DILLARDS INC
Form 10-Q
June 04, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended May 1, 2010

or

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

For the transition period from to .

Commission File Number: 1-6140

DILLARD S, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**71-0388071**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1600 CANTRELL ROAD, LITTLE ROCK, ARKANSAS 72201

(Address of principal executive offices)

(Zip Code)

(501) 376-5200

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). oYes oNo

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). oYes xNo

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

CLASS A COMMON STOCK as of May 29, 2010	**64,539,177**
CLASS B COMMON STOCK as of May 29, 2010	**4,010,929**

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

DILLARD S, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In Thousands)

	May 1, 2010	January 30, 2010	May 2, 2009
Assets			
Current assets:			
Cash and cash equivalents	$ 305,296	$ 341,693	$ 102,731
Accounts receivable, net	55,088	63,222	70,353
Merchandise inventories	1,453,551	1,300,680	1,647,116
Federal income tax receivable	144	217	74,415
Other current assets	41,503	43,717	36,817
Total current assets	**1,855,582**	**1,749,529**	**1,931,432**
Property and equipment, net	2,717,977	2,780,837	2,918,518
Other assets	73,484	75,961	83,142
Total assets	**$ 4,647,043**	**$ 4,606,327**	**$ 4,933,092**
Liabilities and stockholders equity			
Current liabilities:			
Trade accounts payable and accrued expenses	$ 793,393	$ 676,501	$ 849,343
Current portion of long-term debt	1,738	1,719	25,553
Current portion of capital lease obligations	1,794	1,775	1,721
Other short-term borrowings			175,000
Federal and state income taxes including current deferred taxes	80,095	89,027	55,762
Total current liabilities	**877,020**	**769,022**	**1,107,379**
Long-term debt	747,145	747,587	752,266
Capital lease obligations	21,987	22,422	23,700
Other liabilities	213,493	213,471	221,680
Deferred income taxes	339,650	349,722	370,578
Subordinated debentures	200,000	200,000	200,000
Operating leases and commitments			
Stockholders equity:			
Common stock	1,210	1,209	1,209
Additional paid-in capital	784,560	782,746	782,382
Accumulated other comprehensive loss	(21,822)	(22,298)	(16,539)
Retained earnings	2,530,433	2,484,447	2,432,438
Less treasury stock, at cost	(1,046,633)	(942,001)	(942,001)
Total stockholders equity	**2,247,748**	**2,304,103**	**2,257,489**
Total liabilities and stockholders equity	**$ 4,647,043**	**$ 4,606,327**	**$ 4,933,092**

See notes to condensed consolidated financial statements.

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DILLARD S, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

(Unaudited)

(In Thousands, Except Per Share Data)

	Three Months Ended May 1, 2010	Three Months Ended May 2, 2009
Net sales	$ 1,453,596	$ 1,473,870
Service charges and other income	29,065	31,426
	1,482,661	1,505,296
Cost of sales	914,261	979,579
Advertising, selling, administrative and general expenses	393,642	414,284
Depreciation and amortization	63,716	65,524
Rentals	13,014	14,500
Interest and debt expense, net	18,856	18,408
Gain on disposal of assets	(104)	(68)
Asset impairment and store closing charges	2,208	
Income before income taxes and equity in losses of joint ventures	77,068	13,069
Income taxes	27,280	4,650
Equity in losses of joint ventures	(954)	(756)
Net income	**48,834**	**7,663**
Retained earnings at beginning of period	2,484,447	2,427,727
Cash dividends declared	(2,848)	(2,952)
Retained earnings at end of period	**$ 2,530,433**	**$ 2,432,438**
Earnings per share:		
Basic and diluted	$ 0.68	$ 0.10
Cash dividends declared per common share	$ 0.04	$ 0.04

See notes to condensed consolidated financial statements.

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DILLARD S, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In Thousands)

	Three Months Ended			
		May 1, 2010		May 2, 2009
Operating activities:				
Net income	$	48,834	$	7,663
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of property and deferred financing		64,182		66,005
Gain on repurchase of debt				(1,476)
Gain on disposal of property and equipment		(104)		(68)
Excess tax benefits from share-based compensation		(26)		
Asset impairment and store closing charges		2,208		
Changes in operating assets and liabilities:				
Decrease in accounts receivable		8,134		17,645
Increase in merchandise inventories		(152,871)		(272,722)
Decrease in other current assets		2,214		16,308
Decrease in other assets		2,049		2,352
Increase in trade accounts payable and accrued expenses and other liabilities		124,578		202,208
(Decrease) increase in income taxes payable		(18,905)		4,506
Net cash provided by operating activities		**80,293**		**42,421**
Investing activities:				
Purchases of property and equipment		(8,361)		(4,828)
Proceeds from disposal of property and equipment		47		581
Net cash used in investing activities		**(8,314)**		**(4,247)**
Financing activities:				
Principal payments on long-term debt and capital lease obligations		(839)		(4,328)
Cash dividends paid		(2,953)		(2,938)
Purchase of treasury stock		(104,996)		
Proceeds from stock issuance		386		
Excess tax benefits from share-based compensation		26		
Decrease in short-term borrowings				(25,000)
Net cash used in financing activities		**(108,376)**		**(32,266)**
(Decrease) increase in cash and cash equivalents		(36,397)		5,908
Cash and cash equivalents, beginning of period		341,693		96,823
Cash and cash equivalents, end of period	**$**	**305,296**	**$**	**102,731**
Non-cash transactions:				
Accrued capital expenditures	$	1,400	$	5,000
Stock awards		1,767		1,330

See notes to condensed consolidated financial statements.

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DILLARD S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements of Dillard s, Inc. (the Company) have been prepared in accordance with the rules of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair statement have been included. Operating results for the three months ended May 1, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending January 29, 2011 due to the seasonal nature of the business.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended January 30, 2010 filed with the SEC on March 26, 2010.

Reclassifications Certain items have been reclassified from their prior year classifications to conform to the current year presentation.

Note 2. **Business Segments**

The Company operates in two reportable segments: the operation of retail department stores and a general contracting construction company. The construction segment (CDI) that was purchased on August 29, 2008, is engaged in the general contracting and construction business. CDI also constructs and remodels stores for the Company.

For the Company s retail operations reportable segment, the Company determined its operating segments on a store by store basis. Each store s operating performance has been aggregated into one reportable segment. The Company s operating segments are aggregated for financial reporting purposes because they are similar in each of the following areas: economic characteristics, class of consumer, nature of products and distribution methods. Revenues from external customers are derived from merchandise sales, and the Company does not rely on any major customers as a source of revenue. Across all stores, the Company operates one store format under the Dillard s name where each store offers the same general mix of merchandise with similar categories and similar customers. The Company believes that disaggregating its operating segments would not provide meaningful additional information.

The following tables summarize certain segment information, including the reconciliation of those items to the Company s consolidated operations:

	Three Months Ended May 1, 2010		
(in thousands of dollars)	Retail Operations	Construction	Consolidated
Net sales from external customers	$ 1,428,851	$ 24,745	$ 1,453,596
Gross profit	540,307	(972)	539,335
Depreciation and amortization	63,671	45	63,716
Interest and debt expense (income), net	18,899	(43)	18,856
Income (loss) before income taxes and equity in losses of joint ventures	78,898	(1,830)	77,068
Equity in losses of joint ventures	(954)		(954)
Total assets	4,569,287	77,756	4,647,043

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	Three Months Ended May 2, 2009		
(in thousands of dollars)	**Retail Operations**	**Construction**	**Consolidated**
Net sales from external customers	$ 1,414,691	$ 59,179	$ 1,473,870
Gross profit	491,706	2,585	494,291
Depreciation and amortization	65,481	43	65,524
Interest and debt expense (income), net	18,451	(43)	18,408
Income before income taxes and equity in losses of joint ventures	11,794	1,275	13,069
Equity in losses of joint ventures	(756)		(756)
Total assets	4,836,259	96,833	4,933,092

Intersegment construction revenues of $6.6 million and $8.1 million were eliminated during consolidation and have been excluded from net sales for the quarters ended May 1, 2010 and May 2, 2009, respectively.

Note 3. Stock-Based Compensation

The Company has various stock option plans that provide for the granting of options to purchase shares of Class A Common Stock to certain key employees of the Company. Exercise and vesting terms for options granted under the plans are determined at each grant date. There were no stock options granted during the quarters ended May 1, 2010 and May 2, 2009.

Stock option transactions for the three months ended May 1, 2010 are summarized as follows:

Fixed Options	**Shares**	**Weighted Average Exercise Price**
Outstanding, beginning of period	4,044,369	$ 25.79
Granted		
Exercised	(15,000)	$ 25.74
Expired		
Outstanding, end of period	4,029,369	$ 25.79
Options exercisable at period end	4,029,369	$ 25.79

At May 1, 2010, the intrinsic value of outstanding and exercisable stock options was $9.2 million.

Note 4. Asset Impairment and Store Closing Charges

During the quarter ended May 1, 2010, the Company recorded a pretax charge of $2.2 million for asset impairment and store closing costs. The charge was for the write-down of one property currently held for sale.

There were no asset impairment and store closing costs recorded during the quarter ended May 2, 2009.

Following is a summary of the activity in the reserve established for store closing charges for the quarter ended May 1, 2010:

(in thousands)	Balance, Beginning of Period	Adjustments and Charges	Cash Payments	Balance, End of Period
Rentals, property taxes and utilities	$ 2,498	$ 244	$ 631	$ 2,111

Reserve amounts are included in trade accounts payable and accrued expenses and other liabilities.

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Note 5. Earnings Per Share Data

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated (in thousands, except per share data).

	Three Months Ended May 1, 2010	Three Months Ended May 2, 2009
Basic:		
Net income	$ 48,834	$ 7,663
Weighted average shares of common stock outstanding	72,295	73,644
Basic earnings per share	$ 0.68	$ 0.10

	Three Months Ended May 1, 2010	Three Months Ended May 2, 2009
Diluted:		
Net income	$ 48,834	$ 7,663
Weighted average shares of common stock outstanding	72,295	73,644
Dilutive effect of stock-based compensation		
Total weighted average equivalent shares	72,295	73,644
Diluted earnings per share	$ 0.68	$ 0.10

Total stock options outstanding were 4,029,369 and 5,261,375 at May 1, 2010 and May 2, 2009, respectively. Of these, options to purchase 4,029,369 and 5,261,375 shares of Class A common stock at prices ranging from $24.73 to $26.57 and $24.01 to $30.47 per share were outstanding at May 1, 2010 and May 2, 2009, respectively, but were not included in the computation of diluted earnings per share because the effect of their inclusion would be antidilutive.

Note 6. Comprehensive Income

The following table shows the computation of comprehensive income (in thousands):

	Three Months Ended May 1, 2010	Three Months Ended May 2, 2009
Net income	$ 48,834	$ 7,663
Other comprehensive income:		

Amortization of retirement plan and other retiree benefit adjustments, net of taxes		476		333
Total comprehensive income	$	49,310	$	7,996

Note 7. Commitments and Contingencies

On May 27, 2009, a lawsuit was filed in the United States District Court for the Eastern District of Arkansas styled Steven Harben, Derivatively on Behalf of Nominal Defendant Dillard s, Inc. v. William Dillard II et al, *Case Number 4:09-IV-395*. The lawsuit generally seeks return of monies and alleges that certain officers and directors of the Company have been overcompensated and/or received improper benefits at the expense of the Company and its shareholders. While it is too soon to predict the outcome of any litigation filed as recently as this suit, the named officers and directors intend to contest these allegations vigorously.

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On June 10, 2009, a lawsuit was filed in the Circuit Court of Pulaski County, Arkansas styled Billy K. Berry, Derivatively on behalf of Dillard s, Inc. v. William Dillard II et al, *Case Number CV-09-4227-2.* The lawsuit generally seeks return of monies and alleges that certain officers and directors of the Company have been overcompensated and/or received improper benefits at the expense of the Company and its shareholders. On February 18, 2010, the Circuit Court entered an Order of Dismissal with Prejudice and Final Judgment dismissing the case as to all parties defendant. Plaintiff has appealed the Court s Order. The named officers and directors will continue to contest these allegations vigorously.

Various other legal proceedings in the form of lawsuits and claims, which occur in the normal course of business, are pending against the Company and its subsidiaries. In the opinion of management, disposition of these matters is not expected to have a material adverse effect on the Company s financial position, cash flows or results of operations.

At May 1, 2010, letters of credit totaling $89.2 million were issued under the Company s $1.2 billion revolving credit facility.

Note 8. Benefit Plans

The Company has an unfunded, nonqualified defined benefit plan (Pension Plan) for its officers. The Pension Plan is noncontributory and provides benefits based on years of service and compensation during employment. Pension expense is determined using various actuarial cost methods to estimate the total benefits ultimately payable to officers and allocates this cost to service periods. The actuarial assumptions used to calculate pension costs are reviewed annually. The Company made contributions to the Pension Plan of $1.1 million during the quarter ended May 1, 2010. The Company expects to make contributions to the Pension Plan of approximately $4.6 million for the remainder of fiscal 2010.

The components of net periodic benefit costs are as follows (in thousands):

	Three Months Ended	
	May 1, 2010	**May 2, 2009**
Components of net periodic benefit costs:		
Service cost	$ 721	$ 771
Interest cost	1,817	1,826
Net actuarial loss	594	368
Amortization of prior service cost	157	157
Net periodic benefit costs	$ 3,289	$ 3,122

Note 9. Recently Issued Accounting Standards

Consolidation of Variable Interest Entities

On January 31, 2010, the Company adopted changes issued by the Financial Accounting Standards Board (FASB) to accounting for variable interest entities. These changes require an enterprise to perform an analysis to determine whether the enterprise s variable interest or interests give it a controlling financial interest in a variable interest entity; to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity; to eliminate the solely quantitative approach previously required for determining the primary beneficiary of a variable interest entity; to add an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in facts and circumstances occur such that holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity s economic performance; and to require enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise s involvement in a variable interest entity. The adoption of these changes had no material impact on the Company s condensed consolidated financial statements.

Fair Value Measurements and Disclosures

In January 2010, the FASB issued ASU 2010-06, an update to Topic 820, *Fair Value Measurements and Disclosures*. ASU 2010-06 provides an update specifically to Subtopic 820-10 that requires new disclosures including, details of significant transfers in and out of Level 1 and Level 2 measurements and the reasons for the transfers and a gross presentation of activity within the Level 3 roll forward, presenting separately information

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about purchases, sales, issuances, and settlements. ASU 2010-06 is effective for the first interim or annual reporting period beginning after December 15, 2009, except for the gross presentation of the Level 3 roll forward, which is required for interim and annual reporting periods beginning after December 15, 2010. The adoption of ASU 2010-06 did not have a material impact on the Company s condensed consolidated financial statements.

Note 10. Revolving Credit Agreement

At May 1, 2010, the Company maintained a $1.2 billion revolving credit facility (credit agreement) with JPMorgan Chase Bank (JPMorgan) as the lead agent for various banks, secured by the inventory of Dillard s, Inc. operating subsidiaries. The credit agreement expires December 12, 2012.

Borrowings under the credit agreement accrue interest starting at either JPMorgan s Base Rate minus 0.5% or LIBOR plus 1.0% (1.28% at May 1, 2010) subject to certain availability thresholds as defined in the credit agreement.

Limited to 85% of the inventory of certain Company subsidiaries, availability for borrowings and letter of credit obligations under the credit agreement was $905.6 million at May 1, 2010. No borrowings were outstanding at May 1, 2010. Letters of credit totaling $89.2 million were issued under this credit agreement leaving unutilized availability under the facility of approximately $816 million at May 1, 2010. There are no financial covenant requirements under the credit agreement provided availability exceeds $100 million. The Company pays an annual commitment fee to the banks of 0.25% of the committed amount less outstanding borrowings and letters of credit.

Note 11. Stock Repurchase Program

The Company was authorized by its Board of Directors in November 2007 to repurchase up to $200 million of its Class A Common Stock under an open-ended plan (Stock Plan). This authorization permits the Company to repurchase its Class A Common Stock in the open market or through privately negotiated transactions.

During the quarter ended May 1, 2010, the Company repurchased 4.2 million shares of stock for approximately $105.0 million at an average price of $24.88 per share. No shares were repurchased under the Stock Plan during the quarter ended May 2, 2009. Share repurchase authorization remaining under the Stock Plan at May 1, 2010 was $77.6 million.

Note 12. Income Taxes

The total amount of unrecognized tax benefits as of May 1, 2010 and May 2, 2009 was $16.1 million and $27.3 million, respectively, of which $11.7 million and $19.6 million, respectively, would, if recognized, affect the effective tax rate. The Company classifies accrued interest expense and penalties relating to income tax in the condensed consolidated financial statements as income tax expense. The total accrued interest and penalties in the condensed consolidated balance sheets as of May 1, 2010 and May 2, 2009 was $6.3 million and $9.7 million, respectively. The estimated range of the reasonably possible uncertain tax benefit decrease in the next twelve months is between $3 million and $6 million. No significant changes occurred in the status of federal, state or local jurisdiction examinations during the quarter ended May 1, 2010. Changes in the Company s assumptions and judgments can materially affect amounts recognized in the condensed consolidated balance sheets and statements of operations.

During the quarter ended May 1, 2010, income taxes included the recognition of tax benefits primarily due to federal tax credit refund claims.

Note 13. Note Repurchase

During the quarter ended May 2, 2009, the Company repurchased $5.0 million face amount of 9.125% notes with an original maturity on August 1, 2011. This repurchase resulted in a pretax gain of approximately $1.5 million and was recorded in net interest and debt expense. No notes were repurchased during the quarter ended May 1, 2010.

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Note 14.   Fair Value Disclosures

The estimated fair values of financial instruments which are presented herein have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of amounts the Company could realize in a current market exchange.

The fair value of the Company s long-term debt and subordinated debentures is based on market prices or dealer quotes (for publicly traded unsecured notes) and on discounted future cash flows using current interest rates for financial instruments with similar characteristics and maturities (for bank notes and mortgage notes).

The fair value of the Company s cash and cash equivalents and trade accounts receivable approximates their carrying values at May 1, 2010 due to the short-term maturities of these instruments. The fair value of the Company s long-term debt at May 1, 2010 was approximately $694 million. The carrying value of the Company s long-term debt at May 1, 2010 was approximately $749 million. The fair value of the subordinated debentures at May 1, 2010 was approximately $174 million. The carrying value of the subordinated debentures at May 1, 2010 was $200 million.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The FASB s accounting guidance utilizes a fair value hierarchy that prioritizes the inputs to the valuation techniques used to measure fair value into three broad levels:

- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities

- Level 2: Inputs, other than quoted prices, that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active

- Level 3: Unobservable inputs that reflect the reporting entity s own assumptions

		Basis of Fair Value Measurements		
(in thousands)	**Fair Value of Assets (Liabilities)**	**Quoted Prices In Active Markets for Identical Items (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**

Long-lived assets held for sale				
As of May 1, 2010	$ 31,748	$	$	$ 31,748
As of January 30, 2010	33,956			33,956
As of May 2, 2009	30,625			30,625

During the quarter ended May 1, 2010, long-lived assets held for sale with a carrying value of $34.0 million were written down to their fair value of $31.7 million, resulting in an impairment charge of $2.2 million, which was included in earnings for the period. The inputs used to calculate the fair value of these long-lived assets included selling prices from commercial real estate transactions for similar assets in similar markets that we estimated would be used by a market participant in valuing these assets.

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

EXECUTIVE OVERVIEW

Signs of slow recovery from the recent economic recession were noted in consumer spending during the first quarter of fiscal 2010 and had a positive impact on Dillard s, Inc s (the Company , we , us or our) operations. Net sales from retail operations were $1,428.9 million during the quarter ended May 1, 2010, an increase of $14.2 million or 1% from the quarter ended May 2, 2009 while sales in comparable stores increased 2%. Gross profit from retail operations improved 300 basis points of retail sales, primarily due to our inventory management efforts and resulting decrease in markdown activity.

While consumer spending improved during the quarter, commercial spending on construction projects continued to be suppressed. Net sales from construction operations during the quarter ended May 1, 2010 were $24.7 million, down $34.4 million or 58% from the quarter ended May 2, 2009. Gross profit from construction operations decreased 830 basis points of construction sales. This decrease was the result of the decline in demand for construction services that has created pricing pressures in an already competitive market place. This decrease was also due to job delays from bad weather and job underperformance resulting in the recognition of a loss of $2.2 million on certain electrical contracts.

Advertising, selling, administrative and general expenses company-wide were reduced by $20.6 million during the quarter ended May 1, 2010 compared to May 2, 2009 primarily as a result of the Company s cost control measures combined with store closures.

The Company recorded net income for the first quarter of 2010 of $48.8 million, or $0.68 per share, compared to net income of $7.7 million or $0.10 per share for the first quarter of 2009. Included in net income for the quarter ended May 1, 2010 was a $2.2 million pretax asset impairment charge ($1.4 million after tax or $0.02 per share). Included in net income for the quarter ended May 2, 2009 was a $1.5 million pretax gain ($0.9 million after tax or $0.01 per share) on the early extinguishment of debt related to the repurchase of certain unsecured notes.

As of May 1, 2010, we had working capital of $978.6 million, cash and cash equivalents of $305.3 million and $948.9 million of total debt outstanding, excluding capital lease obligations. Cash flows from operating activities were $80.3 million for the first quarter of fiscal 2010. We operated 311 total stores, including 12 clearance centers, and one internet store as of May 1, 2010, a decrease of 4 stores from the same period last year.

Key Performance Indicators

We use a number of key indicators of financial condition and operating performance to evaluate our business, including the following:

	Three Months Ended			
		May 1, 2010		**May 2, 2009**
Net sales (in millions)	$	1,453.6	$	1,473.9
Net sales trend*		(1)%		(16)%
Gross profit (in millions)	$	539.3	$	494.3
Gross profit as a percentage of net sales		37.1%		33.5%
Cash flow from operations (in millions)	$	80.3	$	42.4
Total retail store count at end of period		311		315
Retail sales per square foot	$	27	$	26
Retail store sales trend		1%		(16)%
Comparable retail store sales trend		2%		(13)%
Comparable retail store inventory trend		(12)%		(17)%
Retail merchandise inventory turnover		2.7		2.5

*The net sales trend rate for the quarter ended May 2, 2009 is based on retail segment sales only for comparability with the quarter ended May 3, 2008.

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Trends and Uncertainties

Fluctuations in the following key trends and uncertainties which we have identified may have a material effect on our operating results.

- Cash flow Cash from operating activities is a primary source of liquidity that is adversely affected when the industry faces economic challenges. Furthermore, operating cash flow can be negatively affected when new and existing competitors seek areas of growth to expand their businesses.

- Pricing If our customers do not purchase our merchandise offerings in sufficient quantities, we respond by taking markdowns. If we have to reduce our retail selling prices, the cost of goods sold on our income statement will correspondingly rise, thus reducing our income and cash flow.

- Success of brand The success of our exclusive brand merchandise as well as merchandise we source from national vendors is dependent upon customer fashion preferences and how well we can predict and anticipate trends.

- Sourcing Our store merchandise selection is dependent upon our ability to acquire appealing products from a number of sources. Our ability to attract and retain compelling vendors as well as in-house design talent, the adequacy and stable availability of materials and production facilities from which we source our merchandise and the speed at which we can respond to customer trends and preferences all have a significant impact on our merchandise mix and, thus, our ability to sell merchandise at profitable prices.

- Store growth Although store growth is presently not a near-term goal, such growth is dependent upon a number of factors which could impede our ability to open new stores, such as the identification of suitable markets and locations and the availability of shopping developments, especially in a weak economic environment.

General

Net sales. Net sales include merchandise sales of comparable and non-comparable stores and revenue recognized on contracts of CDI. Comparable store sales include sales for those stores which were in operation for a full period in both the current month and the corresponding month for the prior year. Non-comparable store sales include: sales in the current fiscal year from stores opened during the previous fiscal year before they are considered comparable stores; sales from new stores opened during the current fiscal year; sales in the previous fiscal year for stores closed during the current or previous fiscal year that are no longer considered comparable stores; and sales in clearance centers.

Service charges and other income. Service charges and other income include income generated through the long-term marketing and servicing alliance (Alliance) with GE Consumer Finance (GE), which owns and manages the Dillard s branded proprietary credit cards. Other income includes rental income, shipping and handling fees and lease income on leased departments.

Cost of sales. Cost of sales includes the cost of merchandise sold (net of purchase discounts), bankcard fees, freight to the distribution centers, employee and certain promotional discounts, non-specific margin maintenance allowances and direct payroll for salon personnel. Cost of sales also includes CDI contract costs, which comprise all direct material and labor costs, subcontract costs and those indirect costs related to contract performance, such as indirect labor, employee benefits and insurance program costs.

Advertising, selling, administrative and general expenses. Advertising, selling, administrative and general expenses include buying, occupancy, selling, distribution, warehousing, store and corporate expenses (including payroll and employee benefits), insurance, employment taxes, advertising, management information systems, legal and other corporate level expenses. Buying expenses consist of payroll, employee benefits and travel for design, buying and merchandising personnel.

Depreciation and amortization. Depreciation and amortization expenses include depreciation and amortization on property and equipment.

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Rentals. Rentals include expenses for store leases and data processing and other equipment rentals.

Interest and debt expense, net. Interest and debt expense includes interest, net of interest income, relating to the Company s unsecured notes, mortgage notes, term note and subordinated debentures, gains and losses on note repurchases, amortization of financing costs and interest on capital lease obligations.

Gain on disposal of assets. Gain on disposal of assets includes the net gain or loss on the sale or disposal of property and equipment.

Asset impairment and store closing charges. Asset impairment and store closing charges consist of write-downs to fair value of under-performing properties and exit costs associated with the closure of certain stores. Exit costs include future rent, taxes and common area maintenance expenses from the time the stores are closed.

Equity in losses of joint ventures. Equity in losses of joint ventures includes the Company s portion of the income or loss of the Company s unconsolidated joint ventures.

Critical Accounting Policies and Estimates

The Company s accounting policies are more fully described in Note 1 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the fiscal year ended January 30, 2010. As disclosed in that note, the preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the amounts reported in the consolidated financial statements and accompanying notes. The Company evaluates its estimates and judgments on an ongoing basis and predicates those estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Since future events and their effects cannot be determined with absolute certainty, actual results will differ from those estimates.

Management of the Company believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in preparation of the condensed consolidated financial statements.

Merchandise inventory. Approximately 97% of the inventories are valued at the lower of cost or market using the last-in, first-out retail inventory method (LIFO RIM). Under LIFO RIM, the valuation of inventories at cost and the resulting gross margins are calculated by applying a calculated cost to retail ratio to the retail value of inventories. LIFO RIM is an averaging method that is widely used in the retail industry due to its practicality. Additionally, it is recognized that the use of LIFO RIM will result in valuing inventories at the lower of cost or market if markdowns are currently taken as a reduction of the retail value of inventories. Inherent in the LIFO RIM calculation are certain significant management judgments including, among others, merchandise markon, markups and markdowns, which significantly impact the ending inventory valuation at cost as well as the resulting gross margins. Management believes that the Company s LIFO RIM provides an inventory valuation which results in a carrying value at the lower of cost or market. The remaining 3% of the inventories are valued at the lower of cost or market using the average cost or specific identified cost methods. A 1% change in markdowns would have impacted net income by approximately $2 million for the quarter ended May 1, 2010.

The Company regularly records a provision for estimated shrinkage, thereby reducing the carrying value of merchandise inventory. Complete physical inventories of all of the Company s stores and warehouses are performed no less frequently than annually, with the recorded amount of merchandise inventory being adjusted to coincide with these physical counts. The differences between the estimated amounts of shrinkage and the actual amounts realized have not been material.

Revenue recognition. The Company s retail operations segment recognizes revenue upon the sale of merchandise to its customers, net of anticipated returns of merchandise. The provision for sales returns is based on historical evidence of our return rate. We recorded an allowance for sales returns of $8.5 million and $7.2 million for the quarters ended May 1, 2010 and May 2, 2009, respectively. Adjustments to earnings resulting from revisions to estimates on our sales return provision were not material for the quarters ended May 1, 2010 and May 2, 2009.

The Company s share of income earned under the Alliance with GE involving the Dillard s branded proprietary credit cards is included as a component of service charges and other income. The Company received income of approximately $20.2 million and $22.4 million from GE during the quarters ended May 1, 2010 and May 2, 2009, respectively. Pursuant to this Alliance, the Company has no continuing involvement other than to honor the proprietary credit cards in its stores. Although not obligated to a specific level of marketing commitment, the Company participates in the marketing of the proprietary credit cards and accepts payments on the proprietary credit cards in its stores as a convenience to customers who prefer to pay in person rather than by paying online or mailing their payments to GE.

Revenue from CDI construction contracts is generally recognized by applying percentages of completion for each period to the total estimated revenue for the respective contracts. The length of each contract varies but is typically nine to eighteen months. The percentages of completion are determined by relating the actual costs of work performed to date to the current estimated total costs of the respective contracts. Any anticipated losses on completed contracts are recognized as soon as they are determined.

Merchandise vendor allowances. The Company receives concessions from its merchandise vendors through a variety of programs and arrangements, including co-operative advertising, payroll reimbursements and margin maintenance programs.

Cooperative advertising allowances are reported as a reduction of advertising expense in the period in which the advertising occurred. If vendor advertising allowances were substantially reduced or eliminated, the Company would likely consider other methods of advertising as well as the volume and frequency of our product advertising, which could increase or decrease our expenditures. Similarly, we are not able to assess the impact of vendor advertising allowances on creating additional revenue, as such allowances do not directly generate revenue for our stores.

Payroll reimbursements are reported as a reduction of payroll expense in the period in which the reimbursement occurred.

Amounts of margin maintenance allowances are recorded only when an agreement has been reached with the vendor and the collection of the concession is deemed probable. All such merchandise margin maintenance allowances are recognized as a reduction of cost purchases. Under LIFO RIM, a portion of these allowances reduces cost of goods sold and a portion reduces the carrying value of merchandise inventory.

Insurance accruals. The Company s condensed consolidated balance sheets include liabilities with respect to claims for self-insured workers compensation (with a self-insured retention of $4 million per claim) and general liability (with a self-insured retention of $1 million per claim and a one-time $1 million corridor). The Company estimates the required liability of such claims, utilizing an actuarial method, based upon various assumptions, which include, but are not limited to, our historical loss experience, projected loss development factors, actual payroll and other data. The required liability is also subject to adjustment in the future based upon the changes in claims experience, including changes in the number of incidents (frequency) and changes in the ultimate cost per incident (severity). As of May 1, 2010 and May 2, 2009, insurance accruals of $52.7 million and $54.3 million, respectively, were recorded in trade accounts payable and accrued expenses and other liabilities. Adjustments resulting from changes in historical loss trends have reduced expenses during the quarters ended May 1, 2010 and May 2, 2009, partially due to recently implemented Company programs that have helped decrease both the number and cost of claims. Further, we do not anticipate any significant change in loss trends, settlements or other costs that would cause a significant change in our earnings. A 10% change in our self-insurance reserve would have affected net earnings by $3.3 million for the quarter ended May 1, 2010.

Finite-lived assets. The Company s judgment regarding the existence of impairment indicators is based on market and operational performance. We assess the impairment of long-lived assets, primarily fixed assets, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include the following:

- Significant changes in the manner of our use of assets or the strategy for the overall business;
- Significant negative industry or economic trends; or
- Store closings.

The Company performs an analysis of the anticipated undiscounted future net cash flows of the related finite-lived assets. If the carrying value of the related asset exceeds the undiscounted cash flows, the carrying value is reduced to its fair value. Various factors including future sales growth and profit margins are included in this analysis. To the

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extent these future projections or the Company s strategies change, the conclusion regarding impairment may differ from the current estimates.

Income taxes. Temporary differences arising from differing treatment of income and expense items for tax and financial reporting purposes result in deferred tax assets and liabilities that are recorded on the balance sheet. These balances, as well as income tax expense, are determined through management s estimations, interpretation of tax law for multiple jurisdictions and tax planning. If the Company s actual results differ from estimated results due to changes in tax laws, new store locations or tax planning, the Company s effective tax rate and tax balances could be affected. As such these estimates may require adjustment in the future as additional facts become known or as circumstances change.

The total amount of unrecognized tax benefits as of May 1, 2010 and May 2, 2009 was $16.1 million and $27.3 million, respectively, of which $11.7 million and $19.6 million, respectively, would, if recognized, affect the effective tax rate. The Company classifies accrued interest expense and penalties relating to income tax in the condensed consolidated financial statements as income tax expense. The total accrued interest and penalties in the condensed consolidated balance sheets as of May 1, 2010 and May 2, 2009 was $6.3 million and $9.7 million, respectively. The estimated range of the reasonably possible uncertain tax benefit decrease in the next twelve months is between $3 million and $6 million. No significant changes occurred in the status of federal, state or local jurisdiction examinations during the quarter ended May 1, 2010. Changes in the Company s assumptions and judgments can materially affect amounts recognized in the condensed consolidated balance sheets and statements of operations.

Pension obligations. The discount rate that the Company utilizes for determining future pension obligations is based on the Citigroup High Grade Corporate Yield Curve on its annual measurement date and is matched to the future expected cash flows of the benefit plans by annual periods. The discount rate decreased to 5.7% as of January 30, 2010 from 6.6% as of January 31, 2009. We believe that these assumptions have been appropriate and that, based on these assumptions, the pension liability of $130 million was appropriately stated as of January 30, 2010; however, actual results may differ materially from those estimated and could have a material impact on our consolidated financial statements. A further 50 basis point change in the discount rate would generate an experience gain or loss of approximately $7.8 million.

Seasonality and Inflation

Our business, like many other retailers, is subject to seasonal influences, with a significant portion of sales and income typically realized during the last quarter of our fiscal year due to the holiday season. Because of the seasonality of our business, results from any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

We do not believe that inflation has had a material effect on our results during the periods presented; however, there can be no assurance that our business will not be affected by such in the future.

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RESULTS OF OPERATIONS

The following table sets forth the results of operations and percentage of net sales for the periods indicated.

	Three Months Ended May 1, 2010	Three Months Ended May 2, 2009
Net sales	100.0%	100.0%
Service charges and other income	2.0	2.1
	102.0	102.1
Cost of sales	62.9	66.5
Advertising, selling, administrative and general expenses	27.1	28.1
Depreciation and amortization	4.4	4.4
Rentals	0.9	1.0
Interest and debt expense, net	1.3	1.2
Gain on disposal of assets		
Asset impairment and store closing charges	0.1	
Income before income taxes and equity in losses of joint ventures	5.3	0.9
Income taxes	1.9	0.3
Equity in losses of joint ventures	(0.0)	(0.1)
Net income	3.4%	0.5%

Net Sales

(in thousands of dollars)	Three Months Ended May 1, 2010	Three Months Ended May 2, 2009	$ Change
Net sales:			
Retail operations segment	$ 1,428,851	$ 1,414,691	$ 14,160
Construction segment	24,745	59,179	(34,434)
Total net sales	$ 1,453,596	$ 1,473,870	$ (20,274)

The percent change by category in the Company s retail operations segment sales for the quarter ended May 1, 2010 compared to the three months ended May 2, 2009, as well as the percentage by segment and category to total net sales, is as follows:

	% Change 10-09	% of Net Sales
Retail operations segment		
Cosmetics	(2.8)%	16%
Ladies apparel and accessories	1.2	37
Juniors and children s apparel	(0.9)	9
Men s apparel and accessories	3.1	16

Shoes	8.1	15
Home and furniture	(9.1)	5
		98
Construction segment		2
Total		100%

Net sales from the retail operations segment increased $14.2 million or 1% during the quarter ended May 1, 2010 compared to the quarter ended May 2, 2009, while sales in comparable stores increased 2% between the same

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periods. Sales of shoes were up significantly over the prior year while the sales in the home and furniture category experienced a significant decline.

The net sales increase reflected a 1% increase in the number of sales transactions while the average dollars per sales transaction were up moderately.

We continue to believe that in light of recent signs of modest economic improvement in the United States, we may continue to see some sales growth during the coming months; however, there is no guarantee of improved sales performance. Any further deterioration in the United States economy could have an adverse affect on consumer confidence and consumer spending habits, which could result in reduced customer traffic and comparable store sales, higher inventory levels and markdowns, and lower overall profitability.

Net sales from the construction segment decreased $34.4 million or 58% during the quarter ended May 1, 2010 compared to the quarter ended May 2, 2009 primarily because the recent slowdown in the United States economy continues to have a negative impact on demand for construction projects in private industry. We expect this decreased demand will continue throughout fiscal 2010 and into the first quarter of fiscal 2011.

Service Charges and Other Income

	Three Months Ended			
(in thousands of dollars)	**May 1, 2010**	**May 2, 2009**	**$ Change**	**% Change**
Service charges and other income:				
Retail operations segment				
Leased department income	$ 2,201	$ 3,439	$ (1,238)	(36.0)%
Income from GE marketing and servicing alliance	20,194	22,362	(2,168)	(9.7)
Shipping and handling income	3,937	3,560	377	10.6
Other	2,368	1,865	503	27.0
	28,700	31,226	(2,526)	(8.1)
Construction segment	365	200	165	82.5
Total service charges and other income	$ 29,065	$ 31,426	$ (2,361)	(7.5)

Service charges and other income is composed primarily of income from the Alliance with GE. Income from the Alliance decreased during the quarter ended May 1, 2010 compared to the quarter ended May 2, 2009 primarily due to a lower penetration rate of Dillard s branded proprietary card partially offset by lower funding costs. Leased department income declined primarily because the licensee for the fine jewelry department ceased operations of all licensed outlets during fiscal 2009.

Gross Profit (Loss)

(in thousands of dollars)	Three Months Ended May 1, 2010	May 2, 2009	Change
Gross profit (loss):			
Retail operations segment	$ 540,307	$ 491,706	$ 48,601
Construction segment	(972)	2,585	(3,557)
Total gross profit	$ 539,335	$ 494,291	$ 45,044
Gross profit (loss) as a percentage of segment net sales:			
Retail operations segment	37.8%	34.8%	3.0%
Construction segment	(3.9)	4.4	(8.3)
Total gross profit as a percentage of net sales	37.1	33.5	3.6

Gross profit improved 360 basis points of sales during the quarter ended May 1, 2010 compared to the quarter ended May 2, 2009. Gross profit from retail operations improved 300 basis points of sales during the same comparable periods as a result of the Company s improvements in inventory management and resulting decrease in markdown activity. These improvements include notable changes to the cadence of merchandise receipts to shorten the time span

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between receipt of product and point of sale. The Company will continue to emphasize these shorter cycle times throughout the rest of fiscal 2010 in an effort to reduce markdown risk and to keep customers engaged with a more continuous flow of fresh merchandise selections. Inventory declined 12% in both total and comparable stores as of May 1, 2010 compared to May 2, 2009.

All merchandise categories experienced improvements in gross margin as a percentage of sales during the quarter ended May 1, 2010 compared to May 2, 2009. Slight gross margin improvements were noted in cosmetics, home and furniture and men s clothing and accessories. Moderate improvements were noted in shoes and juniors and children s apparel, and significant improvement was noted in ladies apparel and accessories.

Gross profit from the construction segment declined 830 basis points of sales during the quarter ended May 1, 2010 compared to the quarter ended May 2, 2009. This decrease was the result of the decline in demand for construction services that has created pricing pressures in an already competitive market place. This decrease was also due to job delays from bad weather and job underperformance resulting in the recognition of a loss of $2.2 million on certain electrical contracts.

Advertising, Selling, Administrative and General Expenses (SG&A)

	Three Months Ended			
(in thousands of dollars)	**May 1, 2010**	**May 2, 2009**	**$ Change**	**% Change**
SG&A:				
Retail operations segment	$ 392,445	$ 412,792	$ (20,347)	(4.9)%
Construction segment	1,197	1,492	(295)	(19.8)
Total SG&A	$			