

CHARLOTTE RUSSE HOLDING INC

Form 10-Q

January 26, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED DECEMBER 30, 2006**

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

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COMMISSION FILE NUMBER 000-27677

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**CHARLOTTE RUSSE HOLDING, INC.**

(Exact Name of Registrant as Specified in Its Charter)

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

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

**4645 MORENA BOULEVARD**

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

**92117**  
(Zip Code)

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(858) 587-1500

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

The number of shares of common stock outstanding as of January 24, 2007 was 25,311,364.

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**Table of Contents****CHARLOTTE RUSSE HOLDING, INC.****CONSOLIDATED BALANCE SHEETS**

	December 30,	September 30,	December 24,
	2006	2006	2005
	(Unaudited)	(Audited)	(Unaudited)
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 116,887,735	\$ 90,229,040	\$ 59,976,780
Inventories	39,498,022	44,864,617	41,329,477
Landlord allowances receivable	3,351,310	8,183,959	4,573,444
Prepaid rent expense	9,751,966		
Other current assets	5,685,102	3,196,891	3,389,090
Deferred tax assets	6,160,000	6,010,000	7,800,000
Current assets of discontinued operations			10,594,076
Total current assets	181,334,135	152,484,507	127,662,867
Fixed assets, net	182,026,016	177,577,999	167,273,205
Goodwill	28,790,000	28,790,000	28,790,000
Other assets	698,299	666,216	524,688
Deferred tax assets	300,000		
Non-current assets of discontinued operations			24,073,036
Total assets	\$ 393,148,450	\$ 359,518,722	\$ 348,323,796
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
Current liabilities:			
Accounts payable, trade	\$ 32,046,491	\$ 24,418,975	\$ 23,268,607
Accounts payable, other	5,897,948	8,162,766	8,312,074
Accrued payroll and related expense	4,485,149	6,908,204	6,609,822
Income and sales taxes payable	13,646,267	5,648,541	7,177,584
Other current liabilities	10,464,555	10,002,442	15,718,281
Current liabilities of discontinued operations			5,846,673
Total current liabilities	66,540,410	55,140,928	66,933,041
Deferred rent	97,047,623	97,773,445	92,998,751
Other liabilities			43,894
Deferred tax liabilities		150,000	1,300,000
Non-current liabilities of discontinued operations			10,259,094
Total liabilities	163,588,033	153,064,373	171,534,780
Commitments and contingencies			
Stockholders' equity:			
Preferred stock, \$0.01 par value, 3,000,000 shares authorized, none issued and outstanding			
Common stock, \$0.01 par value, 100,000,000 shares authorized; issued and outstanding shares 25,311,364, 24,878,050 and 22,421,652 at December 30, 2006, September 30, 2006, and December 24, 2005, respectively	253,114	248,780	224,217

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Additional paid-in capital	74,103,617	64,902,477	53,340,724
Retained earnings	155,203,686	141,303,092	123,224,075
<b>Total stockholders' equity</b>	<b>229,560,417</b>	<b>206,454,349</b>	<b>176,789,016</b>
Total liabilities and stockholders' equity	\$ 393,148,450	\$ 359,518,722	\$ 348,323,796

*See accompanying notes.*

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

	Three Months Ended	
	December 30, 2006	December 24, 2005
	(13 weeks)	(13 weeks)
Net sales	\$ 209,238,850	\$ 178,495,124
Cost of goods sold, including buying, distribution and occupancy costs	149,562,875	129,504,787
Gross profit	59,675,975	48,990,337
Selling, general and administrative expenses	37,892,205	33,575,981
Operating income	21,783,770	15,414,356
Other income (expense):		
Interest income, net	1,192,419	352,617
Other charges, net		(62,506)
Total other income	1,192,419	290,111
Income from continuing operations before income taxes	22,976,189	15,704,467
Income taxes	9,075,595	6,234,673
Income from continuing operations	13,900,594	9,469,794
Loss on discontinued operations, net of tax (Note 2)		(2,410,865)
Net income	\$ 13,900,594	\$ 7,058,929
Earnings per share basic:		
Continuing operations	\$ 0.56	\$ 0.43
Discontinued operations		(0.11)
Basic	\$ 0.56	\$ 0.32
Earnings per share diluted:		
Continuing operations	\$ 0.55	\$ 0.39
Discontinued operations		(0.10)
Diluted	\$ 0.55	\$ 0.29
Weighted average shares outstanding:		
Basic	25,044,851	22,212,200
Diluted	25,371,624	24,468,064

*See accompanying notes.*

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

	Three Months Ended	
	December 30, 2006	December 24, 2005
	(13 weeks)	(13 weeks)
<b>Operating Activities</b>		
Net income	\$ 13,900,594	\$ 7,058,929
Adjustments to reconcile net income to net cash provided by operating activities of continuing operations:		
Net loss on discontinued operations		2,410,865
Depreciation and amortization	7,897,611	7,808,286
Amortization of construction allowances	(1,082,825)	(2,808,511)
Landlord construction allowances	452,888	4,140,077
Deferred rent	(95,885)	325,860
Stock based compensation	315,720	620,000
Loss on disposal of assets	147,683	153,949
Deferred income taxes	(600,000)	(490,000)
Changes in operating assets and liabilities:		
Inventories	5,366,595	3,803,930
Other current assets	(7,407,528)	3,128,437
Accounts payable, trade	7,627,516	(4,155,753)
Accounts payable, other	(2,264,818)	1,535,311
Accrued payroll and related expense	(2,423,055)	3,437,617
Income and sales taxes payable	7,997,726	4,081,774
Other current liabilities	1,584,183	5,931,266
Net cash provided by operating activities of continuing operations	31,416,405	36,982,037
Net cash used in operating activities of discontinued operations		(1,574,249)
Net cash provided by operating activities	31,416,405	35,407,788
<b>Investing Activities</b>		
Purchases of fixed assets	(13,607,292)	(10,595,535)
Other assets	(40,172)	50,994
Net cash used in investing activities of continuing operations	(13,647,464)	(10,544,541)
Net cash used in investing activities of discontinued operations		(515,808)
Net cash used in investing activities	(13,647,464)	(11,060,349)
<b>Financing Activities</b>		
Proceeds from issuance of common stock	6,772,454	1,609,853
Excess tax benefits from option exercises	2,117,300	390,000
Net cash provided by financing activities	8,889,754	1,999,853



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Net increase in cash and cash equivalents	26,658,695	26,347,292
Cash and cash equivalents at beginning of the period	90,229,040	33,629,488
Cash and cash equivalents at end of the period	\$ 116,887,735	\$ 59,976,780

*See accompanying notes.*

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**CHARLOTTE RUSSE HOLDING, INC.**

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

**1. Interim Financial Statements**

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

Due to the seasonal nature of the Company's business, the results of operations for the three month period ended December 30, 2006 are not necessarily indicative of the results of a full fiscal year.

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

**2. Discontinued Operations**

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

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

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

	<b>Three Months Ended</b>	
	<b>December 24, 2005</b>	
	<b>(13 weeks)</b>	
Net sales	\$	22,959,071
Loss from operations	\$	3,998,118
Income tax benefit		1,587,253
Net loss on discontinued operations	\$	2,410,865

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

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

**3. Stock Based Compensation***Stock Plan Activity*

Under the 1999 Equity Incentive Plan (the Plan), the Company grants stock options to purchase common stock to some of its employees and non-employee directors at prices equal to the market value of the common stock on the date of grant. Although the Plan allows for issuance of incentive stock options, stock appreciation rights, restricted stock, unrestricted stock awards, deferred stock awards and performance awards, no such awards have been granted to date. Stock options generally vest ratably over five years and expire after 10 years. Outstanding awards that were previously granted under predecessor plans also remain in effect in accordance with their terms. Stock option activity during the first three months of fiscal 2007 was as follows:

	<b>Options</b>	<b>Weighted Average Exercise Price Per Share</b>	<b>Weighted Average Remaining Term</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at September 30, 2006	1,621,700	\$ 17.61	8.0	\$ 16,110,603
Granted	11,000	28.48		
Cancelled	(37,300)	18.08		
Exercised	(427,541)	15.56		\$ 5,881,390
Outstanding at December 30, 2006	1,167,859	\$ 18.44	8.6	\$ 14,372,849

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Intrinsic value is defined as the difference between the relevant current market value of the common stock and the grant price for options with exercise prices less than the market values on such dates. Cash received from stock options exercised during the three months ended December 30, 2006 was \$6.6 million and the actual tax benefit realized from these exercises was \$2.1 million.

Options outstanding and exercisable at December 30, 2006 were as follows:

Exercise Prices	Options Outstanding Weighted					Options Exercisable Weighted			
			Weighted	Average		Average			
			Average	Exercise	Aggregate		Exercise	Aggregate	
			Remaining	Price Per	Intrinsic		Price Per	Intrinsic	
		Outstanding	Term	Share	Value	Outstanding	Share	Value	
\$10.18 \$15.00	597,359	7.9	\$ 12.48	\$ 10,912,071	71,159	\$ 12.08	\$ 1,328,444		
\$15.01 \$20.00	67,500	8.8	17.57	889,583	8,300	16.62	117,287		
\$20.01 \$25.00	36,400	7.9	22.36	305,287	15,000	21.80	134,295		
\$25.01 \$30.00	460,600	9.7	25.84	2,263,388	2,500	27.00	9,375		
\$30.01 \$30.33	6,000	9.9	30.33	2,520					
	1,167,859	8.6	\$ 18.44	\$ 14,372,849	96,959	\$ 14.36	\$ 1,589,401		

**Table of Contents****CHARLOTTE RUSSE HOLDING, INC.****Notes to Consolidated Financial Statements (Unaudited) (Continued)****3. Stock Based Compensation (continued)**

Subject to adjustments for stock splits and similar events, there were a total of 3,250,000 shares authorized under the Plan at December 30, 2006 of which 924,000 were available for future issuance. There were 195,570 shares available for future purchase under the Company's Employee Stock Purchase Plan ( ESPP ) at December 30, 2006.

**Accounting for Stock Based Compensation Expense**

Prior to the beginning of fiscal 2006, the Company did not record compensation expense for its stock based compensation plans, except for options granted just prior to the Company's initial public offering for 120,000 shares, as such treatment was permitted under the provisions of Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees*, related interpretations, and Statement of Financial Accounting Standards ( SFAS ) 123, *Accounting for Stock-Based Compensation*. The Company provided the requisite pro forma disclosures and complied with provisions of SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosures*.

Effective the beginning of fiscal 2006, the Company adopted the fair value recognition provisions of SFAS 123(R), *Share-Based Payment*, using the modified prospective transition method. Under this transition method, compensation expense includes options vesting for (1) share-based payments granted prior to, but not vested as of September 24, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; (2) share-based payments granted after September 24, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R); and (3) shares sold under the ESPP after September 24, 2005, based on calculations of fair value which are similar to how stock option valuations are made. Because this transition method was selected, results of prior periods have not been restated.

The Company recognized the following stock based compensation expense for its stock option and employee stock purchase plans as follows:

	<b>Three Months Ended</b>	
	<b>December 30, 2006</b>	<b>December 24, 2005</b>
	<b>(13 weeks)</b>	<b>(13 weeks)</b>
Cost of goods sold	\$ 53,207	\$ 200,000
Selling, general and administrative expenses	262,513	420,000
Compensation expense	315,720	620,000
Income tax benefit	124,709	246,140

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Reduction of net income	\$ 191,011	\$ 373,860
Reduction of earnings per share:		
Basic	\$ 0.01	\$ 0.01
Diluted	\$ 0.01	\$ 0.01

As of December 30, 2006, there was \$3.6 million (before any related tax benefit) of total unrecognized compensation expense related to nonvested share based compensation that is expected to be recognized over a weighted average period of 2.2 years. The fair value of shares vested during the three months ended December 30, 2006, was \$1.0 million.

**Table of Contents****CHARLOTTE RUSSE HOLDING, INC.****Notes to Consolidated Financial Statements (Unaudited) (Continued)****3. Stock Based Compensation (continued)***Calculation of Fair Value of Stock Options*

The Company estimates the fair value of stock options granted using the Black-Scholes option valuation model and a multiple option award approach. The expected life of options represents the period of time the options are expected to be outstanding and is based on historical trends and other subjective factors. The expected stock volatility is based on the average of historical volatility of the Company's common stock and other subjective factors. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time awards are granted, and the expected dividend rate takes into account the absence of any historical payments and management's intention to retain all earnings for future operations and expansion.

The following table presents the weighted average assumptions used in the pricing model for stock options granted during the following periods:

	Three Months Ended	
	December 30, 2006	December 24, 2005
	(13 weeks)	(13 weeks)
<b>Stock Options:</b>		
Expected life (years)	3.8	4.1
Expected volatility	45%	48%
Expected dividend yield	0%	0%
Risk-free interest rate	4.5%	4.3%
Fair value per option granted	\$ 9.47	\$ 6.40

**4. Net Income Per Common Share**

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

	Three Months Ended	
	December 30, 2006	December 24, 2005
	(13 weeks)	(13 weeks)
Net income from continuing operations	\$ 13,900,594	\$ 9,469,794



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Loss on discontinued operations		(2,410,865)
<b>Net income</b>	<b>\$ 13,900,594</b>	<b>\$ 7,058,929</b>
Weighted average number of shares:		
Basic	25,044,851	22,212,200
Effect of dilutive warrants		1,852,315
Effect of dilutive stock options	326,773	403,549
Diluted	25,371,624	24,468,064
Net income from continuing operations per share:		
Basic	\$ 0.56	\$ 0.43
Effect of dilutive warrants		(0.03)
Effect of dilutive stock options	(0.01)	(0.01)
Diluted	\$ 0.55	\$ 0.39

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

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

	<b>Three Months Ended</b>	
	<b>December 30, 2006</b>	<b>December 24, 2005</b>
	<b>(13 weeks)</b>	<b>(13 weeks)</b>
Anti-dilutive options and warrants	469,038	634,962

**5. Unredeemed Gift Card Income**

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

**6. Recent Accounting Pronouncements**

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

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

consolidated financial statements.

## **7. Commitments and Contingencies**

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

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

**FORWARD-LOOKING STATEMENTS**

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

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

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

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

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

	Three Months Ended	
	December 30, 2006	December 24, 2005
	(13 weeks)	(13 weeks)
Net sales	100.0%	100.0%
Cost of goods sold	71.5	72.6
Gross profit	28.5	27.4
Selling, general and administrative expenses	18.1	18.8
Operating income	10.4	8.6
Interest income, net	0.6	0.2
Other charges, net		(0.0)
Income from continuing operations before income taxes	11.0	8.8
Income taxes	4.4	3.5
Income from continuing operations	6.6	5.3
Loss on discontinued operations		(1.3)
Net income	6.6%	4.0%
Charlotte Russe stores open at end of period	392	356

**Three Months Ended December 30, 2006 Compared to the Three Months Ended December 24, 2005**

*Net Sales.* Our net sales increased to \$209.2 million from \$178.5 million, an increase of \$30.7 million, or 17.2%, over the same quarter last year. This increase reflects \$28.2 million of additional net sales from five new stores opened during the first quarter of fiscal 2007, net sales from stores opened in prior fiscal years that did not qualify as comparable stores and the impact of the 1-week shift in the fiscal calendar in 2007. Consistent with our fiscal year policy, fiscal 2006 included an extra week of business as the fiscal year end was reset at September 30, 2006. As a result, the first quarter of fiscal 2007 shifted forward to include the week between Christmas and New Year's Day; whereas, the same quarter last year ended on December 24, 2005 and did not benefit from the strong clearance selling that traditionally occurs after Christmas. The increase in net sales also benefited from a 1.5% increase in comparable store sales, adjusted to align with comparable weeks last year, which resulted in additional sales of \$2.5 million compared to the same period last year.

*Gross Profit.* Gross profit represents net sales less cost of goods sold, which includes buying, distribution and occupancy costs. Our gross profit increased to \$59.7 million from \$49.0 million, an increase of \$10.7 million, or 21.8%, over the same quarter last year. This increase in amount was primarily the result of higher net sales. As a percentage of net sales, gross profit increased to 28.5% from 27.4%, or 1.1 percentage points,

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from the same quarter last year. The increase in gross profit as a percentage of net sales was principally due to higher initial mark-up (0.9 percentage point impact), leveraging of store rent and occupancy costs as these expenses were spread over a higher average store sales volume (0.5 percentage point impact) and lower buying departmental expenses (0.2 percentage point impact). These favorable factors were partially offset by higher freight costs (0.5 percentage point impact) and higher markdown expense (0.2 percentage point impact).

*Selling, General and Administrative Expenses.* Our selling, general and administrative expenses increased to \$37.9 million from \$33.6 million, an increase of \$4.3 million, or 12.9%, over the same quarter last year. This

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increase in amount was attributable to new store expansion and increased corporate expenses, specifically higher store payroll and operating expenses and higher central office payroll and related expenses. As a percentage of net sales, selling, general and administrative expenses decreased to 18.1% from 18.8%, or 0.7 percentage points, from the same quarter last year. The decrease in expenses as a percentage of net sales was principally due to lower home office expenses (0.6 percentage point impact) and a reduction in marketing expenses (0.3 percentage point impact). These favorable factors were partially offset by higher store operating expenses (0.2 percentage point impact).

*Income Taxes.* Our effective tax rate of 40% for fiscal 2007 approximates our statutory income tax rate and is comparable to the rate utilized in the same quarter last year.

*Income from Continuing Operations.* Our income from continuing operations increased to \$13.9 million from \$9.5 million, an increase of \$4.4 million, or 46.8%, over the same quarter last year. The increase was primarily due to an increase in gross profit which was partially offset by an increase in selling, general and administrative expenses and income taxes.

*Loss on Discontinued Operations.* As a result of their disposition in fiscal 2006, our Rampage stores met the criteria to be classified as discontinued operations as defined by generally accepted accounting principles. We incurred a net loss of \$2.4 million in the first quarter of fiscal 2006. Due to the disposition of these stores prior to the beginning of fiscal 2007, no such losses were incurred in the first quarter of fiscal 2007.

**LIQUIDITY AND CAPITAL RESOURCES**

Our working capital requirements vary consistent with the seasonality of our business. Our capital requirements result primarily from capital expenditures related to new store openings and remodels. We have historically satisfied our cash requirements principally through cash flow from operations. Due to the rapid turnover of our inventory, we generate trade payables and other accrued liabilities sufficient to offset most of our working capital requirements, and this allows us to generally operate with limited working capital investment. As of December 30, 2006, we had working capital of approximately \$114.8 million which included cash and cash equivalents of \$116.9 million.

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

	Three Months Ended	
	December 30, 2006	December 24, 2005
	(13 weeks)	(13 weeks)
Net cash provided by operating activities	\$ 31,416,405	\$ 35,407,788
Net cash used in investing activities	(13,647,464)	(11,060,349)
Net cash provided by financing activities	8,889,754	1,999,853
Change in cash position	\$ 26,658,695	\$ 26,347,292

During the first quarter of fiscal 2007, our net cash provided by operations decreased \$4.0 million over the same period of the prior fiscal year due to an \$7.3 million increase in working capital primarily associated with increased prepaid rents, a \$3.7 million reduction in landlord

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construction allowances and a \$0.8 million change in other factors including stock based compensation expense and deferred rent charges during the first quarter of fiscal 2007. Offsetting these factors was a \$4.4 million increase in income from continuing operations, a \$1.8 million increase in depreciation net of construction allowance amortization, and a \$1.6 million improvement in cash provided from discontinued operations as a result of disposing of the Rampage assets. Net cash used in investing activities primarily consists of capital expenditures. It increased \$2.6 million during the first quarter of fiscal year 2007 as a result of increased capital spending associated with the opening of 5 new stores, compared



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to 14 new stores in the same period of the prior fiscal year, and funding for 15 remodeled stores, compared to 2 remodeled stores in the same period of the prior fiscal year, and increased investments in our information systems and other corporate projects. Net cash provided from financing activities primarily consists of cash and income tax benefits associated with stock option and warrant exercises offset by securities offering costs paid by us. It increased \$6.9 million in the first quarter of fiscal 2007 due to a greater number of stock option exercises during the period.

We expect to continue to invest in capital expenditures to support our growth. After taking into account new store construction, existing store remodeling and other corporate capital projects, total capital expenditures for fiscal 2007 are projected to range from approximately \$55.0 million to \$65.0 million.

We currently have a \$40.0 million secured revolving credit facility, referred to as the Credit Facility, with Bank of America, N.A., which expires on June 30, 2010. Under the terms of the Credit Facility, we may borrow up to the maximum borrowing limit of \$40.0 million less any outstanding letters of credit, and we have set the initial loan ceiling amount at \$30.0 million. Interest on the Credit Facility is payable quarterly, at our option, at either (i) the Bank's prime rate plus 0.50% to 1.00% or (ii) 1.00% to 1.50% over the average interest settlement rate for deposits in the London interbank market banks subject to certain adjustments. Our ability to receive loan advances under the Credit Facility is subject to our continued compliance with various covenants, representations and warranties, and conditions, including but not limited to negative covenants against the incurrence of debt or liens. The Credit Facility also contains events of default customary for facilities of this type and provides that, upon the occurrence of an event of default, payment of all outstanding loans may be accelerated and/or the lenders' commitments may be terminated. Pursuant to this agreement, we and our wholly-owned subsidiaries have (i) provided an unconditional guarantee of the full and punctual payment of obligations under the Credit Facility, (ii) pledged certain of our securities to the collateral agent as security for the full payment and performance of our obligations under the Credit Facility and (iii) granted a security interest in essentially all of our personal property as security for the full payment and performance of our obligations under the Credit Facility. At December 30, 2006, there was no outstanding debt under the Credit Facility and we were in compliance with the terms of the bank credit agreement. As of December 30, 2006, we had \$23.6 million of borrowing availability under the Credit Facility.

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

## **LETTERS OF CREDIT**

Pursuant to the terms of the Credit Facility, we can issue up to \$20.0 million of documentary or standby letters of credit. The outstanding commitments under the Credit Facility at December 30, 2006 totaled approximately \$3.9 million, including \$2.2 million in standby letters of credit.

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Our commitment to make future payments under long-term contractual obligations and commercial obligations as of December 30, 2006 was as follows:

	Total	Less Than			After
		1 Year	1-3 Years (in thousands)	3-5 Years	5 Years
<b>Contractual Obligations</b>					
Operating leases	\$ 443,918	\$ 67,470	\$ 133,147	\$ 115,352	\$ 127,949
Other obligations	30,284	30,284			
	\$ 474,202	\$ 97,754	\$ 133,147	\$ 115,352	\$ 127,949
<b>Commercial Obligations</b>					
Documentary letters of credit	\$ 1,705	\$ 1,705	\$	\$	\$
Standby letters of credit	2,222	2,222			
	\$ 3,927	\$ 3,927	\$	\$	\$

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

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

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

On an on-going basis, management evaluates its estimates and judgments regarding revenues, inventories, long lived assets, intangible assets, accrued liabilities, stock based compensation, self-insurance programs, income taxes and contingencies and litigation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. The

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results from this evaluation form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Under different assumptions or conditions, alternative estimates and judgments could be derived which would differ from the estimates being used by management. Actual results could differ from any or all of these estimates.

### **Revenue**

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

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

## **Inventory**

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

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

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

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

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

Based upon a review of the carrying value of the long-lived assets of the Rampage stores compared with the estimated future discounted and non-discounted cash flows from the operations of the Rampage stores, we recorded a non-cash impairment charge of \$22.5 million in the second quarter of fiscal 2006. This resulted from our unsuccessful efforts to reposition the 64 Rampage stores and the significant deterioration in financial results during the second quarter of fiscal 2006. This charge represented a write down of substantially all of the carrying value of the Rampage long-lived assets.

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We sold the lease rights, store fixtures and equipment associated with 43 Rampage store locations during the fourth quarter of fiscal 2006. Of the remaining 21 Rampage stores in operation at the beginning of the fourth quarter, we converted eight stores into Charlotte Russe locations and returned 13 properties back to their respective landlords prior to the end of fiscal 2006.

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### **Operating Leases**

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

### **Stock Based Compensation**

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

### **Self-Insurance Liabilities**

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

### **Income Taxes**

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

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

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As of December 30, 2006, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

### **RECENT ACCOUNTING PRONOUNCEMENTS**

Information with respect to recent accounting pronouncements is incorporated by reference to Note 6 to our consolidated financial statements for the period ended December 30, 2006, on page 10.

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

Our market risks relate primarily to changes in interest rates. We bear this risk in two specific ways. First, the Credit Facility carries a variable interest rate that is tied to market indices and, therefore, our statement of income and our cash flows will be exposed to changes in interest rates. As of December 30, 2006, we had no borrowings against the Credit Facility. However, we may borrow funds under the Credit Facility as needed.

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

We believe our market risk exposure is minimal.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosures Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures as such item is defined under Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 30, 2006 to provide reasonable assurance that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting**

During our first fiscal quarter ended December 30, 2006, there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.



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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

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

**RISKS RELATING TO OUR BUSINESS**

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

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

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

Our growth will largely depend on successfully opening and operating new stores. During fiscal 2006, we opened 40 new Charlotte Russe stores, closed three stores and converted eight Rampage stores into Charlotte Russe locations. This represented a 13.2% net increase from the number of Charlotte Russe stores open at the end of fiscal 2005. We intend to continue to increase our number of Charlotte Russe stores for at least the next several years.

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In order to support our planned expansion we will need to continually monitor and upgrade our management information and other systems. This expansion also will place increased demand on our managerial, operational, and administrative resources. These increased demands and operating complexities could cause us to operate our business less effectively, which in turn could cause deterioration in the financial performance of our individual stores and our company as a whole and slow our new store growth.

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

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

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

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negotiate acceptable lease terms, including desired tenant improvement allowances;

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

hire, train and retain store personnel;

successfully integrate new stores into our existing operations; and

identify and satisfy the fashion preferences of new geographic areas.

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

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

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

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

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

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

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

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

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

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

Our quarterly results of operations for our individual stores have fluctuated in the past and can be expected to continue to fluctuate in the future. For instance, our quarterly comparable store sales percentages for the

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Charlotte Russe stores have ranged as high as positive 21.0% and as low as negative 6.6% over the last nine fiscal quarters and we expect low single-digit comparable store sales percentage increases during the second quarter of fiscal 2007. Our net sales and operating results are typically lower in the second quarter of our fiscal year due to the traditional retail slowdown immediately following the winter holiday season. In addition, the calendar shift caused by having a 53<sup>rd</sup> week in fiscal 2006 had the effect of transferring the week between Christmas and New Year's Day into the first quarter of fiscal 2007, which increased our net sales in the first quarter of fiscal 2007, but will likely negatively impact our net sales during the second quarter of fiscal 2007. Our comparable store sales and quarterly results of operations are affected by a variety of factors, including:

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

fashion trends;

calendar shifts of holiday or seasonal periods;

our ability to maintain appropriate inventory levels;

changes in our merchandise mix;

timing of promotional events;

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

actions by competitors or mall anchor tenants; and

weather conditions.

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

Our success depends to a significant extent upon the continued services of our key personnel, including senior management, who are at will employees and have made a significant contribution to our business. If any of our key personnel were to leave us, such a loss could reduce future sales, increase costs or both. For example, our Chief Financial Officer has indicated he intends to resign from that position by the end of June 2007. We may be unable to hire a replacement in a timely manner. Our success in the future will also depend upon our ability to attract, train and retain talented and qualified personnel.

*The failure to efficiently complete the planned replacement of certain of our technology and information systems could negatively impact our business.*

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

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

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

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

The continued threat of terrorism, heightened security measures and military action in response to acts of terrorism has disrupted commerce and has intensified concerns regarding the United States economy. Any further

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acts of terrorism, particularly directed at malls, or new or extended hostilities may disrupt commerce and undermine consumer confidence, which could negatively impact our sales by causing mall traffic or consumer spending to decline.

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

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

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

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

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

### ***We may be liable for any defaults with respect to the leases for our recently disposed Rampage stores.***

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

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

Not applicable.

**Dividends**

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



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**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

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

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

- 10.1 Letter Agreement by and between Charlotte Russe Holding, Inc. and Daniel T. Carter dated December 5, 2006 (1)
- 10.2 First Amendment to Amended and Restated Employment Agreement by and between Charlotte Russe Holding, Inc. and Bernard Zeichner dated December 21, 2006 (2)
- 10.3 Charlotte Russe Holding, Inc. 1999 Equity Incentive Plan
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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- (1) Filed as Exhibit 10.1 to our Current Report on Form 8-K filed December 6, 2006.
  - (2) Filed as Exhibit 10.1 to our Current Report on Form 8-K filed December 22, 2006.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this quarterly report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Diego, State of California, on the 26<sup>th</sup> day of January, 2007.

CHARLOTTE RUSSE HOLDING, INC.

By: /s/ DANIEL T. CARTER  
**Daniel T. Carter**

**Executive Vice President and**

**Chief Financial Officer**