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CHARMING SHOPPES INC

Form 10-Q

August 30, 2004

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 31, 2004

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 000-07258

CHARMING SHOPPES, INC.  
-----

(Exact name of registrant as specified in its charter)

PENNSYLVANIA  
-----

(State or other jurisdiction of  
incorporation or organization)

23-1721355  
-----

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

450 WINKS LANE, BENSALEM, PA  
-----

(Address of principal executive offices)

19020  
-----

(Zip Code)

(215) 245-9100  
-----

(Registrant's telephone number, including Area Code)

NOT APPLICABLE  
-----

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

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

Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer  
(as defined in Rule 12b-2 of the Exchange Act).

Yes ☒ No ☐

The number of shares outstanding of the issuer's Common Stock (par

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value \$.10 per share), as of August 24, 2004, was 118,078,888 shares.

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

#### CHARMING SHOPPES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share amounts)	July 31, 2004 ----	January 3 2004 ----
	(Unaudited)	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents .....	\$ 223,856	\$ 123,781
Available-for-sale securities .....	66,438	55,688
Merchandise inventories .....	307,244	309,995
Deferred taxes .....	19,820	19,902
Prepayments and other .....	79,447	57,494
	-----	-----
Total current assets .....	696,805	566,860
	-----	-----
Property, equipment, and leasehold improvements - at cost .....	725,682	705,257
Less accumulated depreciation and amortization .....	415,626	386,633
	-----	-----
Net property, equipment, and leasehold improvements .....	310,056	318,624
	-----	-----
Trademarks and other intangible assets .....	170,148	170,478
Goodwill .....	66,956	66,956
Available-for-sale securities .....	5,249	14,521
Other assets .....	31,361	27,440
	-----	-----
Total assets .....	\$ 1,280,575	\$ 1,164,879
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable .....	\$ 163,195	\$ 135,777
Accrued expenses .....	138,254	138,166
Income taxes payable .....	8,238	1,128
Current portion - long-term debt .....	22,828	17,278
Accrued expenses related to cost reduction plan .....	2,455	2,596

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Total current liabilities .....	334,970	294,945
Deferred taxes and other non-current liabilities .....	62,704	62,030
Long-term debt .....	194,177	202,819
Stockholders' equity		
Common Stock \$.10 par value:		
Authorized - 300,000,000 shares		
Issued - 130,344,247 shares and 125,526,573 shares, respectively	13,034	12,553
Additional paid-in capital .....	235,291	201,798
Treasury stock at cost - 12,265,993 shares .....	(84,136)	(84,136)
Deferred employee compensation .....	(7,810)	(2,539)
Accumulated other comprehensive loss .....	(95)	(365)
Retained earnings .....	532,440	477,774
Total stockholders' equity .....	688,724	605,085
Total liabilities and stockholders' equity .....	\$ 1,280,575	\$ 1,164,879

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## CHARMING SHOPPES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (Unaudited)

	Thirteen Weeks Ended	
	July 31,	August 2,
(In thousands, except per share amounts)	2004	2003
Net sales .....	\$ 611,737	\$ 605,456
Cost of goods sold, buying, and occupancy expenses .....	430,028	428,425
Selling, general, and administrative expenses .....	133,361	136,899
Expenses related to cost reduction plan .....	0	6,389
Total operating expenses .....	563,389	571,713
Income from operations .....	48,348	33,743
Other income, principally interest .....	415	540
Interest expense .....	(3,880)	(3,849)
Income before income taxes and minority interest .....	44,883	30,434

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Income tax provision .....	17,145	11,838
	-----	-----
Income before minority interest .....	27,738	18,596
Minority interest in net loss of consolidated subsidiary .....	0	49
	-----	-----
Net income .....	27,738	18,645
	-----	-----
Other comprehensive income, net of tax:		
Unrealized gains on available-for-sale securities, net of income taxes of \$76 and \$13, respectively .....	142	20
Reclassification of amortization of deferred loss on termination of derivative, net of income taxes of \$23 and \$46, respectively ..	43	85
	-----	-----
Total other comprehensive income, net of taxes .....	185	105
	-----	-----
Comprehensive income .....	\$ 27,923	\$ 18,750
	=====	=====
Basic net income per share .....	\$ .24	\$ .17
	=====	=====
Diluted net income per share .....	\$ .22	\$ .15
	=====	=====

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## CHARMING SHOPPES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (Unaudited)

	Twenty-six Weeks E	
	July 31,	August
(In thousands, except per share amounts)	2004	200
	----	----
Net sales .....	\$ 1,204,475	\$ 1,16
	-----	-----
Cost of goods sold, buying, and occupancy expenses .....	830,415	82
Selling, general, and administrative expenses .....	282,211	28
Expenses related to cost reduction plan .....	0	1
	-----	-----
Total operating expenses .....	1,112,626	1,11
	-----	-----
Income from operations .....	91,849	5

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Other income, principally interest .....	809	
Interest expense .....	(7,763)	(
	-----	-----
Income before income taxes and minority interest .....	84,895	4
Income tax provision .....	30,229	1
	-----	-----
Income before minority interest .....	54,666	2
Minority interest in net loss of consolidated subsidiary .....	0	
	-----	-----
Net income .....	54,666	2
	-----	-----
Other comprehensive income, net of tax:		
Unrealized gains (losses) on available-for-sale securities, net of income tax (provision) benefit of \$(97) and \$11, respectively .....	153	
Reclassification of amortization of deferred loss on termination of derivative, net of income taxes of \$(63) and \$(92), respectively ....	117	
	-----	-----
Total other comprehensive income, net of taxes .....	270	
	-----	-----
Comprehensive income .....	\$ 54,936	\$ 2
	=====	=====
Basic net income per share .....	\$ .48	\$
	=====	=====
Diluted net income per share .....	\$ .43	\$
	=====	=====

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## CHARMING SHOPPES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)	Twenty-six Weeks Ended	
	July 31, 2004 ----	August 2, 2003 ----
Operating activities		
Net income .....	\$ 54,666	\$ 28,334
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization .....	34,383	39,226
Tax benefit related to stock plans .....	4,187	0

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Deferred income taxes .....	(236)	2,240
Loss from disposition of capital assets .....	422	1,342
Other, net .....	185	(133)
Changes in operating assets and liabilities:		
Merchandise inventories .....	2,751	(20,580)
Accounts payable .....	27,418	36,061
Prepayments and other .....	(21,953)	(2,873)
Accrued expenses and other .....	920	(15,286)
Income taxes payable .....	7,110	2,415
Accrued expenses related to cost reduction plan .....	(141)	3,678
	-----	-----
Net cash provided by operating activities .....	109,712	74,424
	-----	-----
Investing activities		
Investment in capital assets .....	(19,397)	(25,914)
Proceeds from sales of available-for-sale securities .....	20,494	19,735
Gross purchases of available-for-sale securities .....	(21,907)	(21,507)
Increase in other assets .....	(3,734)	(3,144)
	-----	-----
Net cash used in investing activities .....	(24,544)	(30,830)
	-----	-----
Financing activities		
Proceeds from short-term borrowings .....	94,706	111,069
Repayments of short-term borrowings .....	(94,706)	(111,069)
Proceeds from long-term borrowings .....	98	1,050
Repayments of long-term borrowings .....	(8,589)	(7,172)
Proceeds from issuance of common stock .....	23,398	376
	-----	-----
Net cash provided by (used in) financing activities ..	14,907	(5,746)
	-----	-----
Increase in cash and cash equivalents .....	100,075	37,848
Cash and cash equivalents, beginning of period .....	123,781	102,026
	-----	-----
Cash and cash equivalents, end of period .....	\$ 223,856	\$ 139,874
	=====	=====
Non-cash financing and investing activities		
Equipment acquired through capital leases .....	\$ 5,399	\$ 9,210
	=====	=====

## CHARMING SHOPPES, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### Note 1. Condensed Consolidated Financial Statements

We have prepared our condensed consolidated balance sheet as of July 31, 2004, and our condensed consolidated statements of operations and comprehensive income and cash flows for the thirteen weeks and twenty-six weeks

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ended July 31, 2004 and August 2, 2003, without audit. In our opinion, we have made all adjustments (which include only normal recurring adjustments) necessary to present fairly our financial position at July 31, 2004, and the results of our operations and cash flows for the thirteen weeks and twenty-six weeks ended July 31, 2004 and August 2, 2003. We have condensed or omitted certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States. These financial statements and related notes should be read in conjunction with our financial statements and related notes included in our January 31, 2004 Annual Report on Form 10-K. The results of operations for the thirteen weeks and twenty-six weeks ended July 31, 2004 and August 2, 2003 are not necessarily indicative of operating results for the full fiscal year.

As used in these notes, the terms "Fiscal 2005" and "Fiscal 2004" refer to our fiscal year ending January 29, 2005 and our fiscal year ended January 31, 2004, respectively. The terms "Fiscal 2005 Second Quarter" and "Fiscal 2004 Second Quarter" refer to the thirteen weeks ended July 31, 2004 and August 2, 2003, respectively. The terms "Fiscal 2005 First Quarter" and "Fiscal 2004 First Quarter" refer to the thirteen weeks ended May 1, 2004 and May 3, 2003, respectively. The term "Fiscal 2004 Third Quarter" refers to the thirteen weeks ended October 1, 2003. The terms "the Company," "we," "us," and "our" refer to Charming Shoppes, Inc. and, where applicable, its consolidated subsidiaries.

We account for cash consideration received from vendors in accordance with the provisions of EITF Issue 02-16, "Accounting by a Customer (Including a Reseller) for Cash Consideration Received from a Vendor." For interim reporting, we generally defer markdown allowances and recognize them in the period in which markdown expenses are recognized. Inasmuch as the markdown allowances at the date of purchase are intended to compensate us for future markdowns taken at the time of sale, we defer the recognition of markdown allowances during the interim periods in order to better match the recognition of markdown allowances to the period the related markdown expenses are recorded.

We account for stock-based compensation using the intrinsic value method, in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and its related interpretations. We amortize deferred compensation expense attributable to stock awards and stock options having an exercise price less than the market price on the date of grant on a straight-line basis over the vesting period of the award or option. We do not recognize compensation expense for options having an exercise price equal to the market price on the date of grant or for shares purchased under our Employee Stock Purchase Plan.

### CHARMING SHOPPES, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) (Unaudited)

#### Note 1. Condensed Consolidated Financial Statements (Continued)

The following table reconciles net income and net income per share as reported, using the intrinsic value method under APB No. 25, to pro forma net income and net income per share using the fair value method under Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards



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("SFAS") No. 123, "Accounting for Stock-based Compensation":

(In thousands, except per share amounts)	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 31, 2004 ----	August 2, 2003 ----	July 31, 2004 ----	August 2, 2003 ----
Net income as reported .....	\$ 27,738	\$ 18,645	\$ 54,666	\$ 28,334
Add stock-based employee compensation using intrinsic value method, net of income taxes .....	377	230	764	500
Less stock-based employee compensation using fair value method, net of income taxes .....	(956)	(695)	(1,797)	(1,684)
Pro forma net income .....	<u>\$ 27,159</u>	<u>\$ 18,180</u>	<u>\$ 53,633</u>	<u>\$ 27,150</u>
Basic net income per share:				
As reported .....	\$ .24	\$ .17	\$ .48	\$ .25
Pro forma .....	.23	.16	.47	.24
Diluted net income per share:				
As reported .....	.22	.15	.43	.24
Pro forma .....	.21	.15	.42	.23

## Note 2. Trademarks and Other Intangible Assets

(In thousands)	July 31, 2004 ----	January 31, 2004 ----
Trademarks, tradenames, and internet domain names .	\$168,800	\$168,800
Customer lists and covenant not to compete .....	3,300	3,300
Total at cost .....	<u>172,100</u>	<u>172,100</u>
Less accumulated amortization of customer lists and covenant not to compete .....	1,952	1,622
Net trademarks and other intangible assets .....	<u>\$170,148</u>	<u>\$170,478</u>

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## Note 3. Long-term Debt

(In thousands)	July 31, 2004 ----	January 31, 2004 ----
4.75% Senior Convertible Notes due 2012	\$150,000	\$150,000
Capital lease obligations .....	36,577	37,934
6.53% mortgage note .....	11,550	12,250
7.77% mortgage note .....	9,806	10,039
7.5% mortgage note .....	5,725	5,840
8.15% note .....	1,827	2,494
Other long-term debt .....	1,520	1,540
	-----	-----
Total long-term debt .....	217,005	220,097
Less current portion .....	22,828	17,278
	-----	-----
Long-term debt .....	\$194,177	\$202,819
	=====	=====

## Note 4. Stockholders' Equity

(Dollars in thousands)	Twenty-six Weeks Ended July 31, 2004 ----
Total stockholders' equity, beginning of period .....	\$605,085
Net income .....	54,666
Issuance of common stock (4,817,674 shares) .....	23,398
Tax benefit related to stock plans .....	4,187
Amortization of deferred compensation expense .....	1,118
Amortization of deferred loss on termination of derivative, net of tax	117
Unrealized gains on available-for-sale securities, net of tax .....	153
	-----
Total stockholders' equity, end of period .....	\$688,724
	=====

## Note 5. Customer Loyalty Card Programs

We offer our customers various loyalty card programs. Customers that join these programs are entitled to various benefits, including discounts and rebates on purchases during the membership period. Customers generally join these programs by paying an annual membership fee. We recognize revenue from these loyalty programs as sales over the life of the membership period based on when the customer earns the benefits and when the fee is no longer refundable. We recognize costs we incur in connection with administering these programs as cost of goods sold when incurred.

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### CHARMING SHOPPES, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) (Unaudited)

#### Note 5. Customer Loyalty Card Programs (Continued)

During the Fiscal 2004 First Quarter, we introduced a new FASHION BUG(R) customer loyalty card program that we operate under our FASHION BUG proprietary credit card program. Like our other loyalty programs, this program entitles customers to various rebates, discounts, and other benefits upon payment of an annual membership fee. This program also provides customers with the option to cancel their membership within 90 days, entitling them to a full refund of their annual fee. Additionally, after 90 days, customers that cancel their membership are entitled to a pro rata fee refund based on the number of months remaining on the annual membership. Accordingly, we recognize 25% of the annual membership fee as revenue after 90 days, with the remaining fee recognized on a pro rata basis over nine months. During the thirteen weeks and twenty-six weeks ended July 31, 2004, we recognized revenues of \$2,290,000 and \$3,705,000, respectively, in connection with this program. During the thirteen weeks and twenty-six weeks ended August 2, 2003, we recognized revenues of \$2,791,000 in connection with this program. No revenues were recognized during the Fiscal 2004 First Quarter. As of July 31, 2004 and January 31, 2004, we accrued \$700,000 and \$1,200,000, respectively, for the estimated costs of discounts earned and coupons issued and not redeemed.

Under a previous FASHION BUG store loyalty card program, we recognized revenues from annual membership fees as sales over the life of the membership based on discounts earned by the customer. For customers who did not earn discounts during the membership period that exceeded the card fee, the difference between the membership fee and discounts earned was recognized as revenue upon the expiration of the annual membership period. Upon early cancellation of the loyalty card, refunds of membership fees were reduced by the amount of any discounts granted to the member under the program. During the thirteen weeks and twenty-six weeks ended August 2, 2003, we recognized revenues of \$2,135,000 and \$6,308,000, respectively, in connection with this program. We discontinued the issuance of new cards under this program in December 2002, and we terminated the program during the Fiscal 2004 Second Quarter. Our CATHERINES(R) brand currently offers a similar loyalty program. During the thirteen weeks and twenty-six weeks ended July 31, 2004, we recognized revenues of \$1,892,000 and \$3,741,000, respectively, in connection with this program. During the thirteen weeks and twenty-six weeks ended August 2, 2003, we recognized revenues of \$1,903,000 and \$3,806,000, respectively in connection with this program.

#### Note 6. Expenses Related to Cost Reduction Plan

On March 18, 2003, we announced a cost reduction plan, designed to take advantage of the centralization of all corporate administrative services throughout the Company and to realize certain efficiencies, in order to improve profitability. We accounted for the plan in accordance with the provisions of SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The total costs recognized during Fiscal 2004 related to this plan were \$11,534,000, with \$4,431,000 of the costs recognized during the Fiscal 2004 First Quarter and \$6,389,000 of the costs recognized during the Fiscal 2004 Second Quarter.

CHARMING SHOPPES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(Unaudited)

Note 6. Expenses Related to Cost Reduction Plan (Continued)

Costs incurred during the thirteen weeks and twenty-six weeks ended August 2, 2003 consisted of the following:

(In thousands)	Thirteen Weeks Ended August 2, 2003 ----	Twenty-six Weeks Ended August 2, 2003 ----
Workforce reduction costs .....	\$ 650	\$ 3,059
Lease termination and related costs .....	3,139	3,440
Acceleration of depreciation of property, equipment, and leasehold improvements	2,340	3,703
Other facility closure costs .....	260	618
	-----	-----
Total costs .....	\$ 6,389 =====	\$10,820 =====

Workforce reduction costs represent involuntary termination benefits and retention bonuses. Employees affected by the plan were notified during the Fiscal 2004 First Quarter. During the Fiscal 2004 First Quarter, we terminated 118 employees at our corporate and divisional home offices. During the Fiscal 2004 Second Quarter, we terminated 231 employees in connection with the closing of our Memphis, Tennessee distribution center, our Hollywood, Florida credit operations, and our remaining Monsoon(R) stores. We accrued the severance benefit in accordance with SFAS No. 146 and recognized retention bonuses ratably over the employees' remaining service period. Lease termination and related costs mainly represent the estimated fair value of the remaining lease obligations at our Hollywood, Florida credit facility, reduced by estimated sublease income. We recognized the present value of the remaining lease obligations, less sublease income, related to the Hollywood facility in June 2003 when we closed the facility.

Accelerated depreciation costs mainly represent the acceleration of depreciation of the net book value of the assets at our Memphis, Tennessee distribution center and our Hollywood, Florida credit facility, which we closed in June 2003, to their estimated fair values. During the Fiscal 2004 First Quarter, we made the decision to sell our Memphis, Tennessee distribution center, and began accelerating the depreciation of the asset to its estimated net realizable value as of its expected cease-use date of June 2003. During the Fiscal 2004 Third Quarter, we began to evaluate alternative uses for the facility, and began to depreciate the then-current carrying amount of the asset over its estimated useful life.

As of July 31, 2004 and January 31, 2004, there were \$2,455,000 and \$2,596,000, respectively, of accrued lease termination costs related to the

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closing of the Hollywood facility.

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## CHARMING SHOPPES, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) (Unaudited)

### Note 7. Net Income Per Share

(In thousands)	Thirteen Weeks Ended July 31, 2004 ----	August 2, 2003 ----	Twenty-six Weeks Ended July 31, 2004 ----	August 2003 ----
Basic weighted average common shares outstanding .....	115,908	112,421	114,603	112,39
Dilutive effect of assumed conversion of convertible notes .....	15,182	15,182	15,182	15,18
Dilutive effect of stock options and awards .....	1,913	807	1,908	49
	-----	-----	-----	-----
Diluted weighted average common shares and equivalents outstanding .....	133,003	128,410	131,693	128,06
	=====	=====	=====	=====
Net income .....	\$ 27,738	\$ 18,645	\$ 54,666	\$ 28,33
Decrease in interest expense from assumed conversion of notes, net of income taxes .....	1,135	1,062	2,269	2,16
	-----	-----	-----	-----
Net income used to determine diluted net income per share .....	\$ 28,873	\$ 19,707	\$ 56,935	\$ 30,49
	=====	=====	=====	=====
Options with weighted average exercise price greater than market price, excluded from computation of net income per share: Number of shares (in thousands) .....	424	8,430	428	10,34
Weighted average exercise price per share .....	\$ 8.24	\$ 6.44	\$ 8.29	\$ 6.1

### Note 8. Income Taxes

The effective income tax rate was 35.6% for the twenty-six weeks ended July 31, 2004, as compared to 38.9% for the twenty-six weeks ended August 2, 2003. The lower effective tax rate for the twenty-six weeks ended July 31, 2004 is primarily the result of finalizing certain prior year tax audits. The tax rate for the twenty-six weeks ended August 2, 2003 was affected by a provision for taxes related to one of our insurance programs, which we settled with the Internal Revenue Service during the second half of Fiscal 2004.

CHARMING SHOPPES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(Unaudited)

Note 9. Impact of Recent Accounting Pronouncements

In January 2003, the FASB issued Financial Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities," an interpretation of Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements." A variable interest entity ("VIE") is a corporation, trust, partnership, or other legal entity used for business purposes that either does not have equity investors with substantive voting rights or has equity investors that do not provide sufficient financial resources for the entity to finance its activities without additional subordinated financial support from other parties. Consolidation of a VIE by a variable interest holder is required if the variable interest holder is subject to a majority of the VIE's risk of loss, is entitled to receive a majority of the VIE's residual returns, or both. The variable interest holder that consolidates the VIE is the primary beneficiary. FIN No. 46 also requires that the primary beneficiary and all other enterprises with a significant variable interest in a VIE provide certain additional disclosures. FIN No. 46 provides certain exceptions to these rules, including qualifying special purpose entities ("QSPEs") subject to the requirements of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities."

FIN No. 46 is effective for all VIEs created after January 31, 2003. The disclosure provisions of FIN No. 46 apply to financial statements issued after January 31, 2003, regardless of when the VIE was established. For VIEs created before February 1, 2003, the consolidation provisions of FIN No. 46, as originally issued, were to be applied in the first interim or annual reporting period beginning after June 15, 2003. In October 2003, the FASB postponed the implementation date for VIEs created before February 1, 2003 to the first interim or annual period ending after December 15, 2003, provided that the reporting entity has not issued financial statements reporting the VIE in accordance with FIN No. 46. In December 2003, the FASB revised FIN No. 46 to delay the required implementation date for entities that are not special purpose entities ("SPEs"), such as equity method investments in operating companies. Adoption of FIN No. 46 did not have a material impact on our financial position or results of operations.

Note 10. Subsequent Event

On August 5, 2004, in connection with our asset securitization program, the Charming Shoppes Master Trust (the "Trust") issued \$180,000,000 of new five-year asset-backed certificates ("Series 2004-1") in a private placement under Rule 144A. Of the \$180,000,000 of certificates issued, \$161,100,000 were sold to investors and we held \$18,900,000 as a retained interest. The certificates pay interest to investors on a floating-rate basis tied to one-month LIBOR. Concurrently, the Trust entered into a series of fixed-rate interest rate hedge agreements with respect to the \$161,100,000 of certificates sold to investors. The blended weighted-average interest rate on the hedged certificates is 4.90%. On August 5, 2004, the Trust used \$61,500,000 of the proceeds to pay down other securitization series and placed the remaining proceeds of \$118,500,000 into a pre-funding cash account. This pre-funding cash

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account will replace Series 1999-1 (which is currently in its amortization period) as well as provide financing for additional receivables. On August 24, 2004, we sold to investors \$9,450,000 of the \$18,900,000 we held as a retained interest.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This management's discussion and analysis of financial condition and results of operations should be read in conjunction with the financial statements and accompanying notes included in Item 1 of this report. It should also be read in conjunction with the management's discussion and analysis of financial condition and results of operations, financial statements, and accompanying notes appearing in our Annual Report on Form 10-K for the fiscal year ended January 31, 2004. As used in this management's discussion and analysis, the terms "Fiscal 2005," "Fiscal 2004," and "Fiscal 2003" refer to our fiscal year ending January 29, 2005 and our fiscal years ended January 31, 2004 and February 1, 2003, respectively. The terms "Fiscal 2005 Second Quarter" and "Fiscal 2004 Second Quarter" refer to the thirteen weeks ended July 31, 2004 and August 2, 2003, respectively. The terms "Fiscal 2005 Third Quarter," and "Fiscal 2005 Fourth Quarter" refer to the thirteen weeks ending October 30, 2004, and January 29, 2005, respectively. The term "Fiscal 2006 First Quarter" refers to the thirteen weeks ending April 30, 2005. The terms "Fiscal 2004 First Quarter," "Fiscal 2004 Third Quarter," and "Fiscal 2004 Fourth Quarter" refer to the thirteen weeks ended May 3, 2003, November 1, 2003, and January 31, 2004, respectively. The terms "the Company," "we," "us," and "our" refer to Charming Shoppes, Inc. and, where applicable, its consolidated subsidiaries.

#### FORWARD-LOOKING STATEMENTS

With the exception of historical information, the matters contained in the following analysis and elsewhere in this report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements may include, but are not limited to, projections of revenues, income or loss, cost reductions, capital expenditures, liquidity, financing needs or plans, and plans for future operations, as well as assumptions relating to the foregoing. The words "expect," "should," "project," "estimate," "predict," "anticipate," "plan," "believes," and similar expressions are also intended to identify forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties, some of which we cannot predict or quantify. Future events and actual results, performance, and achievements could differ materially from those set forth in, contemplated by, or underlying the forward-looking statements. We assume no obligation to update any forward-looking statement to reflect actual results or changes in, or additions to, the factors affecting such forward-looking statements.

Factors that could cause our actual results of operations or financial condition to differ from those described in this report include, but are not necessarily limited to, the following:

- o Our business is dependent upon our being able to accurately predict rapidly changing fashion trends, customer preferences, and other fashion-related factors, which we may not be able to successfully accomplish in the future.

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- o A slowdown in the United States economy, an uncertain economic outlook, and escalating gasoline prices could lead to reduced consumer demand for our apparel and accessories in the future.
- o The women's specialty retail apparel industry is highly competitive and we may be unable to compete successfully against existing or future competitors.
- o We cannot assure the successful implementation of our business plan for increased profitability and growth in our plus-size women's apparel business.
- o Our business plan is largely dependent upon the continued growth in the plus-size women's apparel market, which may not continue.
- o We depend on key personnel, particularly our Chief Executive Officer, Dorrit J. Bern, and we may not be able to retain or replace these employees or recruit additional qualified personnel.

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- o We depend on our distribution centers and could incur significantly higher costs and longer lead times associated with distributing our products to our stores if any of these distribution centers were to shut down for any reason.
- o We depend on the availability of credit for our working capital needs, including credit we receive from our suppliers and their agents, and on our credit card securitization program. If we were unable to obtain sufficient financing at affordable cost, our ability to merchandise our stores would be adversely affected.
- o We rely significantly on foreign sources of production and face a variety of risks generally associated with doing business in foreign markets and importing merchandise from abroad. Such risks include (but are not necessarily limited to) political instability, imposition of, or changes in, duties or quotas, increased security requirements applicable to imports, delays in shipping, increased costs of transportation, and issues relating to compliance with domestic or international labor standards.
- o Our stores experience seasonal fluctuations in net sales and operating income. Any decrease in sales or margins during our peak sales periods, or in the availability of working capital during the months preceding such periods, could have a material adverse effect on our business. In addition, extreme or unseasonable weather conditions may have a negative impact on our sales.
- o War, acts of terrorism, or the threat of either may negatively impact availability of merchandise and customer traffic to our stores, or otherwise adversely affect our business.
- o We may be unable to obtain adequate insurance for our operations at a reasonable cost.
- o We may be unable to protect our trademarks and other intellectual property rights, which are important to our success and our competitive



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position.

- o We may be unable to hire and retain a sufficient number of suitable sales associates at our stores.
- o Our manufacturers may be unable to manufacture and deliver merchandise to us in a timely manner or to meet our quality standards.
- o Our sales are dependent upon a high volume of traffic in the strip centers and malls in which our stores are located, and our future growth is dependent upon the availability of suitable locations for new stores.
- o We may be unable to successfully implement our plan to improve merchandise assortments in our brands.
- o The carrying amount and/or useful life of intangible assets related to acquisitions are subject to periodic valuation tests. An adverse change in interest rates or other factors could have a significant impact on the results of the valuation tests, resulting in a write-down of the carrying value or acceleration of amortization of acquired intangible assets.

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### CRITICAL ACCOUNTING POLICIES

Our critical accounting policies are discussed in the management's discussion and analysis of financial condition and results of operations and notes accompanying the consolidated financial statements that appear in our Annual Report on Form 10-K for the fiscal year ended January 31, 2004. Except as otherwise disclosed in the financial statements and accompanying notes included in this report, there were no material changes in our critical accounting policies or in the assumptions or estimates we used to prepare the financial information appearing in this report.

### RESULTS OF OPERATIONS

The following table shows our results of operations expressed as a percentage of net sales and on a comparative basis:

	Thirteen Weeks Ended		Percentage Change From Prior Period	Twenty-six Weeks Ended	
	July 31, 2004	August 2, 2003		July 31, 2004	August 2003
	----	----	-----	----	----
Net sales.....	100.0%	100.0%	1.0%	100.0%	100.0%
Cost of goods sold, buying, and occupancy expenses.....	70.3	70.8	0.4	68.9	70.0
Selling, general, and administrative expenses.....	21.8	22.6	(2.6)	23.4	22.0

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Expenses related to cost reduction plan.....	-	1.1	(100.0)	-
Income from operations.....	7.9	5.6	43.3	7.6
Other income, principally interest..	0.1	0.1	(23.2)	0.1
Interest expense.....	0.6	0.6	0.8	0.6
Income tax provision.....	2.8	2.0	44.8	2.5
Net income.....	4.5	3.1	48.8	4.5
-----				

The following table shows our net sales by store brand:

(In millions)	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 31, 2004 ----	August 2, 2003 ----	July 31, 2004 ----	August 2, 2003 ----
FASHION BUG(R)	\$ 290.1	\$ 297.1	\$ 552.4	\$ 550.0
LANE BRYANT(R)	238.2	221.0	484.8	445.9
CATHERINES(R)	83.4	86.4	167.3	172.1
Other (1) .....	0.0	1.0	0.0	1.7
	-----	-----	-----	-----
Total net sales	\$ 611.7	\$ 605.5	\$ 1,204.5	\$ 1,169.7
	=====	=====	=====	=====
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The following table shows additional information related to changes in our net sales:

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 31, 2004 ----	August 2, 2003 ----	July 31, 2004 ----	August 2, 2003 ----
Increase (decrease) in comparable store sales(1):				
Consolidated Company.....	0%	(1)%	3%	(4)%
FASHION BUG.....	0	3	4	0
CATHERINES.....	(6)	4	(4)	1
LANE BRYANT.....	3	(9)	4	(10)
Sales from new stores as a percentage of total consolidated prior-period sales:				
FASHION BUG.....	1	1	1	1

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CATHERINES.....	1	1	1	1
LANE BRYANT.....	3	3	3	3
Prior-period sales from closed stores as a percentage of total consolidated prior-period sales:				
FASHION BUG.....	(1)	(5)	(2)	(5)
CATHERINES.....	(1)	(2)	(1)	(2)
LANE BRYANT.....	(1)	(1)	(1)	(1)
Increase (decrease) in total sales.....	1	(5)	3	(8)
-----				

The following table sets forth information with respect to our store activity for the first half of Fiscal 2005 and planned store activity for all of Fiscal 2005 (including the first half of Fiscal 2005):

	FASHION BUG ---	LANE BRYANT -----	CATHERINES -----	Total -----
Fiscal 2005 First Half:				
Stores at January 31, 2004 ...	1,051 -----	710 -----	466 -----	2,227 -----
Stores opened .....	1	10	8	19
Stores closed .....	(5) -----	(5) -----	(4) -----	(14) -----
Net change in stores .....	(4) -----	5 -----	4 -----	5 -----
Stores at July 31, 2004 .....	1,047 =====	715 =====	470 =====	2,232 =====
Stores relocated during period	11	8	3	22
Stores remodeled during period	3	7	--	10
Fiscal 2005:				
Planned store openings .....	5	32	15	52
Planned store closings .....	25	15	10	50
Planned store relocations ....	20	15	15	55

## Comparison of Thirteen Weeks Ended July 31, 2004 and August 2, 2003

### Net Sales

The increase in net sales from the Fiscal 2004 Second Quarter to the Fiscal 2005 Second Quarter resulted primarily from positive results at our LANE BRYANT brand, which were partially offset by lower sales at our FASHION BUG and CATHERINES brands. Comparable store sales increased at LANE BRYANT, were flat for FASHION BUG, and decreased for CATHERINES. We operated 2,232 retail stores

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at the end of the Fiscal 2005 Second Quarter, as compared to 2,240 stores at the end of the Fiscal 2004 Second Quarter.

The increase in LANE BRYANT comparable store sales met our sales plan for the quarter. LANE BRYANT stores experienced slightly weaker traffic levels during the current-year quarter, with the average number of transactions per store decreasing 1%. The slightly weaker traffic levels were offset by increases of 4% in the average dollar sale and 6% in the average number of units sold per customer ("UPC"). The average retail value per unit sold decreased 2% as compared to the prior-year period. LANE BRYANT experienced comparable store sales increases for the quarter in intimate apparel and wear-to-work tops and separates, partially offset by decreases in sales of denim and casual woven tops. During the second quarter of Fiscal 2004, LANE BRYANT experienced poor customer acceptance of, and fit and quality issues with, its product offering and had to maintain higher levels of promotional pricing. Continued improvements in the merchandise assortments offered at LANE BRYANT resulted in improved sales performance during the Fiscal 2005 Second Quarter.

FASHION BUG comparable store sales did not meet our sales plan for the quarter. FASHION BUG experienced strong sales of its summer merchandise in May, but sales slowed in June and July. FASHION BUG store traffic levels were flat during the current-year quarter, with the average UPC, the average number of transactions per store, the average dollar sale, and the average retail value per unit sold increasing or decreasing less than 1%. FASHION BUG stores experienced decreases in sales of junior and plus sportswear and dresses, which were partially offset by increases in sales of misses and intimate apparel. FASHION BUG store sales also benefited from sales of maternity and girls, two new categories added to the FASHION BUG brand during the Fiscal 2004 Fourth Quarter.

CATHERINES stores experienced a decrease in comparable store sales during the Fiscal 2005 Second Quarter, and were below our sales plan for the quarter. The decrease in sales at CATHERINES was primarily a result of disappointing performance in the dress and wear-to-work categories. Traffic levels were down from the prior-year period, with the average number of transactions per store decreasing 4%. The average dollar sale decreased 2% as compared to the prior-year quarter, with a 4% increase in the average UPC offset by a 5% decrease in the average retail value per unit sold, reflecting higher levels of promotional pricing during the current quarter.

We offer our customers various loyalty card programs. Customers who join these programs are entitled to various benefits, including discounts and rebates on purchases during the membership period. Customers generally join these programs by paying an annual membership fee. We recognize revenue on these loyalty programs as sales over the life of the membership period based on when the customer earns the benefits and when the fee is no longer refundable. Costs we incur in connection with administering these programs are recognized in cost of goods sold as incurred. See "Item 1. Notes To Condensed Consolidated Financial Statements (Unaudited); Note 5. Customer Loyalty Card Program" above for further information on our loyalty card programs.

During the Fiscal 2004 First Quarter, we introduced a new FASHION BUG customer loyalty card program that is being operated under our FASHION BUG proprietary credit card program. During the Fiscal 2005 Second Quarter, we

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recognized revenues of \$2.3 million in connection with this loyalty card program. During the Fiscal 2004 Second Quarter, we recognized \$2.8 million of revenues in connection with this program. During the Fiscal 2005 Second Quarter and Fiscal 2004 Second Quarter, we also recognized revenues of \$1.9 million and \$1.9 million, respectively, in connection with our CATHERINES loyalty card program.

During the Fiscal 2004 Second Quarter, we recognized revenues of \$2.1 million in connection with a previous FASHION BUG loyalty card program. We discontinued the issuance of new cards under this program at the end of Fiscal 2003, and we terminated this program during the Fiscal 2004 Second Quarter.

### Cost of Goods Sold, Buying, and Occupancy

The increase in cost of goods sold, buying, and occupancy expenses from the Fiscal 2004 Second Quarter to the Fiscal 2005 Second Quarter principally reflects the increase in net sales. Cost of goods sold as a percentage of net sales decreased 0.2% from the Fiscal 2004 Second Quarter to the Fiscal 2005 Second Quarter. Improvements in merchandise margins at our LANE BRYANT and FASHION BUG brands were offset by decreased margins at our CATHERINES brand. Margins at the CATHERINES brand were negatively affected by the increased promotional activity that resulted from reduced traffic levels during the current quarter. Higher levels of promotional activity at our LANE BRYANT brand negatively affected merchandise margins in the Fiscal 2004 Second Quarter. Cost of goods sold includes merchandise costs net of discounts and allowances, freight, inventory shrinkage, and shipping and handling costs associated with our e-commerce business. Net merchandise costs and freight are capitalized as inventory costs.

Buying and occupancy expenses as a percentage of net sales decreased 0.3% from the Fiscal 2004 Second Quarter to the Fiscal 2005 Second Quarter. The decrease was primarily a result of leverage on relatively fixed occupancy costs as a result of the increase in net sales, and cost savings from the consolidation of our LANE BRYANT and CATHERINES distribution centers into our White Marsh, Maryland facility. Buying expenses include payroll, payroll-related costs, and operating expenses for our buying departments and warehouses. Occupancy expenses include rent, real estate taxes, insurance, common area maintenance, utilities, maintenance, and depreciation for our stores and warehouse facilities and equipment. Buying and occupancy costs are treated as period costs and are not capitalized as part of inventory.

### Selling, General, and Administrative

Selling, general, and administrative expenses decreased from the Fiscal 2004 Second Quarter to the Fiscal 2005 Second Quarter, and decreased 0.8% as a percentage of net sales. The decrease was primarily a result of continued tight control of store expenses and improved performance of our FASHION BUG credit card operations, which experienced favorable trends in delinquencies during the Fiscal 2005 Second Quarter. Selling expenses and general and administrative expenses each decreased 0.4% as a percentage of net sales.

### Expenses Related to Cost Reduction Plan

On March 18, 2003, we announced a cost reduction plan designed to take

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advantage of the centralization of all corporate administrative services throughout the Company and to realize certain efficiencies, in order to improve profitability. See "Item 1. Notes To Condensed Consolidated Financial Statements (Unaudited); Note 6. Expenses Related to Cost Reduction Plan" above and "Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; Note 14. Expenses Related to Cost Reduction Plan" in our Annual Report on Form 10-K for the fiscal year ended January 31, 2004 for details of this program. We accounted for the plan in accordance with the provisions of SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The cost reduction plan was substantially completed during Fiscal 2004. The total costs recognized during Fiscal 2004 related to this plan were \$11.5 million, with \$6.4 million of the costs recognized during the Fiscal 2004 Second Quarter.

This cost reduction plan is expected to improve annualized pre-tax earnings by a total of approximately \$45 million. During Fiscal 2004, we realized cost reductions of more than \$30 million. Except for the remaining benefits to be realized from the consolidation of our distribution centers, which we expect to realize by the end of Fiscal 2005, we have realized the remaining benefits of the cost reduction plan.

During the Fiscal 2004 First Quarter, we made the decision to sell our Memphis, Tennessee distribution center, and began accelerating the depreciation of the asset to its estimated net realizable value as of its expected cease-use date of June 2003. During the Fiscal 2004 Third Quarter, we began to evaluate alternative uses for the facility, and began to depreciate the then-current carrying amount of the asset over its estimated useful life.

Expenses related to the plan incurred during the Fiscal 2004 Second Quarter are included in "Expenses related to cost reduction plan" in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Income.

### Income Tax Provision

The effective income tax rate was 38.2% in the Fiscal 2005 Second Quarter, as compared to 38.9% in the Fiscal 2004 Second Quarter. The tax rate for the Fiscal 2004 Second Quarter was affected by a provision for taxes related to one of our insurance programs, which we settled with the Internal Revenue Service during the second half of Fiscal 2004.

### Comparison of Twenty-six Weeks Ended July 31, 2004 and August 2, 2003

#### Net Sales

The increase in net sales from the first half of Fiscal 2004 to the first half of Fiscal 2005 resulted primarily from positive comparable store sales results at our LANE BRYANT and FASHION BUG brands, which were partially offset by negative comparable store sales results at our CATHERINES brand.

LANE BRYANT stores experienced stronger traffic levels during the current-year period, with both the average number of transactions per store and average dollar sale increasing 2%, and the average number of units sold per

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customer ("UPC") increasing 1%. The average retail value per unit sold increased 1%, reflecting reduced levels of promotional pricing for the brand as compared to the prior-year period. LANE BRYANT experienced comparable store sales increases in most major merchandise categories, especially wear-to-work and intimate apparel, partially offset by decreases in casual woven tops and denim separates. During the first half of Fiscal 2004, LANE BRYANT experienced poor customer acceptance of, and fit and quality issues with, its product offering and had to maintain higher levels of promotional pricing. Continued improvements in the merchandise assortments offered at LANE BRYANT resulted in improved sales performance during the first half of Fiscal 2005.

For FASHION BUG stores, stronger traffic levels during the first four months of the current-year period were offset by reduced traffic levels during June and July. For the twenty-six week period, the average number of transactions per store and average UPC increased 4% and 2%, respectively, while the average dollar sale decreased less than 1% and the average retail value per unit sold decreased 3%. FASHION BUG stores experienced increases in sales of misses sportswear, misses and plus wear-to-work, accessories, and intimate apparel, which were partially offset by decreases in sales of junior and plus sportswear and dresses. FASHION BUG store sales also benefited from sales of maternity and girls, two new categories added to the FASHION BUG brand during the Fiscal 2004 Fourth Quarter.

CATHERINES stores experienced weaker traffic levels during the current-year period, with the average number of transactions per store and average dollar sale decreasing 4% and 1%, respectively. A 3% increase in the average UPC was offset by a 4% decrease in the average retail value per unit sold, reflecting higher levels of promotional pricing during the current period. The decrease in sales at CATHERINES was primarily a result of disappointing performance in the dress and wear-to-work categories.

During the first half of Fiscal 2005, we recognized revenues of \$3.7 million in connection with our FASHION BUG customer loyalty card program. During the first half of Fiscal 2004, we recognized \$2.8 million of revenues in connection with this program. During the first half of Fiscal 2005 and Fiscal 2004, we also recognized revenues of \$3.7 million and \$3.8 million, respectively, in connection with our CATHERINES loyalty card program. During the first half of Fiscal 2004, we also recognized revenues of \$6.3 million in connection with our previous Fashion Bug loyalty card program, which was terminated during the Fiscal 2004 Second Quarter.

### Cost of Goods Sold, Buying, and Occupancy

The increase in cost of goods sold, buying, and occupancy expenses from the first half of Fiscal 2004 to the first half of Fiscal 2005 principally reflects the increase in net sales. Cost of goods sold as a percentage of net sales decreased 0.6% from the first half of Fiscal 2004 to the first half of Fiscal 2005. Improvement in merchandise margins at our LANE BRYANT brand was offset by decreased margins at our FASHION BUG and CATHERINES brands. Margins at the CATHERINES brand for the first half of Fiscal 2005 were negatively affected by the increased promotional activity that resulted from reduced traffic levels during the current period. As discussed above, margins at our LANE BRYANT brand for the first half of Fiscal 2004 were negatively affected by higher levels of promotional activity. Cost of goods sold includes merchandise costs net of discounts and allowances, freight, inventory shrinkage, and shipping and handling costs associated with our e-commerce business. Net merchandise costs and freight are capitalized as inventory costs.

Buying and occupancy expenses as a percentage of net sales decreased 0.9% from the first half of Fiscal 2004 to the first half of Fiscal 2005. The decrease was primarily a result of leverage on relatively fixed occupancy costs as a result of the increase in net sales, and cost savings from the consolidation of our LANE BRYANT and CATHERINES distribution centers into our White Marsh, Maryland facility. Buying expenses include payroll, payroll-related costs, and operating expenses for our buying departments and warehouses. Occupancy expenses include rent, real estate taxes, insurance, common area maintenance, utilities, maintenance, and depreciation for our stores and warehouse facilities and equipment. Buying and occupancy costs are treated as period costs and are not capitalized as part of inventory.

#### Selling, General, and Administrative

Selling, general, and administrative expenses for the first half of Fiscal 2005 were comparable to the first half of Fiscal 2004, and decreased 0.7% as a percentage of net sales. The decrease in selling, general, and administrative expenses as a percentage of net sales was primarily a result of continued tight control of store expenses, improved performance of our FASHION BUG credit card operations, which experienced favorable trends in delinquencies during the current-year period, and leverage from the increase in net sales. Selling expenses decreased 0.5% as a percentage of net sales, and general and administrative expenses decreased 0.2% as a percentage of net sales.

#### Expenses Related to Cost Reduction Plan

On March 18, 2003, we announced a cost reduction plan designed to take advantage of the centralization of all corporate administrative services throughout the Company and to realize certain efficiencies, in order to improve profitability. See "Comparison of Thirteen Weeks Ended July 31, 2004 and August 2, 2003: Expenses Related to Cost Reduction Plan" above for further details related to this plan. The total costs recognized during Fiscal 2004 related to this plan were \$11.5 million, with \$10.8 million of the costs recognized during the first half of Fiscal 2004. Expenses related to the plan incurred during the first half of Fiscal 2004 are included in "Expenses related to cost reduction plan" in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Income.

#### Income Tax Provision

The effective income tax rate was 35.6% in the first half of Fiscal 2005, as compared to 38.9% in the first half of Fiscal 2004. The lower effective tax rate in the first half of Fiscal 2005 is primarily the result of finalizing certain prior-year tax audits. We expect the effective income tax rate for the year to be approximately 36.3%. The tax rate for the first half of Fiscal 2004 was affected by a provision for taxes related to one of our insurance programs, which we settled with the Internal Revenue Service during the second half of Fiscal 2004.



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### LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of working capital are cash flow from operations, our proprietary credit card receivables securitization agreements, our investment portfolio, and our revolving credit facility. The following table highlights certain information related to our liquidity and capital resources:

(Dollars in millions)	July 31, 2004 ----	January 31, 2004 ----
Cash and cash equivalents.....	\$223.9	\$123.8
Long-term available-for-sale securities.....	\$5.2	\$14.5
Working capital.....	\$361.8	\$271.9
Current ratio.....	2.1	1.9
Long-term debt to equity ratio.....	28.2%	33.5%

Our net cash provided by operating activities was \$109.7 million for the first half of Fiscal 2005, as compared to \$74.4 million for the first half of Fiscal 2004. The increase was a result of a \$22.6 million increase in net income before non-cash charges, a decrease of \$14.7 million in our investment in inventories (net of accounts payable), and a \$17.1 million increase in accrued expenses, income taxes, and other liabilities. These increases were partially offset by a \$19.1 million increase in prepaid expenses.

The decrease in the net investment in inventories was primarily a result of tighter control over inventory levels during the first half of Fiscal 2005. Prepaid expenses increased \$22.0 million during the first half of Fiscal 2005, as compared to an increase of \$2.9 million during the first half of Fiscal 2004. The increase was primarily a result of the timing of payments for rent and increases in certain advances related to our securitization program. Accrued expenses and other liabilities increased \$0.8 million during the first half of Fiscal 2005, as compared to a decrease of \$11.6 million during the first half of Fiscal 2004, primarily as a result of the timing of certain payments. Income taxes payable increased \$7.1 million during the first half of Fiscal 2005, as compared to an increase of \$2.4 million during the first half of Fiscal 2004. The increase in income taxes payable was primarily a result of an increase in taxable income for the first half of Fiscal 2005, as compared to the first half of Fiscal 2004.

#### Capital Expenditures

Our capital expenditures were \$19.4 million during the first half of Fiscal 2005. In addition, we acquired \$3.9 million of point-of-sale equipment for our CATHERINES stores and \$1.5 million of equipment for our White Marsh, Maryland distribution center under capital leases. The total investment in property, equipment, and leasehold improvements, including cash expenditures and capital lease financing, was \$24.8 million. During the remainder of Fiscal 2005, we anticipate incurring additional capital expenditures of approximately \$40 - \$45 million, primarily for the construction and fixturing of new stores, remodeling and fixturing of existing stores, and improvements to our corporate offices and distribution centers. We expect to finance these additional capital expenditures primarily through internally generated funds.

#### Common Stock and Dividends

During the first half of Fiscal 2005, we received \$23.4 million of cash in connection with the issuance of approximately 4.5 million shares of our common stock as a result of exercises of employee stock options and purchases of

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shares under our employee stock purchase plan.

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We have not paid any dividends since 1995. The payment of future dividends is within the discretion of our Board of Directors and will depend upon our future earnings, if any, our capital requirements, our financial condition, and other relevant factors. Additionally, our existing credit facility prohibits the payment of dividends on our common stock.

### Off-Balance-Sheet Financing

We have formed a trust called the Charming Shoppes Master Trust (the "Trust") to which Spirit of America National Bank, our credit card bank, has transferred, through a special-purpose entity, its interest in credit card receivables created under our FASHION BUG proprietary credit card program. We, together with the Trust, have entered into various agreements under which the Trust can sell, on a revolving basis, interests in these receivables for a specified term. When the revolving period terminates, an amortization period begins during which principal payments are made to the parties with whom the Trust has entered into the securitization agreement.

As of July 31, 2004, the Trust had the following securitization facilities outstanding:

(Dollars in millions)	Series 1999-1 -----	Series 2002-1 -----	Series 1999-2 -----
Date of facility.....	July 1999	November 2002	May 1999
Type of facility.....	Term	Term	Conduit
Maximum funding.....	\$150.0	\$100.0	\$50.0
Funding as of July 31, 2004.....	\$88.6	\$100.0	\$33.0
First scheduled principal payment....	March 2004	August 2007	Not applicable
Expected final principal payment.....	February 2005	May 2008	Not applicable
Renewal.....	Not applicable	Not applicable	Annual
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The Series 1999-1 securitization began its scheduled amortization period in March 2004, and \$61.4 million of principal was amortized in the first half of Fiscal 2005. The remainder of the principal is scheduled to amortize as follows: \$36.8 million in the Fiscal 2005 Third Quarter; \$36.0 million in the Fiscal 2005 Fourth Quarter; and \$15.8 million in the Fiscal 2006 First Quarter. We will fund this remaining amortization through the issuance of Series 2004-1, which closed on August 5, 2004 and provides \$180.0 million of funding through a five-year term facility (see below).

During the first half of Fiscal 2005, we sold to investors an additional \$9.5 million of certificates under the 2002-1 Series that we were previously holding as a retained interest. These certificates were included in our short-term available-for-sale securities as of January 31, 2004.

On August 5, 2004, in connection with our asset securitization program,

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the Trust issued \$180.0 million of new five-year asset-backed certificates ("Series 2004-1") in a private placement under Rule 144A. Of the \$180.0 million of certificates issued, \$161.1 million were sold to investors, and we held \$18.9 million as a retained interest. The certificates pay interest to investors on a floating-rate basis tied to one-month LIBOR. Concurrently, the Trust entered into a series of fixed-rate interest rate hedge agreements with respect to the \$161.1 million of certificates sold to investors. The blended weighted-average interest rate on the hedged certificates is 4.90%. On August 5, 2004, the Trust used \$61.5 million of the proceeds to pay down other securitization series and placed the remaining proceeds of \$118.5 million into a pre-funding cash account. This pre-funding cash account will replace Series 1999-1 (which is currently in its amortization period) as well as provide financing for additional receivables. On August 24, 2004, we sold to investors \$9.5 million of the \$18.9 million we held as a retained interest.

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As these credit card receivables securitizations reach maturity, we plan to obtain funding for the FASHION BUG proprietary credit card program through additional securitizations. However, we can give no assurance that we will be successful in securing financing through either replacement securitizations or other sources of replacement financing.

We securitized \$161.6 million of private label credit card receivables in the first half of Fiscal 2005 and had \$249.6 million of securitized credit card receivables outstanding as of July 31, 2004. We held certificates and retained interests in our securitizations of \$64.9 million as of July 31, 2004, which were generally subordinated in right of payment to certificates issued by the Trust to third-party investors. Our obligation to repurchase receivables sold to the Trust is limited to those receivables that, at the time of their transfer, fail to meet the Trust's eligibility standards under normal representations and warranties. To date, our repurchases of receivables pursuant to this obligation have been insignificant.

Charming Shoppes Receivables Corp. ("CSRC") and Charming Shoppes Seller, Inc., our consolidated wholly-owned indirect subsidiaries, are separate special-purpose entities created for the securitization program. As of July 31, 2004, CSRC held \$20.6 million of Charming Shoppes Master Trust certificates and retained interests and Charming Shoppes Seller, Inc. held retained interests of \$7.9 million (which are included in the \$66.4 million of short-term available-for-sale securities we held at July 31, 2004). These assets are first and foremost available to satisfy the claims of the respective creditors of these separate corporate entities, including certain claims of investors in the Charming Shoppes Master Trust. Additionally, if either the Trust or Charming Shoppes, Inc. fails to meet certain financial performance standards, the Trust would be obligated to reallocate to third-party investors holding certain certificates issued by the Trust, collections in an amount up to \$7.9 million that otherwise would be available to CSRC. The result of this reallocation would be to increase CSRC's retained interest in the Trust by the same amount. Subsequent to such a transfer occurring, and upon certain conditions being met, these same investors would be required to repurchase these interests. As of July 31, 2004, there were no reallocated collections as the result of a failure to meet these financial performance standards. As a result of the sale to investors on August 24, 2004 of \$9.5 million of certificates we held as a retained interest as discussed above, the potential reallocation of collections subject to these financial performance standards increased from \$7.9 million to \$17.3 million on that date. As of August 24, 2004, there were no reallocated

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collections as a result of a failure to meet these financial performance standards.

We could be affected by certain events that would cause the Trust to hold proceeds of receivables, which would otherwise be available to be paid to us with respect to our subordinated interests, within the Trust as additional enhancement. For example, if we fail or the Trust fails to meet certain financial performance standards, a credit enhancement condition would occur and the Trust would be required to retain amounts otherwise payable to us. In addition, the failure to satisfy certain financial performance standards could further cause the Trust to stop using collections on Trust assets to purchase new receivables, and would require such collections to be used to repay investors on a prescribed basis, as provided in the Trust agreements. If this were to occur, it could result in our having insufficient liquidity; however, we believe we would have sufficient notice to seek alternative forms of financing through other third-party providers. As of July 31, 2004, the Trust was in compliance with all applicable financial performance standards. Amounts placed into enhancement accounts, if any, that are not required for payment to other certificate holders will be available to us at the termination of the securitization series. We have no obligation to directly fund the enhancement account of the Trust, other than for breaches of customary representations, warranties, and covenants and for customary indemnities. These representations, warranties, covenants, and indemnities do not protect the Trust or investors in the Trust against credit-related losses on the receivables. The providers of the credit enhancements and Trust investors have no other recourse to us.

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These securitization agreements are intended to improve our overall liquidity by providing short-term sources of funding. The agreements provide that we will continue to service the credit card receivables and control credit policies. This control allows us, absent certain adverse events, to fund continued credit card receivable growth and to provide the appropriate customer service and collection activities. Accordingly, our relationship with our credit card customers is not affected by these agreements. Additional information regarding this program is included in "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II, Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; Note 16. Asset Securitization" of our Annual Report on Form 10-K for the fiscal year ended January 31, 2004.

We also have non-recourse agreements under which third parties provide accounts receivable proprietary credit card sales accounts receivable funding programs for both our CATHERINES and LANE BRYANT brands. These funding programs expire in January 2005 for CATHERINES and in January 2006 for LANE BRYANT. Under these agreements, the third parties reimburse us daily for sales generated by the respective store's credit card accounts. Additional information regarding these agreements is included in "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II, Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; Note 16. Asset Securitization" of our Annual Report on Form 10-K for the fiscal year ended January 31, 2004.

On January 28, 2004, in accordance with the terms of the Merchant Services Agreement pursuant to which the CATHERINES proprietary credit cards are issued, we gave notification of termination and election to purchase the

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CATHERINES credit card portfolio to the third-party provider. In accordance with the terms of the Merchant Services Agreement, the purchase option required us to provide one year's notice in order to terminate the agreement and to purchase the portfolio, subject to the negotiation of the final purchase agreement. We expect to purchase the CATHERINES credit card portfolio during the Fiscal 2006 First Quarter, and expect to fund the purchase using our securitization program, including a portion of the proceeds from the Series 2004-1 securitization.

We lease substantially all of our operating stores under non-cancelable operating lease agreements. Additional details on these leases, including minimum lease commitments, are included in "Item 8. Financial Statements and Supplementary Data; Notes to Consolidated Financial Statements; Note 17. Leases" of our Annual Report on Form 10-K for the fiscal year ended January 31, 2004.

### FINANCING

#### Revolving Credit Facility

We have a \$300.0 million revolving credit facility (the "Facility") that provides for cash borrowings and enables us to issue up to \$150.0 million of letters of credit for purchases of merchandise and for standby letters of credit. As of July 31, 2004, there were no borrowings outstanding under the Facility. The availability of borrowings under the Facility is subject to limitations based on eligible inventory and, under certain circumstances, credit card receivables and in-transit cash. The Facility is secured by our general assets, except for (i) all assets related to our credit card securitization program, (ii) all real property, (iii) certain equipment subject to other mortgages or capital leases, (iv) the assets of our non-U.S. subsidiaries, and (v) certain other assets. The Facility expires on August 15, 2008.

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The interest rate on borrowings under the Facility ranges from Prime to Prime plus .50% per annum for Prime Rate Loans, and LIBOR plus 1.5% to LIBOR plus 2.00% per annum for Eurodollar Rate Loans. The applicable rate is determined quarterly, based on our average excess and suppressed availability, as defined in the Facility. As of July 31, 2004, the interest rate on borrowings under the Facility was 4.25% for Prime Rate Loans and 2.98% for Eurodollar Rate Loans.

The Facility includes limitations on sales and leasebacks, the incurrence of additional liens and debt, capital lease financing, and other limitations. The Facility also requires, among other things, that we not pay dividends on our common stock and, if our excess and suppressed availability (as defined in the Facility) is less than \$50.0 million at any time within a fiscal quarter, that we maintain a minimum level of consolidated 12-month earnings before interest, taxes, depreciation, and amortization ("EBITDA") (excluding non-recurring, non-cash charges as defined in the Facility). During the Fiscal 2005 Second Quarter, our excess and suppressed availability was above \$50.0 million at all times. As of July 31, 2004, we were not in violation of any of the covenants included in the Facility.

Additional information regarding our long-term borrowings is included in "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II, Item 8. Financial Statements and

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Supplementary Data; Notes to Consolidated Financial Statements; Note 7. Debt" of our Annual Report on Form 10-K for the fiscal year ended January 31, 2004.

We believe that our capital resources and liquidity position are sufficient to support our current operations. Our requirements for working capital, capital expenditures, and repayment of debt and other obligations are expected to be funded from operations, supplemented as needed by short-term or long-term borrowings available under our credit facility, our proprietary credit card receivables securitization agreements, leases, and other available financing sources.

### MARKET RISK

We manage our FASHION BUG proprietary credit card program through various operating entities that we own. The primary activity of these entities is to service our proprietary credit card receivables portfolio, the balances of which we sell under a credit card securitization program. Under the securitization program, we can be exposed to fluctuations in interest rates to the extent that the interest rates charged to our customers vary from the rates paid on certificates issued by the Trust. The finance charges on most of our proprietary credit card accounts are billed using a floating-rate index (the Prime lending rate), subject to a floor and limited by legal maximums. The certificates issued under the securitization include both floating- and fixed-interest-rate certificates. The floating-rate certificates are based on an index of either one-month LIBOR or the commercial paper rate, depending on the issuance. Consequently, we have basis risk exposure to the extent that the movement of the floating-rate index on the certificates varies from the movement of the Prime rate. Additionally, as of July 31, 2004, the floating finance charge rate on the credit cards was below the contractual floor rate, thus exposing us to interest-rate risk on the portion of certificates that are funded at floating rates. In addition, as a result of the Trust entering into a series of fixed-rate interest rate hedge agreements with respect to the \$161.1 million of certificates related to the issuance of Series 2004-1 (see "Off-Balance-Sheet Financing" above), we have significantly reduced the exposure of floating-rate certificates outstanding to interest-rate risk. To the extent that short-term interest rates were to increase by one percentage point by the end of Fiscal 2005, an increase of approximately \$206 thousand in selling, general, and administrative expenses would result.

As of July 31, 2004, there were no borrowings outstanding under our revolving credit facility. To the extent that there are borrowings outstanding under our revolving credit facility, such borrowings would be exposed to variable interest rates. An increase in market interest rates would increase our interest expense and decrease our cash flows. A decrease in market interest rates would decrease our interest expense and increase our cash flows.

We are not subject to material foreign exchange risk, as our foreign transactions are primarily U.S. Dollar-denominated and our foreign operations do not constitute a material part of our business.

### IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

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See "Item 1. Notes To Condensed Consolidated Financial Statements (Unaudited); Note 9. Impact of Recent Accounting Pronouncements" above.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

See "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations; MARKET RISK," above.

### Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate and in such a manner as to allow timely decisions regarding required disclosure. We have a Disclosure Committee, which is made up of several key management employees and reports directly to the CEO and CFO, to centralize and enhance these controls and procedures and assist our management, including our CEO and CFO, in fulfilling their responsibilities for establishing and maintaining such controls and procedures and providing accurate, timely, and complete disclosure.

As of the end of the period covered by this report on Form 10-Q (the "Evaluation Date"), our Disclosure Committee, under the supervision and with the participation of management, including our CEO and CFO, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our management, including our CEO and CFO, has concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective. Furthermore, there has been no change in our internal control over financial reporting that occurred during the period covered by this report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

There have been no material developments in legal proceedings involving the Company or its subsidiaries since those reported in our Annual Report on Form 10-K for the fiscal year ended January 31, 2004.

Other than ordinary routine litigation incidental to our business, there are no other pending material legal proceedings that we or any of our subsidiaries are a party to, and there are no other proceedings that are expected to have a material adverse effect on our financial condition or results of operations.

### Item 2. Unregistered Sales of Equity Securities, Use of Proceeds, and Issuer

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## Purchases of Equity Securities

### (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Period -----	Total Number of Shares Purchased -----	Average Price Paid per Share -----	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2) -----	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs (2) -----
May 2, 2004 through May 29, 2004.....	109,373 (1)	\$7.85 (1)	-	-
May 30, 2004 through July 3, 2004.....	0	-	-	-
July 4, 2004 through July 31, 2004.....	0	-	-	-
Total.....	109,373 =====	\$7.85 =====	-	-
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## Item 4. Submission of Matters to a Vote of Security Holders

Our Annual Meeting of Shareholders was held on June 24, 2004.

Joseph L. Castle II, Pamela S. Lewis, and Katherine M. Hudson were nominated for election, in our Proxy Statement, to serve three-year terms as Class B Directors. The total number of shares represented at the Annual Meeting were 107,958,296 shares, representing 94.0% of the total number of shares outstanding as of the close of business on May 5, 2004 (the record date fixed by the Board of Directors). The following table indicates the number of votes cast in favor of election and the number of votes withheld with respect to each of the Class B Directors nominated:

Name ----	Votes For -----	Votes Withheld -----
Joseph L. Castle, II	100,277,757	7,680,539
Pamela S. Lewis	100,284,429	7,673,867
Katherine M. Hudson	100,267,011	7,691,285

A proposal to approve the 2004 Stock Award and Incentive Plan, which was approved by the Board of Directors on April 30, 2004, was approved, with 75,350,784 votes for the proposal, 16,685,976 votes against the proposal, 259,165 abstentions, and 15,662,371 broker non-votes.



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### Item 6. Exhibits

#### (a) Exhibits

The following is a list of Exhibits filed as part of this Quarterly Report on Form 10-Q. Where so indicated, Exhibits that were previously filed are incorporated by reference. For Exhibits incorporated by reference, the location of the Exhibit in the previous filing is indicated in parenthesis.

- 3.1 Restated Articles of Incorporation, incorporated by reference to Form 10-K of the Registrant for the fiscal year ended January 29, 1994. (File No. 000-07258, Exhibit 3.1)
  - 3.2 Bylaws, as Amended and Restated, incorporated by reference to Form 10-Q of the Registrant for the quarter ended July 31, 1999. (Exhibit 3.2)
  - 10.1 2003 Incentive Compensation Plan, incorporated by reference to Appendix C of the Registrant's Proxy Statement Pursuant to Section 14 of the Securities Exchange Act of 1934, filed on May 22, 2003.
  - 10.2 2004 Stock Award and Incentive Plan, incorporated by reference to Appendix B of the Registrant's Proxy Statement Pursuant to Section 14 of the Securities Exchange Act of 1934, filed on May 19, 2004.
  - 10.3 Amended and Restated Variable Deferred Compensation Plan for Executives, Effective December 23, 2003.
  - 10.4 Fourth Amendment, dated as of August 5, 2004, to Second Amended and Restated Pooling and Servicing Agreement, dated as of November 25, 1997, as amended on July 22, 1999 and on May 8, 2001, among Charming Shoppes Receivables Corp., as Seller, Spirit of America, Inc., as Servicer, and Wachovia Bank, National Association (formerly known as First Union National Bank) as Trustee.
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- 10.5 Series 2004-1 Supplement, dated as of August 5, 2004, to Second Amended and Restated Pooling and Service Agreement, dated as of November 25, 1997 (as amended on July 22, 1999, on May 8, 2001 and on August 5, 2004), among Charming Shoppes Receivables Corp., as Seller, Spirit of America, Inc., as Servicer, and Wachovia Bank, National Association, as Trustee, on behalf of the Series 2004-1 Certificateholders, for \$180,000,000 Charming Shoppes Master Trust Series 2004-1.
  - 10.6 Certificate Purchase Agreement, dated as of July 21, 2004, among Charming Shoppes Receivables Corp., Fashion Service Corp., Spirit of America, Inc., and Barclay's Capital Inc. (as representative of the Initial Purchasers).
  - 10.7 Certificate Purchase Agreement, dated as of August 5, 2004, among Wachovia Bank, National Association as Trustee, Charming Shoppes Receivables Corp. as Seller, Spirit of America, Inc. as Servicer, and Clipper Receivables Company LLC as Initial Class C Holder.
  - 10.8 The Charming Shoppes, Inc. 1993 Employees' Stock Incentive Plan Restricted Stock Agreement, dated as of May 13, 2004, between Charming

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Shoppes, Inc. and Dorrit J. Bern.

- 31.1 Certification by Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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### SIGNATURES

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

CHARMING SHOPPES, INC.

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(Registrant)

Date: August 27, 2004

/S/ Dorrit J. Bern

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Dorrit J. Bern  
Chairman of the Board  
President and Chief Executive Officer

Date: August 27, 2004

/S/ Eric M. Specter

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Eric M. Specter  
Executive Vice President  
Chief Financial Officer

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### Exhibit Index

Exhibit No.	Item
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- |     |  |
|-----|--|
| 3.1 | Restated Articles of Incorporation, incorporated by reference to Form 10-K of the Registrant for the fiscal year ended January 29, |
|-----|--|

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1994. (File No. 000-07258, Exhibit 3.1)

- 3.2 Bylaws, as Amended and Restated, incorporated by reference to Form 10-Q of the Registrant for the quarter ended July 31, 1999. (Exhibit 3.2)
- 10.1 2003 Incentive Compensation Plan, incorporated by reference to Appendix C of the Registrant's Proxy Statement Pursuant to Section 14 of the Securities Exchange Act of 1934, filed on May 22, 2003.
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