitation, statements regarding our plans, expectations, assumptions, and estimations for fiscal 2002, gross profit margin, and earnings, as well as anticipated sales trends and future development of our business strategy, are considered forward-looking and speak only as of today's date. As such, these statements are subject to a number of risks and uncertainties. Future results may be materially different from those expressed or implied by these statements due to a number of factors. Currently, we believe that the principal factors that create uncertainty about our future results are the following: customer response to our merchandise offerings, circulation changes and other initiatives; the mix of our sales between full price and liquidation merchandise; overall consumer confidence and general economic

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conditions, both domestic and foreign; effects of shifting patterns of e-commerce versus catalog purchases; costs associated with printing and mailing catalogs and fulfilling orders; dependence on consumer seasonal buying patterns; fluctuations in foreign currency exchange rates; and changes that may have different effects on the various sectors in which we operate (e.g., rather than individual consumers, the Corporate Sales Division, included in the specialty segment, sells to numerous corporations, and certain of these sales are for their corporate promotional activities). Our future results could, of course, be affected by other factors as well. More information about these risks and uncertainties may be found in the company's 10-K filings with the S.E.C.

The company does not undertake to publicly update or revise its forward-looking statements even if experience or future changes make it clear that any projected results expressed or implied therein will not be realized.

Item 3: Quantitative and Qualitative Disclosure About Market Risk

The company attempts to reduce its exposure to the effects of currency fluctuations on cash flows by using derivative instruments to hedge. The company is subject to foreign currency risk related to its transactions with operations in Japan, Germany and United Kingdom and with foreign third-party vendors. The company's foreign currency risk management policy is to hedge the majority of merchandise purchases by foreign operations and from foreign third-party vendors, which includes forecasted transactions, through the use of foreign exchange forward

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contracts and options to minimize this risk. The company's policy is not to speculate in derivative instruments for profit on the exchange rate price fluctuation, trade in currencies for which there are no underlying exposures or enter into trades for any currency to intentionally increase the underlying exposure. Derivative instruments used as hedges must be effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the contract.

As of April 27, 2001, the company had outstanding foreign currency forward contracts totaling about \$59 million and options totaling almost \$16 million, compared in the prior year of nearly \$49 million for foreign currency forward contracts and no option contracts outstanding.

The company is subject to the risk of fluctuating interest rates in the normal course of business, primarily as a result of its short-term borrowing and investment activities at variable interest rates. As of April 27, 2001, the company had no outstanding financial instruments related to its debt or investments.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

There are no material legal proceedings presently pending, except for routine litigation incidental to the business, to which Lands' End, Inc., is a party or of which any of its property is the subject.

Items 2 and 3 are not applicable and have been omitted.

Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Shareholders held on May 16, 2001, pursuant to the Notice of Annual Meeting of Shareholders and Proxy Statement dated April 16, 2001, the voting results were as follows:

- (a) Each of the two nominees (Gary C. Comer and Eliot Wadsworth, III) were elected to the Board of Directors as follows:

Director's name	Shares voted FOR	Shares WITHHELD
Gary C. Comer	26,812,952	1,019,568
Eliot Wadsworth, II	27,750,966	81,554

- (b) The appointment of Arthur Andersen LLP as independent public accountants for the company for the fiscal year ending February 1, 2002, was approved (27,441,137 shares voted FOR;

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376,394 shares voted AGAINST; and 14,989 shares ABSTAINED).

- (c) Shareholder proposal to commit the company to full implementation of human rights standards (as set forth in the Proxy) by its international suppliers and its own international production facilities and commit to a program of outside, independent monitoring of compliance with these standards was defeated (729,007 shares voted FOR; 23,328,692 shares voted AGAINST; and 1,356,701 shares ABSTAINED).

Item 5 is not applicable and has been omitted

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits

There were no exhibits filed as part of this report.

- (b) Reports on Form 8-K

The following report was filed on Form 8-K during the three-month period ended April 27, 2001:

Form 8-K was filed on March 27, 2001, announcing its fourth quarter performance and fiscal year 2001 results.

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SIGNATURE

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

LANDS' END, INC.

Date: June 8, 2001

By /s/ DONALD R. HUGHES
Donald R. Hughes
Senior Vice President,
and Chief Financial Officer