J JILL GROUP INC
Form 10-Q
August 11, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED JUNE 28, 2003**

OR

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

Commission file number 0-22480

The J. Jill Group, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**04-2973769**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
4 Batterymarch Park, Quincy, MA	**02169**
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: **(617) 376-4300**

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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ý No o

Shares outstanding of the registrant's common stock (par value $0.01) at August 1, 2003: 19,575,504

THE J. JILL GROUP, INC.
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FOR THE QUARTER ENDED JUNE 28, 2003

THE J. JILL GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	June 28, 2003	June 29, 2002	December 28, 2002
ASSETS			
Current assets:			
Cash and cash equivalents	$ 55,194	$ 49,335	$ 44,734
Cash held in escrow	998	805	538
Accounts receivable, net	11,483	5,900	21,317
Inventory, net	34,699	29,775	33,998
Prepaid catalog expenses	4,650	4,879	4,082
Deferred income taxes	6,331	7,202	6,149
Other current assets	6,576	4,747	5,144
Total current assets	119,931	102,643	115,962
Property and equipment, net	113,401	97,429	108,676
Other non-current assets	3,781	3,098	3,622
Total assets	$ 237,113	$ 203,170	$ 228,260

	June 28, 2003	June 29, 2002	December 28, 2002
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	$ 14,423	$ 14,264	$ 13,013
Accrued expenses	19,523	14,726	20,609
Accrued customer returns	5,663	6,422	7,328
Current portion of long-term debt	1,678	1,731	1,788
Total current liabilities	41,287	37,143	42,738
Long-term debt, less current portion	13,100	14,707	13,802
Deferred credits from landlords	27,549	18,690	24,765
Deferred income taxes	2,746	639	1,856
Commitments			
Stockholders' equity:			
Special preferred stock (par value $0.01) 1,000,000 shares authorized			
Common stock (par value $0.01) 30,000,000 shares authorized, 19,575,004, 19,301,799 and 19,495,411 shares issued and outstanding as of June 28, 2003, June 29, 2002 and December 28, 2002, respectively	196	193	195
Additional paid-in capital	107,692	103,920	107,227
Retained earnings	44,543	27,878	37,677
Total stockholders' equity	152,431	131,991	145,099
Total liabilities and stockholders' equity	$ 237,113	$ 203,170	$ 228,260

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

THE J. JILL GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002
Net sales	$ 97,365	$ 86,355	$ 179,728	$ 159,712
Cost of products and merchandising	60,744	50,913	117,552	98,849
Gross margin	36,621	35,442	62,176	60,863
Selling, general and administrative expenses	26,030	24,488	50,081	45,156
Income before interest and taxes	10,591	10,954	12,095	15,707
Interest, net	167	173	363	384

	Three Months Ended				Six Months Ended			
Income before taxes		10,424		10,781		11,732		15,323
Income tax provision		4,326		4,366		4,866		6,212
Net income	$	6,098	$	6,415	$	6,866	$	9,111
Earnings per share:								
Basic	$	0.31	$	0.34	$	0.35	$	0.49
Diluted	$	0.30	$	0.32	$	0.34	$	0.46
Weighted average shares outstanding:								
Basic		19,575		19,051		19,571		18,705
Diluted		20,100		20,153		20,044		19,879

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

THE J. JILL GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended			
	June 28, 2003		June 29, 2002	
Cash flows provided by operating activities:				
Net income	$	6,866	$	9,111
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		7,629		5,791
(Gain) loss on trust assets		(171)		53
Deferred income taxes		708		1,105
Changes in assets and liabilities:				
Decrease in accounts receivable		9,834		7,715
(Increase) decrease in inventory		(701)		2,080
Increase in prepaid catalog expenses		(568)		(296)
Increase in other assets		(720)		(925)
Increase in accounts payable		1,293		844
Increase (decrease) in accrued expenses		(814)		2,416
Decrease in accrued customer returns		(1,665)		(140)
Increase in deferred credits from landlords		2,784		4,641
Net cash provided by operating activities		24,475		32,395

	Six Months Ended	
Cash flows used in investing activities:		
Additions to property and equipment	(12,509)	(16,396)
Investment in trust assets	(700)	(1,921)
Increase in cash held in escrow	(460)	(307)
Net cash used in investing activities	(13,669)	(18,624)
Cash flows (used in) provided by financing activities:		
Borrowings under debt agreements		6,260
Payments of debt borrowings	(812)	(7,167)
Proceeds from stock transactions	466	6,319
Net cash (used in) provided by financing activities	(346)	5,412
Net increase in cash and cash equivalents	10,460	19,183
Cash and cash equivalents at:		
Beginning of period	44,734	30,152
End of period	$ 55,194	$ 49,335
Supplemental information:		
Non-cash investing activities:		
Construction costs accrued, not paid	$ 2,372	$ 1,890

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

THE J. JILL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The financial statements included herein have been prepared by The J. Jill Group, Inc. (together with its wholly owned consolidated subsidiaries, 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 of normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for the interim periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with Generally Accepted Accounting Principles ("GAAP") have been omitted pursuant to such rules and regulations. Accordingly, although the Company believes that the disclosures are adequate to make the information presented not misleading, these financial statements should be read in conjunction with the Company's consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2002 ("fiscal 2002"). As a retailer, the Company is subject to seasonal fluctuations in net sales. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

A. Nature of business:

The Company is a multi-channel specialty retailer of high quality women's apparel, accessories and footwear that markets its products through catalogs, retail stores and an e-commerce website.

B. Accounting for stock-based compensation:

At June 28, 2003, the Company had three stock-based plans, which are described in Note G to the financial statements contained in the Company's Annual Report on Form 10-K for fiscal 2002. The Company discloses stock-based compensation information in accordance with Financial Accounting Standards Board ("FASB") issued Statement No. 148 ("SFAS 148"), *"Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123"* and FASB issued Statement No. 123 ("SFAS 123"), *"Accounting for Stock-Based Compensation."* The Company has elected to continue to account for its stock-based plans under Accounting Principles Board Opinion No. 25, *"Accounting for Stock Issued to Employees"* as well as to provide disclosure of stock-based compensation as outlined in SFAS 123 as amended by SFAS 148. No compensation expense has been recognized for the Company's stock-based plans.

A reconciliation of net income, as reported, to pro forma net income including compensation expense for the Company's stock-based plans as calculated based on the fair value at the grant dates for awards made under these plans in accordance with the provisions of SFAS 123 as well as a comparison of as

reported and pro forma basic and diluted earnings per share ("EPS") follows (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002
Net income:				
As reported	$ 6,098	$ 6,415	$ 6,866	$ 9,111
Total stock-based compensation expense, net of tax	(1,361)	(999)	(2,366)	(2,115)
Pro forma	$ 4,737	$ 5,416	$ 4,500	$ 6,996
Earnings per share:				
Basic				
As reported	$ 0.31	$ 0.34	$ 0.35	$ 0.49
Pro forma	0.24	0.28	0.23	0.37
Diluted				
As reported	0.30	0.32	0.34	0.46
Pro forma	$ 0.24	$ 0.27	$ 0.22	$ 0.35

The Black-Scholes option-pricing model is used to estimate the fair value on the date of grant of each option granted. The Black-Scholes model is also used to estimate the fair value on the date of grant of the employees' purchase rights associated with the Company's amended 1998 Employee Stock Purchase Plan. The assumptions used in the estimation of the fair value of stock option grants and employee purchase right grants for the three and six months ended June 28, 2003 were made on a basis consistent with the assumptions made at December 28, 2002.

C. Debt:

The Company's credit facilities at June 28, 2003 consisted of (i) a $60,000,000 revolving credit facility (the "Revolving Credit Facility"); (ii) a $12,000,000 real estate loan (the "Tilton Facility Loan"); and (iii) a $4,100,000 equipment loan (the "Equipment Loan").

On June 26, 2003, the Company amended its Revolving Credit Facility primarily to extend its term, increase its letter of credit capacity and remove a prior borrowing restriction. The maturity date of the Revolving Credit Facility, as amended, is June 1, 2005. The amount of the Revolving Credit Facility, as amended, was increased from $50,000,000 to $60,000,000, providing the Company with an additional $10,000,000 in letter of credit capacity. Letters of credit are primarily used to procure inventory from foreign vendors. The amount available under the Revolving Credit Facility is reduced by outstanding borrowings and outstanding letters of credit. Outstanding borrowings may not exceed $20,000,000. The Revolving Credit Facility is collateralized by substantially all of the personal property, both tangible and intangible, of the Company. Outstanding borrowings bear interest at an annual rate equal to the prime lending rate announced by one of the participating banks or the LIBOR lending rate plus 1.75% per annum. At June 28, 2003, the Revolving Credit Facility bore interest at 4.00% per annum. There were no outstanding borrowings on the Revolving Credit Facility at June 28, 2003 or June 29, 2002. Outstanding letters of credit totaled $29,083,000 and

$29,825,000 at June 28, 2003 and June 29, 2002, respectively. Availability under the Revolving Credit Facility at June 28, 2003 and June 29, 2002 was $30,917,000, and $20,175,000, respectively, subject in each case to the applicable borrowing cap. Outstanding letters of credit do not bear interest. The Company is required to pay a commitment fee of 1/4 of 1% per annum on the unused portion of the Revolving Credit Facility.

The Tilton Facility Loan is collateralized by a mortgage lien on the Company's operations, fulfillment and distribution center in Tilton, New Hampshire (the "Tilton facility"). The Tilton facility is owned by Birch Pond Realty Corporation, a wholly owned subsidiary of The J. Jill Group, Inc., and leased to The J. Jill Group, Inc. Payments of principal and interest on the Tilton Facility Loan, a 10-year loan, are due monthly, based on a 20-year amortization, with a balloon payment of the remaining balance payable on April 1, 2009. The interest rate on the Tilton Facility Loan is fixed at 7.30% per annum.

The Equipment Loan is collateralized by substantially all of the Company's materials handling equipment. On May 30, 2003, the Company refinanced the promissory notes outstanding under the Equipment Loan in order to reduce the weighted average interest rate of the Equipment Loan. Payments of principal and interest on the Equipment Loan, as amended, are due monthly with a balloon payment of the remaining balance payable on June 1, 2006. The interest rate on the Equipment Loan is fixed at 5.00% per annum.

The Company's credit facilities contain various lending conditions and covenants including restrictions on permitted liens. In the case of the Revolving Credit Facility, these conditions and covenants include certain financial coverage calculations and ratios, including (i) indebtedness and outstanding letter of credit balance to tangible net worth; (ii) hard current assets to current liabilities; (iii) debt service coverage; (iv) indebtedness, outstanding letter of credit balance and net present value of operating leases to tangible net worth; (v) minimum tangible net worth; and (vi) minimum annual net profit. The manner of making these calculations and computing these ratios is defined by the provisions of the Fifth Amended and Restated Loan Agreement, as amended, which is part of the Revolving Credit Facility. The Company was in compliance with the covenants associated with its credit facilities as of and for the quarters ended June 28, 2003 and June 29, 2002.

A summary of the Company's outstanding long-term debt follows (in thousands):

	June 28, 2003	June 29, 2002	December 28, 2002
Real estate loans	$ 10,767	$ 11,099	$ 10,937
Equipment loans	3,993	5,270	4,609
Capitalized lease obligations	18	69	44
Total long-term debt	14,778	16,438	15,590
Less current maturities	(1,678)	(1,731)	(1,788)
Long-term debt, less current portion	$ 13,100	$ 14,707	$ 13,802

At June 28, 2003, the Company estimated the fair value of its outstanding borrowings, including current maturities, to be $16,773,000.

D. Earnings per share:

A reconciliation of the numerators and denominators of the basic and diluted EPS computations follows (in thousands, except per share data):

Three Months Ended		Six Months Ended	
June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002

	Three Months Ended		Six Months Ended	
Numerator:				
Net income	$ 6,098	$ 6,415	$ 6,866	$ 9,111
Denominator (shares):				
Basic weighted average shares outstanding	19,575	19,051	19,571	18,705
Assumed exercise of stock options	525	1,102	473	1,174
Diluted weighted average shares outstanding	20,100	20,153	20,044	19,879
Earnings per share:				
Basic	$ 0.31	$ 0.34	$ 0.35	$ 0.49
Diluted	$ 0.30	$ 0.32	$ 0.34	$ 0.46

For the three-month and six-month periods ending June 28, 2003, of the options then outstanding, options to purchase 1,357,000 and 1,793,500 shares of common stock, respectively were excluded from the computation of diluted EPS on the basis that such options were antidilutive. For the three-month and six-month periods ending June 29, 2002, there were no options excluded from the computation.

During the second quarter of fiscal 2003, options to purchase 264,500 shares of the Company's common stock were granted and no options were exercised pursuant to the Company's stock option plans. During the second quarter of fiscal 2002, options to purchase 669,000 shares of the Company's common stock were granted and options to purchase 704,091 shares of common stock were exercised. Also during the second quarter of fiscal 2002, the Company received $3,491,000 in cash from the exercise of stock options and recorded a related tax benefit of $2,062,000 as an increase to additional paid-in capital.

During the six months ended June 28, 2003, options to purchase 264,500 shares of the Company's common stock were granted and options to purchase 48,602 shares of common stock were exercised pursuant to the Company's stock option plans in connection with which the Company received $98,000 in cash and did not record any related tax benefit. During the six months ended June 29, 2002, options to purchase 1,060,500 shares of the Company's common stock were granted and options to purchase 1,158,695 shares of common stock were exercised. Also, during the six months ended June 29, 2002, the Company received $5,979,000 in cash from the exercise of stock options and recorded a related tax benefit of $3,624,000 as an increase to additional paid-in capital.

E. Commitments:

The Company leases certain of its facilities under non-cancelable operating leases having initial or remaining terms of more than one year. Many of the Company's leases contain scheduled increases in annual rent payments and the majority of the Company's real estate leases also require the Company to pay maintenance, insurance and real estate taxes. Additionally, certain of the Company's leases include provisions for the payment of additional rent based on a percentage of sales over an established minimum.

During the six months ended June 28, 2003, the Company entered into leases for 19 retail stores, each having terms not exceeding 10 years. At June 28, 2003, the future minimum lease payments for operating

leases having a remaining term in excess of one year at such date, including the 19 operating leases entered into during the six-month period, were as follows (in thousands):

For the remainder of fiscal 2003	$ 10,886
Fiscal 2004	22,891
Fiscal 2005	23,678
Fiscal 2006	23,963
Fiscal 2007	24,300
Thereafter	105,088

Total	$	210,806

In addition to the commitments represented in the above table, the Company enters into a number of cancelable and non-cancelable commitments during the year. Typically, these commitments are for less than a year in duration and are principally focused on the construction of new retail stores and the procurement of inventory. The Company typically commits to construction costs one to six months in advance of a new retail store opening. Preliminary commitments with the Company's private label merchandise vendors typically are made five to seven months in advance of planned receipt date. Initial merchandise commitments for branded merchandise typically are made four to six months before planned receipt date.

Most of the Company's retail store leases contain provisions that allow for early termination of the lease if certain predetermined annual sales levels are not met. Generally, these provisions allow the lease to be terminated between the third and fifth year of the lease. Should the lease be terminated under these provisions, the unamortized portion of any landlord allowances related to that property would be payable to the landlord. The unamortized portion of landlord allowances included in deferred credits from landlords at June 28, 2003 was $25,513,000. The Company is currently considering utilizing the early termination option for one of its retail stores. The unamortized portion of the landlord allowance related to this store was $78,000 at June 28, 2003. In addition, during the six months ended June 28, 2003 the Company received a $250,000 deposit from one of its vendors, which is refundable to the vendor in the event of an early termination of the contract. The Company is recognizing this deposit over the term of the contract. The unamortized portion of this deposit at June 28, 2003 was $235,000.

F. Segment information:

The Company currently has two reportable business segments, direct and retail. Each segment is separately managed and utilizes distinct distribution, marketing and inventory management strategies. The direct segment markets merchandise through catalogs and an e-commerce website. The retail segment markets merchandise through retail stores. Results from the Company's catalog outlet stores are included in the direct segment. Results from the Company's retail outlet store are included in the retail segment. Segment reporting is intended to give financial statement users a view of the Company "through the eyes of management." The Company's internal management reporting is the basis for the information disclosed for its business segments. In accordance with GAAP, the Company's internally defined measure of segment profit or loss, direct contribution, is required to be disclosed, but it is not a GAAP measure. Information related to segment direct contribution should be read in conjunction with the reconciliation to "Income before interest and taxes" as determined by GAAP.

The Company evaluates its segment profitability based on the direct contribution of each segment. Direct contribution represents each segment's net sales less direct costs related to the segment's operations. Direct costs for both segments include merchandise acquisition and control costs and

provisions for markdowns. Direct costs also include catalog costs, certain order processing costs and e-commerce selling costs for the direct segment and retail store selling, occupancy, depreciation and administrative costs for the retail segment. Direct contribution less unallocated shared-service costs and general and administrative expenses is equal to income before interest and taxes. Unallocated shared-service costs include distribution and warehousing costs as well as merchandising and product development costs. General and administrative expenses include corporate executive management costs, support service costs (e.g., shared information systems, finance and human resources) and corporate headquarters occupancy costs.

Segment assets are those that are directly used in or identified with segment operations, including inventory, fixed assets primarily related to store construction, accounts receivable and other operating assets. Unallocated assets include corporate cash and cash equivalents, the Company's corporate headquarters and distribution facility, corporate information systems, deferred tax amounts and other corporate assets. In the third quarter of fiscal 2002, the Company changed its internal segment reporting related to identifiable assets such that all inventory is now fully allocated to each operating segment. Segment information at June 29, 2002 has been presented to conform to current period presentation.

The accounting policies of the Company's segments are the same as those described in Note B to the financial statements contained in the Company's Annual Report on Form 10-K for fiscal 2002. In addition, inter-segment balances and transactions have been eliminated.

The following tables summarize financial information by segment and provide a reconciliation of segment direct contribution to income before interest and taxes (in thousands):

	Three Months Ended	Six Months Ended

	June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002
Net sales:				
Direct	$ 54,470	$ 56,010	$ 105,532	$ 107,188
Retail	43,087	30,591	74,614	53,002
Other (1)	(192)	(246)	(418)	(478)
Total net sales	$ 97,365	$ 86,355	$ 179,728	$ 159,712
Direct contribution reconciliation:				
Direct	$ 16,989	$ 18,953	$ 33,035	$ 35,367
Retail	4,672	4,462	1,498	3,607
Total direct contribution	21,661	23,415	34,533	38,974
Unallocated shared-service costs	(5,874)	(5,940)	(12,117)	(12,039)
General and administrative expenses	(5,196)	(6,521)	(10,321)	(11,228)
Income before interest and taxes	$ 10,591	$ 10,954	$ 12,095	$ 15,707

(1) Other represents certain sales allowances not specifically attributable to the direct or retail business segments.

	Direct	Retail	Unallocated Assets	Total
Identifiable assets:				