NORFOLK SOUTHERN CORP
Form 11-K
June 23, 2010

FORM 11-K

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

ANNUAL REPORT

[X] Annual Report Pursuant to Section 15(d) of the Securities Exchange Act of 1934

[Fee Required]

For the fiscal year ended December 31, 2009

OR

[ ] Transition Report Pursuant to Section 15(d) of the Securities Exchange Act of 1934

[No Fee Required]

For the transition period from ___________ to __________

Commission file number 1-8339

a. Full title of the Plan:

THRIFT AND INVESTMENT PLAN OF NORFOLK SOUTHERN CORPORATION

AND PARTICIPATING SUBSIDIARY COMPANIES

b. Name of issuer of the securities held pursuant to the Plan and the

address of its principal executive office:

NORFOLK SOUTHERN CORPORATION

Three Commercial Place

Norfolk, VA 23510

THE VANGUARD GROUP, INC.

P. O. Box 2900

Valley Forge, PA 19482

VANGUARD RETIREMENT SAVINGS TRUST

P. O. Box 2900

Valley Forge, PA 19482

WESTERN ASSET FUNDS, INC.

Western Asset Management Company

385 East Colorado Boulevard

Pasadena, CA 91101

THE ROYCE FUNDS

1414 Avenue of the Americas

New York, NY 10019

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Board of Managers of the Thrift and Investment Plan of Norfolk Southern Corporation and Participating Subsidiary Companies has duly caused this annual report to be signed on its behalf by the undersigned thereunto duly authorized.

THRIFT AND INVESTMENT PLAN OF

NORFOLK SOUTHERN CORPORATION AND

PARTICIPATING SUBSIDIARY COMPANIES

Date: June 23, 2010

BY: /s/G. W. Dana

G. W. Dana

Secretary, Board of Managers

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Report of Independent Registered Public Accounting Firm

The Board of Managers
Thrift and Investment Plan of Norfolk Southern Corporation

and Participating Subsidiary Companies:

We have audited the accompanying statements of assets available for benefits of the Thrift and Investment Plan of Norfolk Southern Corporation and Participating Subsidiary Companies (the Plan) as of December 31, 2009 and 2008, and the related statements of changes in assets available for benefits for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets available for benefits of the Plan as of December 31, 2009 and 2008, and the changes in assets available for benefits for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of the Plan (Schedule H, line 4i - Schedule of Assets (Held at End of Year) as of December 31, 2009) is presented for the purpose of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This supplemental schedule is the responsibility of the Plan's management. The supplemental schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ KPMG LLP

KPMG LLP

Norfolk, VA

June 23, 2010

THRIFT AND INVESTMENT PLAN OF

NORFOLK SOUTHERN CORPORATION AND PARTICIPATING SUBSIDIARY COMPANIES

Statements of Assets Available for Benefits

December 31, 2009 and 2008

	2009	2008
Assets:		
Investments (notes 4, 5 and 8):		
Interest in Master Trust for Norfolk		
Southern Corporation common stock	$ 286,131,406	$ 260,121,329
Mutual funds:		
Equity growth and income funds	134,789,628	98,295,249
Balanced funds	104,627,798	75,658,892
International stock fund	39,018,402	24,558,753
Bond fund	22,086,076	19,001,320
Common collective trust - stable value fund	103,917,860	98,374,759
Participant loans	13,584,295	12,855,559
Assets available for benefits at fair value	704,155,465	588,865,861
Adjustment from fair value to contract value for		
fully benefit-responsive investment contracts (note 1)	(2,246,530)	1,286,124
Assets available for benefits	$ 701,908,935	$ 590,151,985

See accompanying notes to financial statements.

THRIFT AND INVESTMENT PLAN OF

NORFOLK SOUTHERN CORPORATION AND PARTICIPATING SUBSIDIARY COMPANIES

Statements of Changes in Assets Available for Benefits

Years Ended December 31, 2009 and 2008

	2009	2008
Investment income (loss) (note 8):		
Net appreciation (depreciation) in fair value		
of investments (note 4)	$ 88,094,749	$ (130,603,633)
Dividends	14,382,175	16,334,864
Interest	3,643,053	4,359,142
Total investment income (loss)	106,119,977	(109,909,627)
Contributions:		
Employee contributions	27,444,459	27,371,188
Employer contributions	10,406,119	10,255,662
Assets transferred in from Thoroughbred		
Retirement Investment Plan (note 2)	722,853	5,576,320
Total contributions	38,573,431	43,203,170
Distributions:		
Benefits paid (note 9)	(32,682,323)	(42,404,421)
Administrative expenses (note 2)	(254,135)	(250,329)

Total distributions (note 9)		(32,936,458)		(42,654,750)
Net increase (decrease)		111,756,950		(109,361,207)
Assets available for benefits:				
Beginning of year		590,151,985		699,513,192
End of year	$	701,908,935	$	590,151,985

See accompanying notes to financial statements.

THRIFT AND INVESTMENT PLAN OF

NORFOLK SOUTHERN CORPORATION AND PARTICIPATING SUBSIDIARY COMPANIES

Notes to Financial Statements

December 31, 2009 and 2008

1. Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements have been prepared on an accrual basis.

The Thrift and Investment Plan of Norfolk Southern Corporation (NS) and Participating Subsidiary Companies (the Plan) meets the definition of a defined contribution employee benefit plan under the Employee Retirement Income Security Act of 1974, as amended (ERISA), and is thus subject to the reporting and disclosure, participation and vesting, fiduciary responsibility, and administration and enforcement provisions of Title I of ERISA. As an individual account plan, however, the Plan is not subject to the funding provisions of Title I or to the benefit guaranty provisions of Title IV of ERISA.

As described in Accounting Standards Codification (ASC) 946, "Financial Services - Investment Companies," and ASC 962, "Plan Accounting - Defined Contribution Pension Plans," investment contracts held by a defined-contribution plan are required to be reported at fair value. However, contract value is the relevant measurement attribute for that portion of the assets available for benefits of a defined-contribution plan attributable to fully benefit-responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the Plan. As required by the ASC, the Statements of Assets Available for Benefits present the fair value of the investment contract as well as the adjustment of the fully benefit-responsive investment contract from fair value to contract value. The Statements of Changes in Assets Available for Benefits reflect such investment contracts on a contract value basis.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(c) Investments

The presentation of investments at fair value in the accompanying financial statements of the Plan is required by and is in accordance with U.S. GAAP. Fair value is based on quotations from national securities exchanges; where securities are not listed on an exchange, quotations are obtained from brokerage firms. Fair value for investments in the Common collective trust-stable value fund is based on the estimated fair value of the underlying assets held in the fund. Investments also include participant loans, which are carried at cost, approximating fair value (note 2).

THRIFT AND INVESTMENT PLAN OF

NORFOLK SOUTHERN CORPORATION AND PARTICIPATING SUBSIDIARY

COMPANIES

The Plan's investment in NS common stock (NS Stock) is included in a Master Trust with investments in NS Stock held by the Thoroughbred Retirement Investment Plan (TRIP) of NS and Participating Subsidiary Companies. The NS Stock Fund consists of shares of NS Stock, measured at fair value, and a small cash balance for liquidity purposes, and is divided into units (rather than shares of stock) for the purpose of valuing the assets of the participating plans and the participants' accounts. A unit represents a proportionate ownership interest in investments of the Master Trust. A unit value is calculated daily by dividing the total value of NS Stock and cash, reduced by any unpaid commissions and fees associated with the Master Trust's transactions, by the total number of units credited to participants of both plans in the Master Trust. Units are allocated among the plans based on total units credited to participants of each plan. The Plan's percentage of Master Trust investment assets was 58.1% at December 31, 2009, and December 31, 2008. The Plan's interest in the fair value of Master Trust investment assets was $286,131,406 at December 31, 2009, and $260,121,329 at December 31, 2008.

Investment income for the Master Trust was as follows:

	Years Ended December 31,	
	2009	20Massachusetts

12 12 12 8.

New Hampshire
3 4 4 9.
New Jersey
19 20 20 10.
New York
21 21 21 11.
North Carolina
13 12 11 12.
Pennsylvania
25 25 23 13.
Rhode Island
1 1 1 14.
South Carolina
5 4 4 15.
Tennessee
1 1 1 16.
Virginia
9 9 9 17.
West Virginia
2 2 2

Total Stores Open at End of Year **134 135 132**

The following table represents a summary of store opening and closing activity, as well as relocation and remodel activity over the last three fiscal years:

		Fiscal Year	
	2010	**2009**	**2008**
Stores Open at Beginning of Year	135	132	132
Stores Opened During the Year	2	3	9
Stores Closed During the Year	(3)	0	(9)
Stores Open at End of Year	**134**	**135**	**132**
Stores Relocated	3	2	1
Stores Remodeled to Nevada Model	12	1	0

Nevada Model Stores Open at End of Year	39	24	18

Store leases generally have an initial term of 10 years, with three five-year renewal options, and provide for predetermined escalations in future minimum annual rent. Rent payments are amortized over the initial lease term commencing on the date we take possession. The pro rata portion of scheduled rent payments has been included in the caption Accrued lease liability on our Consolidated Balance Sheets.

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We own our distribution center located in Berlin, New Jersey. It contains approximately 707,000 square feet for distribution and warehousing and an additional 60,000 square feet used for our corporate office. This facility opened in the third quarter of 2004 at a cost of approximately $46.3 million.

ITEM 3. LEGAL PROCEEDINGS.

We are involved in legal proceedings from time to time in the ordinary course of business. Management believes that none of these legal proceedings will have a materially adverse effect on our financial condition, results of operations or cash flows. However, there can be no assurance that future costs of such litigation would not be material to our financial condition or results of operations.

ITEM 4. (REMOVED AND RESERVED)

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is listed on the NASDAQ Stock Market and trades under the symbol ACMR . The following table sets forth the high and low sales prices per share of our common stock as reported on the NASDAQ Stock Market for the periods indicated.

	High	Low
Fiscal 2010		
First Quarter	$ 3.62	$ 2.41
Second Quarter	4.20	2.06
Third Quarter	2.69	1.71
Fourth Quarter	2.90	1.82
Fiscal 2009		
First Quarter	$ 2.68	$ 1.00
Second Quarter	4.38	1.87
Third Quarter	4.21	2.85
Fourth Quarter	5.63	2.29

The number of record holders of our common stock as of March 28, 2011 was 95.

Since becoming a public company we have never declared or paid any cash dividends on our common stock. We currently intend to retain our future earnings, if any, to finance the expansion of our business and do not expect to pay any cash dividends in the foreseeable future.

See Note 8 of the Notes to Consolidated Financial Statements for a description of our equity compensation plans.

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ITEM 6. SELECTED FINANCIAL DATA.

The following selected financial data is derived from the audited Consolidated Statements of Operations, Consolidated Balance Sheets and Consolidated Statements of Cash Flows for each of the fiscal years ended January 1, 2011, January 2, 2010, January 3, 2009 and December 31, 2007 and 2006.

			Fiscal		
	2010	**2009**	**2008**	**2007**	**2006**
(In thousands except per share data)					
Statement of Operations Data:					
Net sales	$ 448,058	$ 468,889	$ 534,665	$ 559,693	$ 589,506
Gross margin	185,220	187,275	217,281	228,731	226,828
Selling, general and administrative expenses	211,390	213,268	232,307	219,597	217,923
Store pre-opening and closing expenses	2,613	4,477	8,742	3,229	4,616
Income (loss) from operations	(28,783)	(30,470)	(23,768)	5,470	913
Net income (loss)	(30,180)	(25,903)	(26,571)	3,783	(406)
Net income (loss) per share, diluted	$ (1.23)	$ (1.15)	$ (1.31)	$ 0.19	$ (0.02)
Weighted average shares outstanding, diluted	24,443	22,470	20,301	20,349	19,929
(In thousands)					
Balance Sheet Data (as of):					
Working capital	$ 73,432	$ 96,627	$ 102,074	$ 145,037	$ 143,206
Total assets	237,636	265,469	293,746	321,890	314,264
Total debt	19,000	19,000	29,071	21,642	24,214
Shareholders equity	131,413	160,074	174,300	199,600	192,505
(In thousands except sales per square foot and store count)					
Other Data:					
Cash flows from operating activities	$ 3,564	$ (17,932)	$ 17,719	$ 8,610	$ 31,496
Number of stores open at end of period	134	135	132	132	122
Net sales per total square foot (1)	$ 146	$ 155	$ 177	$ 198	$ 234
Average net sales per store (1)	$ 3,295	$ 3,519	$ 4,047	$ 4,674	$ 5,401
Comparable store sales increase (decrease) (2)	(5)%	(11)%	(9)%	(10)%	0%

Certain prior year amounts have been reclassified to conform to current year classification.

(1) Includes only stores open during the entire period.

(2) Stores are added to the comparable store base at the beginning of the fourteenth full month of operation. Comparable stores that are relocated or remodeled remain in the comparable store base. Stores that close are removed from the comparable store base as of the beginning of the month of closure.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Overview

General

We are a specialty retailer of arts, crafts and floral merchandise for a wide range of customers. Our first store opened in Moorestown, New Jersey in 1985. As of January 1, 2011, we operated 134 stores in the Eastern United States. Our stores typically range from 20,000 to 25,000 square feet with an average of 22,800 square feet. We also serve customers nationally through our e-commerce site, www.acmoore.com.

In fiscal 2010, net sales totaled $448.1 million, a decrease of 4.4 percent compared to fiscal 2009 sales of $468.9 million. For stores open for the full calendar year, our average net sales per square foot was $146 and our average net sales per store was $3.3 million. For fiscal 2010 our comparable store sales decreased by 5.4 percent. The decline in comparable store sales was primarily due to weak sales in scrapbooking, fashion crafts and seasonal products. These three departments accounted for 70 percent of the decline in comparable store sales.

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Gross margin as a percent of net sales increased 1.4 percentage points in fiscal 2010, to 41.3 percent from 39.9 percent in fiscal 2009. This 140 basis point increase in gross margin was primarily the result of improvements in promotional and everyday price management, inventory security and control. We remain focused on margin enhancement opportunities in 2011 by continuing our everyday shelf pricing and promotional price optimization initiatives, along with continued improvements in inventory control and security. The competitive environment could result in additional downward pressure on comparable store sales or cause us to be more promotional than we currently expect, which would have a negative impact on margin.

We have developed a process to review and evaluate existing store performance and the prospects for new stores in order to identify underperforming locations and develop a strategy for locations that are no longer strategically or economically viable. As a result of this analysis, we closed nine stores in fiscal 2008 and reduced our planned store openings for fiscal 2008 from a previously announced 14 locations to nine. We incurred $7.4 million in expenses related to the store closings and reduction in new store openings which included an accrual of $5.7 million for the estimated future net lease payments for stores that closed where the Company was not able to terminate its lease for the store space. In fiscal 2009 and fiscal 2010, we recorded additional store closing expenses of $3.5 million and $1.9 million, respectively, when we increased the estimated future net rental obligations for these closed stores due to continuing weakness in the commercial real estate market.

As part of this ongoing real estate portfolio review, we test the recoverability of our store fixed assets. The net book value of these assets are reviewed when events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Events that trigger a test for recoverability include material adverse changes in projected revenues and expenses, significant underperformance relative to historical or projected future operating results, and significant negative industry or economic trends. When evaluating operating stores for impairment, the asset group is at an individual store level since that is the lowest level for which cash flows are identifiable.

As a result of this analysis, we recorded impairment charges against store fixed assets of $6.0 million in fiscal 2008, $4.3 million in fiscal 2009 and $0.9 million in fiscal 2010. Management believes that it has included all available information and utilized its best estimates when performing these asset impairment tests. However, a continuing decline in store sales or gross margin could have an adverse effect on store profitability which may increase the likelihood of additional asset impairments in the future. As of the end of fiscal 2010, a total of 29 stores have been impaired and there are $26.9 million of long-lived assets, net of depreciation, associated with operating stores.

Business and Operating Strategy

We have experienced net losses in each of the last three fiscal years. These losses are primarily the result of declines in same store sales for each of the last four years. We anticipate a net loss in fiscal 2011. Management s primary business and operating initiatives are designed to address what we believe to be opportunities to improve our results. These initiatives support our focus on driving sales, improving store profitability and increasing gross margin.

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Drive sales. We continue to be focused on driving sales through better execution in customer service; a broad and differentiated merchandise assortment; a high in-stock position, especially in basic craft components; and increased productivity of our integrated marketing/advertising programs.

Customer insight. Understanding our customers expectations of A.C. Moore, along with product trends and customer interests, is core to our ability to develop stronger relationships and be our customers store of choice. We primarily utilize our social networking sites and our REWARDS loyalty program to gain consumer insight, supplemented by other studies from time to time.

Differentiated merchandise assortment. We continually seek to identify new and unique product lines and merchandise assortments that differentiate us from our competitors. We regularly review our supplier base and product assortment to ensure that we are offering newness to our customers and enhancing the overall shopping experience.

Improved in-stock position. A high in-stock position is critical to maximizing our sales potential and enhancing customer loyalty. Since 2007, we have invested significant resources in supply chain and inventory management systems. We continue to refine our inventory management processes to ensure we maintain high in-stock levels, especially on basic craft components that are meaningful to our customers.

Integrated marketing/advertising program. We continue to enhance and diversify our marketing and advertising mix based on our customer and craft consumer preferences. Our marketing mix is designed to allow us to reach both current and prospective customers in an efficient manner. Diversified marketing vehicles allow us to market more efficiently based on our customer product preferences. Through these different vehicles, we can target our marketing of promotional items, new products and programs, creating both sales and margin enhancements.

Promotional strategies. We continue to test new advertising and marketing vehicles to enhance both sales and margin. While print advertising remains an important vehicle for us, we continue to build our direct marketing capabilities to drive profitable sales and traffic from both existing and prospective customers. We also continue to test other vehicles based on insight on how our customers and crafters use media.

A.C. Moore Rewards program. In July 2009, we launched our REWARDS customer loyalty program throughout the chain. We utilize this powerful tool to interact with our customers based on their purchase history and product preferences, delivering targeted product information and promotions. We believe this initiative will increase our share of wallet with our existing customers and enable us to differentiate ourselves from our competition.

Improve store profitability. We continue to strive to improve our store profitability. During 2010, we continued to focus on improving store profitability using the following tactics:

Real estate portfolio strategy. Management continually reviews opportunities to open stores in new and existing markets and to relocate or remodel existing stores where strategically prudent and economically viable. Existing stores are reviewed on a periodic basis to identify underperforming locations for potential relocation, remodeling or closure. During 2010, we opened two new stores, relocated three stores, and remodeled 12 stores. We also completed several lease renegotiations, which lowered the cost of occupancy in these stores.

Store operations leadership. In fiscal 2010, we reorganized our store operations leadership team to provide more training and development capabilities within our field organization. We believe this structure will enhance our ability to improve store profitability.

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Increase gross margin. We are focused on increasing gross margin through implementation of a category management process where we regularly review our product mix, and optimize our regular and promotional prices and supply chain.

Category management. The category management process leverages merchandise assortment planning tools, the use of a merchandise planning calendar and an open-to-buy process focused on sales and inventory productivity.

Price optimization. We believe we have significant opportunities to increase our gross margin by optimizing our regular shelf prices and employing our market basket tools to improve the profitability and sales of promotional products. We believe that we offer competitive pricing, but there are opportunities to strategically improve margins while focusing on growing market share.

Supply chain optimization. In addition to our ongoing supply chain initiatives, which include improving in-stock positions, optimizing inventory levels, increasing merchandise turns and improving distribution efficiencies, in fiscal 2010 we completed two significant projects: automated replenishment and advance shipment notification (ASN) supported cross-docking. Over 70 percent of our products were on automated replenishment by the end of fiscal 2010, improving service levels to our stores. Our second key project was ASN supported cross-docking. This program now allows our vendors to ship orders, which were previously shipped to stores, directly to our warehouse. Once at our warehouse, these orders are received, combined with orders picked from our warehouse stock and shipped to the stores on the same trailers. This project has lowered vendor direct-to-store shipments, reduced freight costs, and enabled us to leverage our current distribution center to handle the vast majority of all merchandise sold in our stores, allowing store associates to spend more time serving our customers. At the end of fiscal 2010, over 90 percent of our merchandise was shipped to stores directly from our distribution center.

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Results of Operations

The following table sets forth, for the periods indicated, selected statement of operations data expressed as a percentage of net sales:

	Fiscal		
	2010	2009	2008
Net sales	100.0%	100.0%	100.0%
Cost of sales	58.7	60.1	59.4
Gross margin	41.3	39.9	40.6
Selling, general and administrative expenses	47.2	45.5	43.4
Store pre-opening and closing expenses	0.6	1.0	1.6
Loss from operations	(6.4)	(6.5)	(4.4)
Interest expense (income), net	0.2	0.2	0.6
Loss before income taxes	(6.6)	(6.7)	(5.0)
Provision for (benefit from) income taxes	0.1	(1.2)	(0.0)
Net loss	(6.7)%	(5.5)%	(5.0)%

Fiscal 2010 Compared to Fiscal 2009

Net Sales. Net sales decreased $20.8 million, or 4.4 percent, to $448.1 million in fiscal 2010 from $468.9 million in fiscal 2009. This decrease was due to (i) a comparable store sales decrease of $24.9 million, or 5.4 percent, (ii) an increase in net sales of $6.8 million from stores not included in the comparable store base and e-commerce sales, and (iii) a decrease in net sales of $2.8 million from stores closed since the comparable period last year. The decline in comparable store sales was primarily due to weak sales in scrapbooking, fashion crafts and seasonal products. These three departments accounted for 70 percent of the decline in comparable store sales. Categories that experienced comparable store sales increases included cake decorating and candy making, everyday floral and checkout or impulse products. We ended the year with 130 custom frame shops, the same number we had at the end of fiscal 2009.

Comparable store sales increase (decrease) represents the increase (decrease) in net sales for stores open during the same period of the previous year. Stores are added to the comparable store base at the beginning of the fourteenth full month of operation. Comparable stores that are relocated or remodeled remain in the comparable store base. Stores that close are removed from the comparable store base as of the beginning of the month of closure.

Gross Margin. Gross margin is net sales minus the cost of merchandise which includes purchasing and receiving costs, inbound freight, duties related to import purchases, internal transfer costs and warehousing costs. Gross margin as a percent of net sales increased 1.4 percent in fiscal 2010 to 41.3 percent, from 39.9 percent in fiscal 2009. This 140 basis point increase in gross margin was primarily the result of promotional and everyday price management, inventory control and security. We remain focused on margin enhancement opportunities in 2011 by continuing our everyday shelf pricing and promotional price optimization initiatives along with continued improvements in inventory control and security. The competitive environment could result in additional downward pressure on comparable store sales or cause us to be more promotional than we currently expect, which would have a negative impact on margin.

Selling, General and Administrative Expenses. Selling, general and administrative expenses include: (i) direct store level expenses, including rent and related operating costs, payroll, advertising, depreciation and other direct costs, and (ii) corporate level costs not directly associated with or allocable to cost of sales including executive salaries, accounting and finance, corporate information systems, office facilities, stock based compensation and other corporate expenses.

In fiscal 2010, selling, general and administrative expenses totaled $211.4 million compared to $213.3 million in fiscal 2009, a reduction of $1.9 million. This decrease was primarily attributable to a reduction in asset impairment charges in fiscal 2010 compared to fiscal 2009 and a shift to lower cost advertising media, partially offset by an increase in severance benefits. As a percent of net sales, selling, general and administrative expenses increased 1.7 percent in fiscal 2010, to 47.2 percent from 45.5 percent in fiscal 2009. On a per store average basis this represents a 2.2 percent decrease compared to fiscal 2009.

Store Pre-Opening and Closing Expenses. We expense store pre-opening costs as they are incurred, which includes lease costs prior to a store opening. Store closing costs include severance, inventory liquidation costs, asset related charges, lease termination payments and the net present value of future rent obligations less estimated sub-lease income.

Pre-opening expenses for the two stores opened and the three stores relocated in fiscal 2010 were $0.4 million. For the three stores opened and the two stores that relocated in fiscal 2009, preopening expenses were $0.5 million.

In fiscal 2010, store closing expenses were $2.2 million. These charges are related to the three stores we closed in 2010 and revisions in the estimates of net future rent obligations for stores that were closed in prior years. In fiscal 2009, we did not close any stores. The $4.0 million in store closing expenses for that period related to revisions in estimates of net future rent obligations for stores that were closed in prior years.

Interest Income and Expense. In fiscal 2010, interest expense decreased to $1.0 million compared to $1.4 million in fiscal 2009. Fiscal 2009 included interest expense of $0.4 million related to the termination of an interest rate swap. Fiscal 2010 interest income was less than $0.1 million compared to $0.3 million in fiscal 2009. This decline is the result of a decline in investments and lower interest rates.

Income Taxes. In June 2010, the Company reached a preliminary agreement with the Internal Revenue Service on all open audit issues relating to the 2003 through 2008 tax years. This agreement resulted in a $0.4 million reduction of a refund related to a previously filed net operating loss carry back claim and was recorded as income tax expense in fiscal 2010. Based upon its historical and continuing operating losses, the Company recorded a 100 percent valuation allowance against its net deferred tax assets in fiscal 2010 and expects to continue to do so in fiscal 2011. The expiration of statutes and closing of audits during fiscal 2011 may reduce the amount of unrecognized tax benefits by approximately $0.3 million which would result in a current tax benefit.

Fiscal 2009 Compared to Fiscal 2008

Net Sales. Net sales decreased $65.8 million, or 12.3 percent, to $468.9 million in fiscal 2009 from $534.7 million in fiscal 2008. This decrease was due to (i) a comparable store sales decrease of $55.3 million, or 10.8 percent, (ii) an increase in net sales of $7.1 million from stores not included in the comparable store base and e-commerce sales, and (iii) a decrease in net sales of $17.6 million from stores closed since the comparable period last year. The decline in comparable store sales was primarily due to weak sales in scrapbooking, ready made frames and seasonal products. These three departments accounted for 81% of the decline in comparable store sales. Categories that performed better than average included kid s activities, custom framing, cake and candy making, and yarn. We ended the year with 130 custom frame shops, versus 120 at the end of fiscal 2008.

Gross Margin. Gross margin is net sales minus the cost of merchandise which includes purchasing and receiving costs, inbound freight, duties related to import purchases, internal transfer costs and warehousing costs. Gross margin as a percent of net sales decreased 0.7 percent in fiscal 2009, to 39.9 percent from 40.6 percent in fiscal 2008. The 70 basis point decrease in gross margin was attributable to clearance activity based on over 20 department resets during the year, increased promotional activity on seasonal merchandise and a deleveraging of distribution and buying expenses measured against a decline in sales. We expect to grow our margin in 2010 through category management, with heavy emphasis on price optimization on everyday shelf prices and promotional programs. However, competitive pressure could result in additional downward pressure on comparable store sales or cause us to be more promotional than we currently expect, which would have a negative impact on margin.

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Selling, General and Administrative Expenses. Selling, general and administrative expenses include: (i) direct store level expenses, including rent and related operating costs, payroll, advertising, depreciation and other direct costs, and (ii) corporate level costs not directly associated with or allocable to cost of sales including executive salaries, accounting and finance, corporate information systems, office facilities, stock based compensation and other corporate expenses.

In fiscal 2009, selling, general and administrative expenses totaled $213.3 million compared to $232.3 million in fiscal 2008, a reduction of $19.0 million. This decrease was primarily attributable to reductions in store payroll as well as a reduction in store occupancy costs resulting from operating fewer stores, on average, during 2009 compared to 2008. In addition, last year included an asset impairment of $6.0 million compared to $4.3 million this year. As a percent of net sales, selling, general and administrative expenses increased 2.1 percent in fiscal 2009, to 45.5 percent from 43.4 percent in fiscal 2008. This increase was a result of the deleveraging of expenses against a decline in store sales.

Store Pre-Opening and Closing Expenses. We expense store pre-opening costs as they are incurred, which includes lease costs prior to a store opening. Store closing costs include severance, inventory liquidation costs, asset related charges, lease termination payments and the net present value of future rent obligations less estimated sub-lease income.

Pre-opening expenses for the three stores opened and the two stores relocated in fiscal 2009 were $0.5 million. For the nine stores opened and the one store that relocated in fiscal 2008, preopening expenses were $1.3 million.

In fiscal 2009 store closing expenses were $4.0 million. These charges are primarily related to revisions in the estimates for the net future rent obligations, after consideration of estimated sub-lease income, for stores that were closed in prior years. In fiscal 2008, store closing expenses for the nine stores which closed and the new stores which did not open were $7.4 million, which includes $5.7 million in estimated net lease termination payments, $0.6 million in asset related charges and $1.1 million for severance, inventory liquidation and other costs.

Interest Income and Expense. In fiscal 2009, interest expense decreased to $1.4 million compared to $4.2 million in fiscal 2008. Fiscal 2008 included interest expense of $2.4 million from adjusting an interest rate swap to fair market value because it no longer qualified for cash flow hedge accounting treatment. The remainder of the decrease is the result of lower interest rates. Fiscal 2009 interest income was $0.3 million compared to $1.2 million in fiscal 2008. This decline is the result of a decline in investments and lower interest rates.

Income Taxes**.** Our effective tax rate for fiscal 2009 was a benefit of 17.9 percent. In December 2009, a federal tax law change extended the carry back period for net operating losses to five years from a previously allowed two years. This change allowed the Company to recognize $15.8 million of net operating losses and as a result recorded a tax benefit of $6.0 million. During fiscal 2008, we generated a cumulative three-year loss. Based on this and other available evidence, management concluded that a valuation allowance of $10.5 million should be recorded against its net deferred tax asset. In fiscal 2008, our effective income tax rate was a benefit of 0.9 percent. In fiscal 2009, the Company continued to record a valuation allowance against its net deferred tax asset and absent the federal tax law change described above the Company s effective tax rate for fiscal 2009 would have been close to zero percent.

Quarterly Results and Seasonality

The following table sets forth unaudited quarterly operating results for our twelve most recent quarterly periods, and the number of stores open at the end of each period (dollars in thousands, except share and store data).

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 2010 (a)				
Net sales	$ 105,369	$ 99,850	$ 99,669	$ 143,170
Gross margin	45,468	43,554	42,234	53,964
Loss from operations	(7,312)	(8,958)	(7,916)	(4,596)
Net loss	(7,563)	(9,662)	(8,147)	(4,807)
Net loss per share, diluted	$ (0.31)	$ (0.40)	$ (0.33)	$ (0.20)
Diluted average shares outstanding	24,342	24,419	24,494	24,531
Number of stores open at end of period	136	135	135	134
Comparable store sales decrease	(5)%	(6)%	(7)%	(4)%
Fiscal 2009				
Net sales	$ 108,647	$ 104,442	$ 106,083	$ 149,717
Gross margin	46,547	43,464	40,733	56,531
Loss from operations	(3,684)	(8,031)	(12,694)	(6,061)
Net loss	(4,308)	(8,149)	(12,909)	(537)
Net loss per share, diluted	$ (0.21)	$ (0.38)	$ (0.53)	$ (0.02)
Diluted average shares outstanding	20,305	21,323	24,325	24,325
Number of stores open at end of period	132	133	133	135
Comparable store sales decrease	(13)%	(14)%	(8)%	(9)%
Fiscal 2008				
Net sales	$ 126,544	$ 126,430	$ 116,661	$ 165,030
Gross margin	54,111	52,363	50,433	60,374
Loss from operations	(2,127)	(6,622)	(4,285)	(10,734)
Net loss	(1,767)	(4,265)	(7,539)	(13,000)
Net loss per share, diluted	$ (0.09)	$ (0.21)	$ (0.37)	$ (0.64)
Diluted average shares outstanding	20,299	20,299	20,300	20,304
Number of stores open at end of period	136	139	135	132
Comparable store sales decrease	(12)%	(5)%	(9)%	(9)%

(a) In the fourth quarter of fiscal 2010 the Company recorded a $774 out of period charge to Selling, general and administrative expenses and reduction to fixed assets to reflect increased depreciation in the current period resulting from the correction of understatements of depreciation in the prior quarters of fiscal 2010. This adjustment had no impact on the full year fiscal 2010 Consolidated Statement of Operations or Consolidated Balance Sheets. The company determined the impact of this adjustment was not material to the financial position or results of operations for the current and prior interim periods.

Due to the importance of our peak selling season, which includes the Fall and Winter holiday seasons, the fourth quarter has historically contributed, and is expected to continue to contribute, a significant portion of our operating results for the entire year. As a result, any factors negatively affecting us during the fourth quarter of any year, including adverse weather and unfavorable economic conditions, would have a material adverse effect on our results of operations for the entire year.

Our quarterly results of operations also may fluctuate based upon such factors as the length of holiday seasons, the date on which holidays fall, the number and timing of new store openings, the amount of store pre-opening expenses, the amount of net sales contributed by new and existing stores, the mix of products sold, the amount of sales returns, the timing and level of markdowns and other competitive factors.

Liquidity and Capital Resources

We have experienced net losses in each of the past three years. We had net losses in fiscal 2008, fiscal 2009 and fiscal 2010 of $26.6 million, $25.9 million and $30.2 million respectively. We anticipate a net loss in fiscal 2011. These losses are primarily the result of declines in same store sales for each of the last four years. Our same store sales declined 10.3% in fiscal 2007, 8.7% in fiscal 2008, 10.8% in fiscal 2009 and 5.4% in fiscal 2010.

One of our primary sources of liquidity is a $60.0 million credit facility provided by Wells Fargo Retail Finance, LLC (WFRF Loan Agreement). Although we currently have $37.8 million of availability and have not increased our borrowing under this credit facility since it was put in place two years ago, the agreement does contain various events of default which if triggered would allow the lender to take actions including raising the interest rate, discontinuing advances and accelerating the Company s obligations. This agreement was due to expire on January 15, 2012.

On March 4, 2011, the Company entered into an amendment with WFRF (the WFRF amendment). The WFRF amendment renewed the facility for an additional five years, until March 4, 2016. Prior to the WFRF amendment, interest was calculated at either adjusted LIBOR or WFRF s base rate plus a margin of between 1.75 and 2.50 percent per annum, depending upon the level of excess availability as defined in the loan agreement. In addition, the Company paid an annual fee of between 0.25 and 0.50 percent per annum on the amount of unused availability, also dependent on the level of excess availability. As a result of the amendment, interest is calculated at either adjusted LIBOR or WFRF s base rate plus a margin of between 2.25 and 2.75 percent per annum, depending upon the level of excess availability, and WFRF s base rate has a floor equal to the adjusted LIBOR rate plus 1.00 percent per annum. In addition, the Company will pay an annual fee between 0.375 and 0.50 percent per annum on the amount of unused availability, also dependent on the level of excess availability. At closing, the Company paid or incurred deferred financing costs of approximately $0.4 million that will be amortized over the term of the facility. The amendment also modified certain provisions of the agreement in order to permit the Company to enter into, and perform its obligations under, contracts to effect a strategic alternatives transaction (as defined in the WFRF amendment). However, in order to consummate a strategic alternatives transaction, the Company will need to either payoff and terminate the credit facility or obtain WFRF s consent.

On February 15, 2011, the Company announced that it had engaged Janney Montgomery Scott LLC to serve as financial advisor in the exploration of strategic alternatives to enhance shareholder value. These alternatives include, but are not limited to, a sale of the Company, corporate financing or capital raise. The Company has received third party expressions of interest but there can be no assurance that a transaction will result from this process.

Our capital requirements are primarily to support seasonal increases in inventory and inventory purchases for new stores, capital assets to support new, remodeled and relocated stores as well as investments in information technology infrastructure and systems. In recent years, we have financed operations and new store growth primarily with cash generated from operating activities and a $10.0 million private placement of our common stock which occurred in May of 2009. In January 2009, we entered into a financing agreement with WFRF at which time we borrowed $19.0 million under the WFRW loan agreement, the proceeds of which were used to repay the outstanding balance of an existing loan agreement with Wachovia Bank.

As of our 2010 and 2009 fiscal year ends, we had working capital of $72.8 million and $96.6 million, respectively. In fiscal 2010, net cash provided by operating activities totaled $3.6 million as compared to $17.9 million of cash used in operations in fiscal 2009. This increase of $21.5 million was primarily attributable to a $16.9 million decrease in our net investment in inventory (merchandise inventory less trade payables) in fiscal 2009 compared to a $14.9 million increase in fiscal 2009. In fiscal 2010, our year-end inventory decreased $10.8 million compared to our fiscal 2009 ending inventory. This decrease was realized through reductions in warehouse inventory. In fiscal 2010 we completed enhancements to our warehouse supply chain software which allowed us to efficiently cross dock merchandise through the warehouse directly onto the outbound store delivery. Our fiscal 2010 year-end in-store inventory increased by 10 percent compared to year-end of fiscal 2009.

In fiscal 2009 our inventory increased because we moved up the receipt date of much of our spring 2010 seasonal merchandise to the fourth quarter of 2009. This allowed us to set the merchandise in stores earlier and maximize our first quarter 2010 seasonal sales. We also moved purchases forward into the fourth quarter of 2009 that would have been subject to increased tariffs had they been received in 2010.

In fiscal 2008, we were able to reduce our inventory by more than $17.0 million through a combination of reductions in imported merchandise and better category management. Reducing our import purchases allowed us to order closer to customer demand which is particularly beneficial in a difficult sales environment. Improved category management provided for a better sell through on seasonal merchandise.

Cash used in investing activities during fiscal years 2010, 2009 and 2008 was $9.4 million, $10.3 million and $15.9 million respectively, all of which were for capital expenditures. In fiscal 2010 we invested $9.4 million including $5.8 million for new, relocated and remodeled stores, $2.3 million for store maintenance capital and the remainder for technology infrastructure and systems. In fiscal 2009, we invested $10.3 million including $3.4 million for new and relocated stores, $3.8 million for technology infrastructure and systems and the remainder for remodeling existing stores and maintenance capital. In fiscal 2008, $15.9 million was invested, including $7.9 million for new store openings, $6.2 for information technology infrastructure and systems with the remainder for remodeling existing stores and warehouse equipment. The Company estimates that capital expenditures in fiscal 2011 will be approximately $7.5 million. This includes $2.2 million for new and remodeled stores, $2.6 million for maintenance capital and the balance for information technology and distribution center equipment.

At the end of fiscal 2008, the Company had a loan agreement with Wachovia Bank (Wachovia Loan Agreement) which consisted of two mortgage agreements and a line of credit. There was $19.1 million outstanding under these mortgages and $10.0 million outstanding under the line of credit. The Company had entered into a pay fixed interest rate swap agreements on these mortgages. The line of credit was for $30.0 million and was due to expire on May 30, 2009.

On January 15, 2009, the Company terminated the Wachovia Loan Agreement and interest rate swaps and entered into a new credit agreement with WFRF (WFRF loan agreement). This agreement, which was due to expire on January 15, 2012, is an asset-based senior secured revolving credit facility with an aggregate principal amount of up to $60.0 million, with a $15.0 million sub-limit for letters of credit. At closing, the Company borrowed $19.0 million under this agreement and combined with $13.2 million of its own funds repaid all outstanding obligations under the Wachovia Loan Agreement including $18.9 million of principal and interest to satisfy the mortgages, $10.0 million to repay an advance under the line of credit and $2.8 million to terminate the interest rate swaps. Borrowings under this agreement are for revolving periods of up to three months. Subject to availability, there is no debt service requirement during the term of this agreement. As of January 1, 2011, there was a $19.0 million loan and $3.2 million of stand-by letters of credit outstanding against the line of credit, leaving availability of $37.8 million.

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The WFRF loan agreement contains customary terms and conditions which, among other things, restrict the Company s ability to incur additional indebtedness or guaranty obligations, create liens or other encumbrances, pay dividends, redeem or issue certain equity securities or change the nature of the business. In addition, there are limitations on the type of investments, acquisitions, or dispositions the Company can make. The Company is also required to maintain greater than $90.0 million in book value of inventory and have excess availability of more than 10 percent of the borrowing base or $6.0 million, whichever is less.

The WFRF loan agreement also defines various events of default which include, without limitation, a material adverse effect (as defined in the agreement), failure to pay amounts when due, cross-default provisions, material liens or judgments, insolvency, bankruptcy or a change of control.

In March 2008, the Company received permission from the Internal Revenue Service to change its method of accounting for inventory effective on its 2007 income tax return. As a result of this change, the Company received a tax refund of $7.0 million in June 2008. In fiscal 2009 the Company received tax refunds of $7.7 million from tax losses generated in fiscal 2008 that it was able to carry back to prior years.

We believe our cash on hand, cash generated from operations during the year and available borrowings under our credit agreement with WFRF will be sufficient to finance our working capital and capital expenditure requirements for at least the next 12 months.

We lease our retail stores and some equipment under non-cancelable operating leases. At January 1, 2011, our total obligations under these operating leases were $211.5 million. The following table reflects as of January 1, 2011 the payments due (including those for unopened stores) for the periods indicated.

	Payments Due By Period ($000)				
Contractual Obligations	**Total**	**< 1 Year**	**1 3 Years**	**4 5 Years**	**> 5 Years**
Short-term debt (1)	$ 19,000	$ 19,000	$	$	$
Store operating leases (2)	210,644	42,752	101,090	36,967	29,834
Equipment leases	904	454	450		
Purchase obligations (3)	3,329	1,796	1,533		
Deferred tax liability (4)					
Liability for uncertain tax positions (5)					
Total contractual cash obligations	**$ 233,877**	**$ 64,003**	**$ 103,073**	**$ 36,967**	**$ 29,834**

(1) Short-term debt represents advances under the Company s line of credit. These advances are renewed over periods of between 30 and 90 days.

(2) Most store leases have an average initial term of ten years, with three five-year renewal options, and provide for predetermined escalations in future minimum annual rent. Rent payments are amortized over the initial lease term commencing on the date we take possession. The pro rata portion of scheduled rent escalations has been included in other long-term liabilities in the balance sheet. Amounts listed in this table only include minimum rent payments. Most leases contain provisions that require payment for other items such as real estate taxes, common area maintenance and insurance. Historically, these additional items have been equal to approximately 35 percent of the minimum lease payments.

(3) Purchase obligations include agreements for goods and services that are enforceable and legally binding to the Company and that specify all significant terms. Such obligations were primarily for the purchase of information technology hardware and software.

(4)

The amount of deferred income taxes has been excluded from the above table as the timing of any cash payment is uncertain. See Note 7 of the Notes to Consolidated Financial Statements for additional information regarding our deferred tax position.

(5) The Company s liability for uncertain tax positions was excluded from the table above, as the timing of any cash payment is uncertain. See Note 7 of the Notes to Consolidated Financial Statements for additional information regarding our uncertain tax positions.

Critical Accounting Estimates

Our accounting policies are more fully described in Note 1 of the Notes to Consolidated Financial Statements included herein. As disclosed in Note 1 of the Notes to Consolidated Financial Statements, the preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Since future events and their effects cannot be determined with absolute certainty, actual results may differ from those estimates. Management makes adjustments to its assumptions and judgments when facts and circumstances dictate. The amounts currently estimated by us are subject to change if future events cause us to change our assumptions. We evaluate our estimates and judgments on an ongoing basis and predicate those estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Management believes the following critical accounting estimates encompass the more significant judgments and estimates used in preparation of the Consolidated Financial Statements.

Merchandise Inventories. The Company values its inventory at the lower of cost or market, with cost determined using a weighted average method based upon the purchase order cost of the merchandise at time of receipt. The cost of purchasing, warehousing, and transportation are also included in the cost of inventory. Vendor allowances, which primarily represent volume discounts and cooperative advertising funds, are recorded as a reduction in the cost of merchandise inventories. For merchandise where we are the direct importer, ocean freight and duty are included as inventory costs. These additional costs and cost adjustments are not assigned to specific units of inventory. Management uses all available information to determine the appropriate amount of net inventory costs to be recognized and deferred in each reporting period.

Perpetual inventory records are used to value store and warehouse inventories. A full physical inventory is taken at every location at least once per year and the perpetual records are adjusted to the physical counts. Estimates for inventory shrinkage from the date of the most recent physical inventory through the end of each reporting period are based on results from physical inventories and shrink trends. These estimates are updated to actual at the time of the physical inventory. A 10 percent change in our estimate for inventory shrinkage would have impacted gross margin by approximately $0.7 million for fiscal 2010.

Our inventory valuation methodology also requires other management estimates and judgment, such as the net realizable value of merchandise designated for clearance or slow-moving merchandise. Our adjustment to inventory cost for clearance and slow-moving merchandise is based on several factors including the quantity of merchandise on hand, sales trends and future advertising and merchandising plans. The accuracy of these estimates can be impacted by many factors, some of which are outside of management s control, including changes in economic conditions and consumer buying trends. Based on prior experience we do not believe the assumptions used in these estimates will change significantly. A 10 percent change in this adjustment to inventory cost would have impacted gross margin by approximately $0.6 million for fiscal 2010.

Impairment of Long-lived Assets. In accordance with generally accepted accounting principles, we review long-lived assets for impairment whenever events or changes in circumstance indicate that their carrying amount may not be recoverable by comparing the carrying value of the assets with the estimated future undiscounted cash flows that those assets will generate. This analysis is performed for each asset group, which in the case of our retail operations is at the individual store level. To the extent these future estimates change, the conclusion regarding impairment may differ from our current estimates, and the loss, if any, would be recognized at that time. The impairment loss is calculated as the difference between asset carrying values and the present value of estimated net cash flows, giving consideration to recent operating performance and pricing trends. We recorded impairment losses totaling $0.9 million, $4.3 million and $6.0 million, in fiscal 2010, fiscal 2009 and fiscal 2008 respectively.

Reserve for Closed Stores. We maintain a reserve for future rental obligations, carrying costs and other costs related to closed stores. We recognize exit costs for store closures at the time the store is closed. The costs of closing a store or facility are calculated as the present value of future rental obligations remaining under the lease, less estimated sublease rental income or the lease termination fee. The determination of these reserves is dependent on our ability to make reasonable estimates of costs to be incurred post-closure and of rental income to be received from subleases. The reserves could vary materially if market conditions were to vary significantly from our assumptions. Once a store has been identified for closure, we accelerate the remaining depreciation so that the assets are fully depreciated at the date of closure.

Income Taxes. The Company uses the asset and liability method of accounting for income taxes. We do business in various jurisdictions that impose income taxes. Management determines the aggregate amount of income tax expense to accrue and the amount currently payable based upon the tax statutes of each jurisdiction. This process involves adjusting income determined using generally accepted accounting principles for items that are treated differently by the applicable taxing authorities. The tax rate we use throughout the year is based on our estimate of an annual effective rate. This rate is evaluated quarterly and adjusted for known trends in earnings and permanent tax differences. We also evaluate the effect of any changes in uncertain tax positions including the initiation or settlement of audits.

Deferred taxes are reflected on our balance sheet for temporary differences that will reverse in subsequent years. A change in tax rates is recognized as income or expense in the period in which the change becomes effective. Valuation allowances are recorded to reduce the carrying amount of deferred tax assets, when it is more likely than not that such assets will not be realized. In fiscal 2008, the Company determined that it was necessary to record a valuation allowance against its net deferred tax assets due to, among other factors, the Company s cumulative three-year loss position. In fiscal 2010, the Company was still in a cumulative three-year loss position and continued to record a valuation allowance against its deferred tax assets. As of January 1, 2011, this valuation allowance was $31.7 million. Based upon its historical and continuing operating losses, the Company expects to record 100 percent valuation allowances against its net deferred tax assets in fiscal 2011. The expiration of statutes and closing of audits in fiscal 2011 may reduce the amount of unrecognized tax benefits by approximately $0.3 million which would result in a current tax benefit.

In the fourth quarter of fiscal 2009 there was a change in the Internal Revenue Code that extended the period from 2 years to 5 years over which the Company could carry back its net operating losses. As a result of this change the Company was able to utilize $15.8 million of net operating losses and as a result recorded an income tax benefit in 2009 of $6.0 million. In June 2010, the Company reached a preliminary agreement with the Internal Revenue Service on all open audit issues relating to the 2003 through 2008 tax years. This agreement resulted in a $0.4 million reduction of a refund related to a previously filed net operating loss carry back claim and was recorded as income tax expense in fiscal 2010.

Other Estimates. Management uses estimates in the determination of the required accruals for general liability, workers compensation and health insurance. These estimates are based upon examination of historical trends, industry claims experience and, in certain cases, calculations performed by third-party experts. We maintain coverage that limits our loss exposure on both a per-claim and aggregate basis for certain risks. Projected claims information may change in the future and may require management to revise these accruals. Historically, these revisions have not been significant.

We are periodically involved in various legal actions arising in the normal course of business. Management is required to assess the probability of any adverse judgments as well as the potential range of any losses. Management determines the need for any required accruals after a diligent review of the facts of each legal action. Any accruals may change in the future due to new developments in these matters**.**

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Change in Accounting Principles

Effective January 1, 2008, the Company changed its method of accounting for store inventories from the retail inventory method to weighted average cost. See the *Merchandise Inventories* section of Note 1, Summary of Significant Accounting Policies for further discussion.

New Accounting Pronouncements

In February 2010, we adopted revised guidance that removes the requirement to disclose the date through which an entity has evaluated subsequent events. This amendment was made to alleviate potential conflicts with existing SEC guidance. The adoption did not have a material impact on our financial statements.

In January 2010, the FASB issued guidance requiring new disclosures about recurring or nonrecurring fair value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances and settlements on a gross basis in the Level 3 reconciliation. We adopted this guidance as of January 1, 2010, except for the Level 3 reconciliation disclosures, which are deferred until annual periods beginning after December 15, 2010. The adoption did not have a material impact on our financial statements. See Note 1, *Fair Value of Financial Instruments*, for additional information.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We invest cash balances in excess of operating requirements primarily in money market accounts. The fair value of our cash and equivalents at January 2, 2011 approximated carrying value. A hypothetical decrease in interest rates of 10 percent compared to the rates in effect at year end would reduce our interest income by less than $0.1 million annually.

At January 2, 2010, the Company had $19.0 million outstanding under its loan agreement. The interest rate on the loan fluctuates with market rates and therefore the fair value of this financial instrument will not be impacted by a change in interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
A.C. MOORE ARTS & CRAFTS, INC.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of A.C. Moore Arts & Crafts, Inc.

In our opinion, the consolidated financial statements listed in the accompanying index appearing under Item 8 present fairly, in all material respects, the financial position of A.C. Moore Arts & Crafts, Inc. and its subsidiaries at January 1, 2011 and January 2, 2010 and the results of their operations and their cash flows for each of the three fiscal years in the period ended January 2, 2010 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 1, 2011 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 3 to the consolidated financial statements, the Company changed the manner in which it accounts for store inventory in 2008.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Philadelphia, PA
March 31, 2011

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A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands except shares)

	January 1, 2011	January 2, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,970	$ 45,952
Inventories	111,266	122,058
Prepaid expenses and other current assets	9,104	9,239
Prepaid and receivable income taxes		472
Deferred tax assets	2,153	3,577
	162,493	181,298
Non-current assets:		
Property and equipment, net	73,771	81,938
Other assets	1,192	2,233
	$ 237,456	**$ 265,469**
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Short-term debt	$ 19,000	$ 19,000
Trade accounts payable	43,131	37,047
Accrued payroll and payroll taxes	2,224	1,973
Accrued expenses	22,815	24,580
Accrued lease liability	2,478	2,071
	89,648	84,671
Non-current liabilities:		
Deferred tax liability and other	1,920	3,344
Accrued lease liability	14,475	17,380
	16,395	20,724
	106,043	105,395
Commitments and contingencies (See Note 10)		
Shareholders equity:		
Preferred stock, no par value, 10,000,000 shares authorized; none issued		

Common stock, no par value, 40,000,000 shares authorized; shares issued and outstanding 25,346,412 and 24,851,594 at January 1, 2011 and January 2, 2010, respectively	138,105	136,586
Retained earnings (deficit)	(6,692)	23,488
	131,413	160,074
	$ 237,456	**$ 265,469**

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

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A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands except per share data)

	Fiscal 2010	Fiscal 2009	Fiscal 2008
Net sales	$ 448,058	$ 468,889	$ 534,665
Cost of sales (including buying and distribution costs)	262,838	281,614	317,384
Gross margin	185,220	187,275	217,281
Selling, general and administrative expenses	211,390	213,268	232,307
Store pre-opening and closing expenses	2,613	4,477	8,742
Loss from operations	(28,783)	(30,470)	(23,768)
Interest expense	991	1,417	4,245
Interest (income)	(45)	(319)	(1,210)
Loss before income taxes	(29,729)	(31,568)	(26,803)
Provision for (benefit from) income taxes	451	(5,665)	(232)
Net loss	$ (30,180)	$ (25,903)	$ (26,571)
Basic net loss per share	$ (1.23)	$ (1.15)	$ (1.31)
Diluted net loss per share	$ (1.23)	$ (1.15)	$ (1.31)
Basic weighted average shares outstanding	24,443	22,470	20,301
Diluted weighted average shares outstanding	24,443	22,470	20,301

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

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A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(In thousands except share data)

	Shares	Common Stock	Retained Earnings (Deficit)	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2007	20,375,646	$ 122,921	$ 77,162	$ (483)	$ 199,600
Net (loss)			(26,571)		(26,571)
Unrealized (loss), net of taxes of $633				$ (951)	(951)
Reclassification adjustment, net of taxes of $955				1,434	1,434
Total comprehensive income (loss)					$ (26,088)
Exercise of stock options	2,200	8			8
Tax benefit from exercise of stock options		3			3
Stock-based compensation expense		1,977			1,977
Restricted shares, net	89,305				
Change in accounting principle			(1,200)		(1,200)
Balance, January 3, 2009	20,467,151	$ 124,909	$ 49,391	$	$ 174,300
Net (loss)			(25,903)		(25,903)
Total comprehensive income (loss)					$ (25,903)
Stock-based compensation expense		1,824			1,824
Issuance of common stock	4,000,000	9,853			9,853
Restricted shares, net	384,443				
Balance, January 2, 2010	24,851,594	136,586	23,488	$	160,074
Net (loss)			$ (30,180)		(30,180)
Total comprehensive income (loss)					$ (30,180)
Exercise of stock options	63,155	(122)			(122)
Stock-based compensation expense		1,641			1,641
Restricted shares, net	431,663				
Balance, January 1, 2011	25,346,412	$ 138,105	$ (6,692)	$	$ 131,413

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

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A.C. MOORE ARTS & CRAFTS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Fiscal 2010	Fiscal 2009	Fiscal 2008
Cash flows from operating activities:			
Net income (loss)	$ (30,180)	$ (25,903)	$ (26,571)
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	16,686	16,220	15,714
Stock-based compensation expense	1,641	1,824	1,977
Impairment of fixed assets	905	4,252	6,016
Loss on disposal of assets		328	1,112
Provision for (benefit of) deferred income taxes, net		(192)	2,388
Changes in assets and liabilities:			
Inventories	10,792	(12,693)	17,012
Prepaid expenses and other current assets	135	(893)	3,594
Income taxes receivable	472	1,433	3,193
Accounts payable	6,084	(2,227)	(9,506)
Accrued payroll, payroll taxes and accrued expenses	(1,514)	260	5,560
Accrued lease liability	(2,499)	(798)	(259)
Income taxes payable			(1,909)
Other	1,042	458	(602)
Net cash provided by (used in) operating activities	3,564	(17,932)	17,719
Cash flows from investing activities:			
Capital expenditures	(9,424)	(10,335)	(15,917)
Cash flows used in investing activities	(9,424)	(10,335)	(15,917)
Cash flows from financing activities:			
Exercise of stock options	(122)		8
Tax benefit of stock options			3
Issuance of common stock		9,853	
Borrowing under line of credit		19,000	10,000
Repayment of debt		(29,071)	(2,571)
Net cash provided by (used in) financing activities	(122)	(218)	7,440
Net (decrease) increase in cash and cash equivalents	(5,982)	(28,485)	9,242
Cash and cash equivalents at beginning of period	45,952	74,437	65,195
Cash and cash equivalents at end of period	$ 39,970	$ 45,952	$ 74,437

Supplemental cash flow information:						
Cash paid (received) during the year for:						
Interest	$	993	$	3,343	$	2,190
Income taxes, net of refunds	$	23	$	(7,349)	$	649

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

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A.C. MOORE ARTS & CRAFTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization and Basis of Presentation. A.C. Moore Arts & Crafts, Inc. became a holding company in July 1997 by incorporating in Pennsylvania and exchanging its common stock for all of the capital stock of A.C. Moore Incorporated held by its shareholders. The consolidated financial statements include the accounts of A.C. Moore Arts & Crafts, Inc. and its wholly owned subsidiaries (collectively, the Company). All inter-company accounts and transactions have been eliminated. As of January 1, 2011, the Company operated a 134 store chain of retail arts and crafts stores in the eastern region of the United States.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the amount of revenues and expenses during the reporting period. Differences from those estimates, if any, are recorded on our financial statements and accompanying notes in the period they become known.

Fiscal Year. On December 19, 2008, the Board of Directors approved a change in the Company s fiscal year end, moving it from December 31 to a 52 or 53 week fiscal year ending on the Saturday before or after December 31 of each year. The change was effective beginning with the Company s fiscal year 2008 fiscal 2008 , which ended on Saturday January 3, 2009. The change in our fiscal year end from December 31 to January 3 added three additional days to fiscal 2008, which accounted for $3.0 million in fiscal 2008 sales, or 0.6 percent of total sales. Fiscal 2009 ended January 2, 2010 and Fiscal 2010 ended January 1, 2011.

Cash and Cash Equivalents. Cash and cash equivalents are stated at cost, which approximates market value. Cash equivalents include only securities having an original maturity of three months or less.

Concentration of Credit Risk. Financial instruments, which potentially subject the Company to concentrations of credit risk, are cash and cash equivalents. The Company limits its credit risk by placing its investments in highly rated, highly liquid funds.

Merchandise Inventories. Effective January 1, 2008, the Company changed its method of accounting for store inventories from the retail inventory method to lower of cost or market, with cost determined using a weighted average method based upon the purchase order cost of the merchandise at time of receipt. The Company believes weighted average cost is a preferable method as it results in an inventory valuation which more closely reflects the acquisition cost of inventory and provides for a better matching of cost of sales with the related sales. The Company s warehouse inventory has historically been valued using weighted average cost.

The cost of purchasing, warehousing, and transportation are also included in the cost of inventory. Vendor allowances, which primarily represent volume discounts and cooperative advertising funds, are recorded as a reduction in the cost of merchandise inventories. For merchandise where we are the direct importer, ocean freight and duty are included as inventory costs. These additional costs and cost adjustments are not assigned to specific units of inventory. Management uses all available information to determine the appropriate amount of net inventory costs to be recognized and deferred in each reporting period.

Perpetual inventory records are used to value store and warehouse inventories. A full physical inventory is taken at every location at least once per year and the perpetual records are adjusted to the physical counts. Estimates for inventory shrinkage from the date of the most recent physical inventory through the end of each reporting period are based on results from physical inventories and shrink trends. These estimates are updated to actual at the time of the physical inventory. A 10 percent change in our estimate for inventory shrinkage would have impacted gross margin by approximately $0.7 million for fiscal 2010.

Our inventory valuation methodology also requires other management estimates and judgment, such as the net realizable value of merchandise designated for clearance or slow-moving merchandise. Our adjustments to inventory cost for clearance and slow-moving merchandise is based on several factors including the quantity of merchandise on hand, sales trends and future advertising and merchandising plans. The accuracy of these estimates can be impacted by many factors, some of which are outside of management s control, including changes in economic conditions and consumer buying trends. Based on prior experience we do not believe the assumptions used in these estimates will change significantly. A 10 percent change in this adjustment to inventory cost would have impacted gross margin by approximately $0.6 million for fiscal 2010.

Property and Equipment. Property and equipment are stated at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets. Buildings are depreciated over 40 years and building improvements are depreciated principally over 20 years. Furniture, fixtures and equipment are depreciated over periods of five to 10 years and leasehold improvements are depreciated over the shorter of their estimated useful lives or the original term of the related lease. Maintenance and repairs are charged to operations as incurred and major improvements are capitalized.

Property and equipment consists of:

	Fiscal Year Ended		
(In thousands)	**2010**	**2009**	**2008**
Land	$ 2,466	$ 2,466	$ 2,466
Buildings and improvements	38,370	38,370	38,370
Furniture, fixtures, software and equipment	137,381	131,036	129,949
Leasehold improvements	10,534	9,555	8,183
Equipment for future stores	382	705	552
	189,133	182,132	179,520
Less: Accumulated depreciation and amortization	(115,362)	(100,194)	(87,117)
	$ 73,771	$ 81,938	$ 92,403
Depreciation and amortization expense	$ 16,686	$ 16,220	$ 15,714

The Company capitalizes certain costs incurred in connection with developing or obtaining internal use software. These capitalized software costs are included in Property and equipment, net on the Consolidated Balance Sheets, and are being amortized over the estimated useful life of the software, not to exceed five years.

The following table sets forth capitalized software development costs and the related cost amortization for each of the last three fiscal years.

	Fiscal		
(In thousands)	**2010**	**2009**	**2008**
Capitalized software development costs	$ 147	$ 307	$ 5,848
Amortization of capitalized software development costs	1,309	1,445	481

Impairment of Long-lived Assets. In accordance with generally accepted accounting principles, we review long-lived assets for impairment whenever events or changes in circumstance indicate that their carrying amount may not be recoverable by comparing the carrying value of assets with their estimated future undiscounted cash flows. This analysis is performed for each asset group, which for our Company is at the individual store level. To the extent these future estimates change, the conclusion regarding impairment may differ from our current estimates, and the loss, if any, would be recognized at that time. The impairment loss is calculated as the difference between asset carrying values and the present value of estimated net cash flows, giving consideration to recent operating performance and pricing trends.

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Other Assets. Other assets include amounts incurred to obtain store leases which are being amortized over the life of the original lease.

Revenue Recognition. The Company recognizes revenue at the time of sale of merchandise to its customers, with the exception of the sale of custom frames, which are recognized at the time of delivery. If the purchase is from our e-commerce channel, revenue is recognized at the time of shipment. The value of point of sale coupons, which have a very limited life, and other discounts that result in a reduction of the price paid by the customer are recorded as a reduction of sales at the time the coupon is utilized. Sales returns, which are reserved for based on historical experience, are provided for in the period that the related sales are recorded. Sales taxes are not recorded as a component of sales.

The following table sets forth total net sales by merchandise category for each of the last three fiscal years:

		Fiscal	
(In thousands)	**2010**	**2009**	**2008**
Art and scrapbooking	$ 119,961	$ 130,003	$ 156,898
Traditional crafts	153,664	150,810	148,248
Floral and floral accessories	40,203	41,539	53,057
Fashion crafts	39,691	43,828	51,217
Home décor and frames	75,823	81,145	95,183
Seasonal items	18,716	21,564	30,061
Total	$ 448,058	$ 468,889	$ 534,665

During the third quarter of fiscal 2008, the Company began testing a customer loyalty program in a limited number of stores which was expanded to all of our stores in the second quarter of fiscal 2009. This program allows members to earn points for purchases of merchandise at the participating locations. When members have earned a specified number of points they are entitled to receive a certificate that may be redeemed on future purchases. The value of points earned are recorded as a reduction of revenue at the time the points are earned and the value of unredeemed points is included in Accrued expenses on our Consolidated Balance Sheets.

Proceeds from the sale of gift cards are recorded as gift card liabilities and recognized as revenue when redeemed by the holder. Unredeemed gift cards are evaluated to determine whether the likelihood for redemption is remote (gift card breakage). We recognize gift card breakage as income based on historical redemption patterns. In fiscal 2010, fiscal 2009 and fiscal 2008, we recognized income of $0.3 million, $0.6 million and $0.5 million, respectively, related to gift card breakage.

Lease Accounting. The Company commences accounting for store leases on the date they take possession of the leased space. Landlord allowances and incentives are recorded as deferred rent liabilities and are amortized as a reduction of rent expense over the initial term of the lease, commencing with the date of possession.

Store Pre-opening and Closing Costs. Store pre-opening costs are expensed as incurred and include direct incremental costs to prepare a store for opening, including rent expense from the date we take possession of the property.

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Store closing costs include employee severance, inventory liquidation costs, lease termination payments and the net present value of future lease obligations less estimated sub-lease income. Once a store has been identified for closure, we accelerate the remaining depreciation so that the assets are fully depreciated at the date of closure.
The following table sets forth the components of store pre-opening and closing costs:

				Fiscal		
(In thousands)		**2010**		**2009**		**2008**
Store pre-opening costs	$	418	$	495	$	1,295
Store closing costs		2,195		3,982		7,447
	$	2,613	$	4,477	$	8,742

Reserve for Closed Stores. We maintain a reserve for future rental obligations, carrying costs and other costs related to closed stores. We recognize exit costs for store closures at the time the store is closed. The costs of closing a store or facility are calculated as the present value of future rental obligations remaining under the lease, less estimated sublease rental income or the lease termination fee. The determination of the reserves is dependent on our ability to make reasonable estimates of costs to be incurred post-closure and of rental income to be received from subleases. The reserves could vary materially if market conditions were to vary significantly from our assumptions. This reserve is included in Accrued expenses on our Consolidated Balance Sheets.
Advertising Costs. The costs incurred for advertising are expensed in the first period the advertising takes place. We have cooperative advertising agreements with many of our vendors. However, they do not require that we advertise specific products. Cooperative advertising funds are recorded as a reduction in the purchase price of merchandise and recognized in cost of sales when the merchandise is sold. Advertising expense was $25.3 million, $26.9 million and $28.8 million in fiscal 2010, 2009 and 2008, respectively, and is included in Selling, general, and administrative expense.
Insurance Liabilities. The Company uses a combination of third-party and self-insurance to cover certain risks, including workers compensation, general liability, property, ocean marine and medical claims. Insurance liabilities are a component of Accrued expenses on our Consolidated Balance Sheets and represent an estimate of the ultimate cost of our uninsured liability as of the balance sheet date, less claims that have been paid. The accrual for workers compensation and general liability claims was $8.4 million and $8.2 million as of January 1, 2011 and January 2, 2010, respectively. These liabilities are actuarially estimated based on historical data and industry trends.
Fair Value of Financial Instruments. Accounting standards require disclosure of the fair value of certain assets and liabilities including information about how their fair value was determined. The determination of fair value has been grouped into three broad categories referred to as levels 1, 2 and 3. The fair market value of level 1 can be determined from quoted market prices for identical assets on an active market, level 2 from quoted prices for similar assets on an active market and for level 3 from assumptions that management makes based on the best available information.

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The following table sets forth the financial assets and liabilities carried at fair value measured as of January 1, 2011 and January 2, 2010:

(In thousands)	Carrying Value	Fair Value Measurements Level 1	Level 2	Level 3	Gains (Losses)
Recurring					
January 1, 2011					
Cash and cash equivalents	$ 39,970	$ 39,970	$	$	$
January 2, 2010					
Cash and cash equivalents	$ 45,952	$ 45,952	$	$	$
Nonrecurring					
January 1, 2011					
Long-lived assets held and used (1)	$ 180	$	$	$ 180	$ (905)
January 2, 2010					
Long-lived assets held and used (1)	$ 1,256	$	$	$ 1,256	$ (4,300)

(1) Represents retail store fixed assets written down to their fair value, resulting in a impairment charge which was included in earnings for the period.

Cash and cash equivalents are measured at fair value using quoted market prices and are classified within Level 1 of the valuation hierarchy. The remeasurement of long-lived assets represents store assets written down to fair value using a discounted cash flow model. The loss is the amount by which the carrying amount of the asset exceeds its fair market value. Key management judgments and estimates in the valuation include sales and profitability for fiscal 2010 and future years, and rates at which to discount projected future cash flows. The fair value measurement is classified within Level 3 of the valuation hierarchy as the valuation model inputs are not observable based on readily available market data.

Stock-based Compensation. In accordance with accounting standards, the Company recognizes compensation expense in the Consolidated Statement of Operations related to the fair value of its stock-based awards. The Company recognizes the cost of all stock-based awards on a straight-line attribution basis over their respective vesting periods, net of estimated forfeitures.

The Company determines fair value of such awards using the Black-Scholes options pricing model with the following weighted-average assumptions:

	Fiscal 2010	2009	2008
Average fair value of awards	$ 1.56	$ 1.02	$ 2.20
Risk free interest rate	1.2%	1.8%	2.7%
Dividend yield			
Average expected life in years	4.3	4.5	4.5
Expected stock price volatility	71.6%	60.6%	46.3%

Expected volatilities were based on historical volatilities of the Company s common stock; the expected life represents the weighted average period of time that options granted are expected to be outstanding using a formula that averages the time between vesting and expiration; and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option.

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In fiscal 2010, fiscal 2009 and fiscal 2008, the Company recognized $1.6 million, $1.8 million and $2.0 million, respectively, of stock-based compensation as a component of Selling, general and administrative expense.

Income Taxes. The Company uses the asset and liability method of accounting for income taxes. We do business in various jurisdictions that impose income taxes. Management determines the aggregate amount of income tax expense to accrue and the amount currently payable based upon the tax statutes of each jurisdiction. This process involves adjusting income determined using generally accepted accounting principles for items that are treated differently by the applicable taxing authorities. The tax rate we use throughout the year is based on our estimate of an annual effective rate. This rate is evaluated quarterly and adjusted for known trends in earnings and permanent tax differences. We also evaluate the effect of any changes in uncertain tax positions including the initiation or settlement of audits.

Deferred taxes are reflected on our balance sheet for temporary differences that will reverse in subsequent years. A change in tax rates is recognized as income or expense in the period in which the change becomes effective. Valuation allowances are recorded to reduce the carrying amount of deferred tax assets, when it is more likely than not that such assets will not be realized. In fiscal 2008, the Company determined that it was necessary to record a valuation allowance against its net deferred tax assets due to, among other factors, the Company s cumulative three-year loss position. In fiscal 2010, the Company was still in a cumulative three-year loss position and continued to record a valuation allowance against its deferred tax assets. As of January 1, 2011, this valuation allowance was $31.7 million. Based upon its historical and continuing operating losses, the Company expects to record 100 percent valuation allowances against its net deferred tax assets in fiscal 2011. The expiration of statutes and closing of audits in fiscal 2011 may reduce the amount of unrecognized tax benefits by approximately $0.3 million which would result in a current tax benefit.

In the fourth quarter of fiscal 2009 there was a change in the Internal Revenue Code that extended the period from 2 years to 5 years over which the Company could carry back its net operating losses. As a result of this change the Company was able to utilize $15.8 million of net operating losses and as a result recorded an income tax benefit in 2009 of $6.0 million. In June of 2010, the Company reached a preliminary agreement with the Internal Revenue Service on all open audit issues relating to the 2003 through 2008 tax years. This agreement resulted in a $0.4 million reduction of a refund related to a previously filed net operating loss carry back claim and was recorded as income tax expense in fiscal 2010.

Liquidity and Capital Resources. We have experienced net losses in each of the past three years. We had net losses in fiscal 2008, fiscal 2009 and fiscal 2010 of, respectively, $26.6 million, $25.9 million and $30.2 million. These losses are primarily the result of declines in same store sales for each of the last four years. Our same store sales declined 10.3% in fiscal 2007, 8.7% in fiscal 2008, 10.8% in fiscal 2009 and 5.4% in fiscal 2010. We anticipate a net loss in fiscal 2011.

One of our primary sources of liquidity is a $60.0 million credit facility provided by Wells Fargo Retail Finance, LLC (WFRF). Although we currently have $37.8 million of availability and have not borrowed under this credit since it was put in place two years ago, the agreement does contain various events of default which if triggered would allow the lender to take actions including raising the interest rate, discontinuing advances and accelerating the Company s obligations. This agreement was due to expire on January 15, 2012. On March 4, 2011 the Company entered into an amendment to the agreement with WFRF to extend the facility for an additional five years, until March 4, 2016.

On February 15, 2011, the Company announced that it had engaged Janney Montgomery Scott LLC to serve as financial advisor in the exploration of strategic alternatives to enhance shareholder value. These alternatives include, but are not limited to, a sale of the Company, corporate financing or capital raise. The Company has received third party expressions of interest but there can be no assurance that a transaction will result from this process.

Our primary sources of liquidity include available cash and cash equivalents, cash generated from operations and availability under our credit agreement with WFRF. We believe these sources of liquidity will be sufficient to finance our working capital and capital expenditure requirements for at least the next 12 months.

2. New Accounting Pronouncements

In February 2010, we adopted revised guidance that removes the requirement to disclose the date through which an entity has evaluated subsequent events. This amendment was made to alleviate potential conflicts with existing SEC guidance. The adoption did not have a material impact on our financial statements.

In January 2010, the FASB issued guidance requiring new disclosures about recurring or nonrecurring fair value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances and settlements on a gross basis in the Level 3 reconciliation. We adopted this guidance as of January 1, 2010, except for the Level 3 reconciliation disclosures, which are deferred until annual periods beginning after December 15, 2010. The adoption did not have a material impact on our financial statements.

3. Impairment of Long-lived Assets

The Company evaluates whether the carrying value of long-lived assets are fairly stated when events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Events that trigger a test for recoverability include material adverse changes in projected revenues and expenses, significant underperformance relative to historical or projected future operating results, and significant negative industry or economic trends. When evaluating operating stores for impairment, the asset group is at an individual store level since that is the lowest level for which cash flows are identifiable. The carrying amount of a long-lived asset is not recoverable if it exceeds the undiscounted cash flows expected from the use and eventual disposition of the asset. An impairment loss is calculated as the amount by which the carrying amount of the asset exceeds its fair market value. The Company uses a present value technique to estimate the fair market value of its long-lived assets. Management believes that it includes all available information and utilizes its best estimates when performing these asset impairment tests. However, a continuing decline in store sales or gross margin could have an adverse effect on store profitability which may increase the likelihood of additional asset impairments in the future.

In fiscal 2010, 2009 and 2008 the Company recorded impairment charges of $0.9 million, $4.3 million and $6.0 million, respectively. At January 1, 2011 and January 2, 2010, respectively, the Company had $26.9 million and $37.5 million of long-lived assets, net of depreciation, that were associated with operating stores.

4. Store Closing Costs

The Company regularly reviews store performance. If the Company were to determine that a store does not meet certain performance criteria over a sustained period of time, the Company may decide to close that location. Store closing costs include non-cancellable lease obligations net of estimated sub lease income, asset related charges, employee severance, inventory liquidation and other costs.

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The following table sets forth the components of store closing costs and the accrued liability as of year-end:

(In thousands)	Non-cancellable lease obligations	Asset related charges	Severence, liquidation and other	Total
Charges	5,702	580	1,165	7,447
Non-cash adjustments		(580)		(580)
Cash payments			(1,165)	(1,165)
Balance, January 3, 2009	$ 5,702	$	$	$ 5,702
Charges	3,475	304	203	3,982
Non-cash adjustments		(304)		(304)
Cash payments	(1,796)		(203)	(1,999)
Balance, January 2, 2010	$ 7,381	$	$	$ 7,381
Charges	1,941	126	128	2,195
Non-cash adjustments		(126)		(126)
Cash payments	(2,529)		(128)	(2,657)
Balance, January 1, 2011	$ 6,793	$	$	$ 6,793

The Company has developed a process to review and evaluate existing store performance and the prospects for new stores in order to identify underperforming locations and develop a strategy for locations that were no longer strategically or economically viable. As a result of this analysis, the Company closed nine stores in fiscal 2008 and reduced its planned store openings for fiscal 2008 from 14 locations to nine. In fiscal 2010 and fiscal 2009, the Company closed three and zero stores, respectively.

In fiscal 2008, we incurred $7.4 million in expenses related to these store closings and reduction in new store openings which included an accrual of $5.7 million for the estimated future net lease payments for stores that closed where the Company was not able to terminate its lease for the store space. In fiscal 2009 and fiscal 2010 the Company recorded additional store closing expenses of $4.0 million and $2.2 million, respectively, of which $3.5 million and $1.9 million, respectively, related to increases the estimated future net rental obligations for stores closed in prior years.

5. Earnings Per Share
The following table sets forth the computation of basic and diluted earnings per share:

	Fiscal Year		
(In thousands, except per share data)	**2010**	**2009**	**2008**
Net income (loss)	$ (30,180)	$ (25,903)	$ (26,571)
Weighted average shares:			
Basic	24,443	22,470	20,301
Incremental shares from assumed exercise of stock options and stock appreciation rights			
Incremental restricted shares			
Diluted	24,443	22,470	20,301
Basic net income (loss) per share	$ (1.23)	$ (1.15)	$ (1.31)
Diluted net income (loss) per share	$ (1.23)	$ (1.15)	$ (1.31)
Stock options and stock appreciation rights excluded from the calculation because the exercise price was greater than the average market price	1,953	1,287	1,439
Potentially dilutive shares excluded from the calculation as the result would be anti-dilutive	1,350	894	228

6. Financing Agreements
At the end of fiscal 2008, the Company had a loan agreement with Wachovia Bank (Wachovia loan agreement) which consisted of two mortgage agreements and a line of credit. There was $19.1 million outstanding under these mortgages and $10.0 million outstanding under the line of credit. The Company had entered into pay fixed interest rate swap agreements on these mortgages. The line of credit was for $30.0 million and was due to expire on May 30, 2009.

On January 15, 2009, the Company terminated the Wachovia loan agreement and interest rate swaps and entered into a new credit agreement with Wells Fargo Retail Finance, LLC (WFRF loan agreement). Because the terms of the WFRF loan agreement had been substantially finalized prior to the end of fiscal 2008 and the existing Wachovia mortgages were not refinanced with similar long-term debt, the Company classified the Wachovia mortgages as short-term debt as of January 3, 2009. In addition, the interest rate swap no longer qualified for hedge accounting treatment because it was no longer probable that the transaction would continue. As such, losses on the swap that were previously deferred in accumulated other comprehensive income (AOCI) were reclassified to earnings during the fourth quarter of fiscal 2008. The total mark to market loss on the swap as of January 3, 2009, including the fair value adjustment previously deferred in AOCI, was $2.4 million and is recorded as Interest expense in the Consolidated Statements of Operations.

Upon closing of the WFRF loan agreement, the Company borrowed $19.0 million under the line of credit and, combined with $13.2 million of its own funds, repaid all outstanding obligations under the Wachovia loan agreement including $18.9 million of principal and interest to satisfy the mortgages, $10.0 million to repay an advance under the line of credit and $2.8 million to terminate the interest rate swap. Borrowings under this agreement are for revolving periods of up to three months. As of January 1, 2011 there was $19.0 million borrowed under the line of credit, $3.2 million of outstanding stand-by letters of credit and availability of $37.8 million. Subject to availability, there is no debt service requirement during the term of this agreement.

The WFRF loan agreement is an asset-based senior secured revolving credit facility in an aggregate principal amount of up to $60.0 million, with a $15.0 million sub-limit for letters of credit. Interest is calculated at either LIBOR or Wells Fargo s base rate plus between 1.75 and 2.50 percent, which is dependent upon the level of excess availability as defined in the agreement. In addition, the Company pays an annual fee of between 0.25 and 0.50 percent on the amount of unused availability, which is also dependent on the level of excess availability. At closing in January 2009, the Company had paid or incurred approximately $0.7 million in deferred financing costs which will be amortized over the term of the agreement.

The agreement contains customary terms and conditions which, among other things, restrict the Company s ability to incur additional indebtedness or guaranty obligations, create liens or other encumbrances, pay dividends, redeem or issue certain equity securities or change the nature of the business. In addition, there are limitations on the type of investments, acquisitions, or dispositions the Company can make. As defined in the agreement, the Company is also required to maintain greater than $90.0 million in book value of inventory and have excess availability of more than 10 percent of the borrowing base or $6.0 million, whichever is less.

The agreement defines various events of default which include, without limitation, a material adverse effect (as defined in the agreement), failure to pay amounts when due, cross-default provisions, material liens or judgments, insolvency, bankruptcy or a change of control. Upon the occurrence of an event of default, the lender may take actions that include increasing the interest rate on outstanding obligations, discontinuing advances and accelerating the Company s obligations.

The WFRF loan agreement was due to expire on January 15, 2012. On March 4, 2011, the parties amended the agreement (the WFRF amendment) for an additional five-year term through March 4, 2016. Prior to the WFRF amendment, interest was calculated at either adjusted LIBOR or WFRF s base rate plus a margin of between 1.75 and 2.50 percent per annum, depending upon the level of excess availability as defined in the loan agreement. In addition, the Company paid an annual fee of between 0.25 and 0.50 percent per annum on the amount of unused availability, also dependent on the level of excess availability. As a result of the amendment, interest is calculated at either adjusted LIBOR or WFRF s base rate plus a margin of between 2.25 and 2.75 percent per annum, depending upon the level of excess availability, and WFRF s base rate has a floor equal to the adjusted LIBOR rate plus 1.00 percent per annum. In addition, the Company will pay an annual fee between 0.375 and 0.50 percent per annum on the amount of unused availability, also dependent on the level of excess availability. At closing, the Company paid or incurred deferred financing costs of approximately $0.4 million that will be amortized over the term of the facility. The amendment also modified certain provisions of the agreement in order to permit the Company to enter into, and perform its obligations under, contracts to effect a strategic alternatives transaction (as defined in the WFRF amendment). However, in order to consummate a strategic alternatives transaction, the Company will need to either payoff and terminate the credit facility or obtain WFRF s consent.

7. Income Taxes

During fiscal 2010 there were no material changes to the Company s reserve for unrecognized tax benefits which is included under the caption Accrued expenses on our Consolidated Balance Sheets. The Company records interest on uncertain tax positions as a component of interest expense and penalties are recorded as a component of income tax expense.

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows:

		Fiscal	
(In thousands)	**2010**	**2009**	**2008**
Gross unrecognized tax benefits, beginning of period	$ 610	$ 251	$ 2,826
Increases in tax positions for prior years		360	563
Decreases in tax positions for prior years			(493)
Increases in tax positions for current year	33	34	388
Settlements		(21)	(3,033)
Lapse in statute of limitations	(8)	(14)	

Gross unrecognized tax benefits, end of period	$	635	$	610	$	251

Approximately $0.4 million of the unrecognized tax benefits as of January 1, 2011 would affect the effective tax rate if recognized. During fiscal 2010, 2009 and 2008, the Company recognized $42,000, $15,000 and $340,000 respectively, of tax related interest in its Consolidated Statements of Operations and had $73,000, $23,000 and $10,000 tax related interest accrued on its January 1, 2011, January 2, 2010 and January 3, 2009 Consolidated Balance Sheets, respectively.

In June of 2010, the Company reached a preliminary agreement with the Internal Revenue Service on all open audit issues relating to the 2003 through 2008 tax years. This agreement resulted in a $0.4 million reduction of a refund related to a previously filed net operating loss carry back claim and was recorded as income tax expense during fiscal 2010. Based upon its historical and continuing operating losses, the Company recorded a 100 percent valuation allowances against its net deferred tax assets in fiscal 2010 and expects to continue to do so in fiscal 2011. The expiration of statutes and closing of audits in fiscal 2011 may reduce the amount of unrecognized tax benefits by approximately $0.3 million which would result in a current tax benefit.

In the 2008 tax year, the Company had a tax loss of $21.5 million. Of this loss, $5.7 million was carried back to prior tax years, which generated a refund of previously paid taxes in the amount of $1.7 million which was received in July of 2009. In the fourth quarter of fiscal 2009 there was a change in the Internal Revenue Code that extended the period from 2 years to 5 years over which the Company could carry back its net operating losses. As a result of this change, the Company was able to carry back the remaining tax losses generated in the 2008 tax year and receive a refund in the amount of $6.0 million of taxes paid in the 2003 through 2006 tax years. Of the $6.0 million refund, $5.7 million was received in fiscal 2009 with the remaining $0.3 million recorded in Prepaid and receivable income taxes on the January 2, 2010 balance sheet.

In March 2008, the Company received permission from the Internal Revenue Service to change its method of accounting for inventory effective on its fiscal 2007 income tax return. As a result of this change, the Company received a tax refund of $7.0 million in June 2008.

The Company is subject to U.S. Federal income tax as well as income tax within the states in which it operates. In February 2008, the Company finalized an audit with the Internal Revenue Service that covered the 2004, 2005 and 2006 tax years. Subsequent to completion of that audit the Company filed a net operating loss carry back claim and received a refund of taxes previously paid in the tax years 2003 through 2006. As a result, these years remain subject to audit until 2012. The Company is currently under audit for its 2007 U.S. Federal income tax return. The Company has substantially concluded all material tax matters in states where it files tax returns through the 2005 tax year.

A reconciliation of income tax expense at the federal income tax rate to the income tax provision is as follows:

	Fiscal		
(In thousands)	**2010**	**2009**	**2008**
United States federal taxes at statutory rate	$ (10,405)	$ (11,049)	$ (9,381)
State and local taxes, net	(1,673)	(1,842)	(1,679)
Change in estimates for uncertain tax positions	(8)	466	309
Valuation allowance	12,157	6,812	10,474
Incentive stock option compensation			32
Tax free interest	(15)	(73)	(304)
Other	394	20	317
Income tax provision (benefit)	$ 451	$ (5,665)	$ (232)

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The income tax provision consists of the following:

(In thousands)	2010	Fiscal 2009	2008
Current tax expense (benefit):			
Federal	$ 415	$ (5,550)	$ (3,249)
State	36	57	629
Total current	451	(5,494)	(2,620)
Deferred tax expense (benefit):			
Federal		(172)	1,828
State			560
Total deferred		(172)	2,388
Total income tax provision (benefit)	$ 451	$ (5,665)	$ (232)

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax liabilities and assets are recognized for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. The tax effect of temporary differences and carry forwards that comprise significant portions of deferred tax assets and liabilities is as follows:

(In thousands)	2010	Fiscal Year Ended 2009	2008
Current deferred taxes			
Inventory valuation	$ 2,582	$ 2,824	$ 2,402
Accrued expenses	6,810	6,804	5,876
Deferred revenue	228	209	265
Valuation allowance	(7,468)	(6,260)	(3,943)
Total current deferred taxes	$ 2,152	$ 3,577	$ 4,600
Non-current deferred taxes			
Property and equipment	(8,767)	(10,676)	(14,501)
Stock option compensation	3,425	3,040	2,368
Accrued rent expense	4,611	5,628	5,946
Federal net operating losses and credits	16,949	7,580	6,328
State net operating loss carryforwards	6,259	4,658	3,412
Valuation allowance	(24,253)	(13,304)	(8,577)
Other	(99)	(227)	529
Total non-current deferred taxes	(1,876)	(3,301)	(4,495)
Net deferred tax assets	$ 276	$ 276	$ 105

Deferred tax assets	$ 40,863	$ 30,743	$ 27,126
Deferred tax liabilities	(40,587)	(30,467)	(27,021)
Net deferred tax assets	$ 276	$ 276	$ 105

At January 1, 2011, the Company had approximately $46.6 million of federal and $121.7 million of state net operating loss (NOL) carry forwards, none of which expired in fiscal 2010, with the balance expiring through 2029. If utilized, these NOLs would result in future federal tax benefits of $16.6 million and combined net future state tax benefits of $6.3 million. The Company has recorded valuation allowances against all net federal and state deferred tax assets and NOLs.

8. Stock-based Compensation

The Company s shareholders have approved the A.C. Moore Arts & Crafts, Inc. 2007 Stock Incentive Plan (the Plan). Awards issued under this Plan may take the form of stock options, stock appreciation rights, restricted stock awards, performance awards or stock units. There are 5,100,000 shares approved for issuance under this Plan. Any awards under this Plan that are not based on the appreciation in the value of the Company s common stock in excess of an amount greater than the market value on the date of grant will decrease the share reserve by 1.31 shares for each share granted. As of January 1, 2011, the share reserve may be increased by up to 542,437 shares relating to options outstanding under the existing plans that are not exercised due to expiration, termination, cancellation or forfeiture.

The following table summarizes information about the stock award and restricted stock activity for fiscal 2010, 2009 and 2008, and options outstanding as of January 1, 2011, January 2, 2010 and January 3, 2009.

			Fiscal			
(In thousands except per share data and # of months)		**2010**		**2009**		**2008**
Stock-based compensation expense	$	1,641	$	1,824	$	1,977
Effect on net income		1,641		1,824		1,977
Effect on earnings per share		0.07		0.08		0.10
Market value in excess of grant price for options exercised		250				6
Intrinsic value of options outstanding		342		551		27
Unrecognized compensation cost	$	3,679	$	2,399	$	3,264
Months over which compensation costs will be recognized		35		45		57
Shares available for future grant		2,533		4,148		734

Summarized in the following tables are the stock options and restricted stock activity for awards under the 1997 Employee, Director and Consultant Plan, the 2002 Stock Options Plan, and the 2007 Stock Incentive Plan:

Stock Options and Stock Appreciation Rights

Stock options and stock appreciation rights activity in the Company s stock plans for fiscal 2010 and fiscal 2009 was as follows:

	Fiscal 2010			**Fiscal 2009**		
	Stock Options and Stock Appreciation Rights		**Weighted Average Exercise Price**	**Stock Options and Stock Appreciation Rights**		**Weighted Average Exercise Price**
Outstanding at beginning of period	1,631,616	$	6.52	1,500,454	$	15.34
Activity:						
Granted	1,815,028		2.74	357,054		1.94
Expired	505,204		16.61	26,968		2.88
Forfeited	284,108		3.59	198,923		10.14
Exercised	160,934		1.22			
Outstanding at end of period	2,496,398	$	6.81	1,631,616	$	6.52

The weighted average grant date fair value of stock options and stock appreciation rights was $1.56, $1.01 and $2.20 per share for fiscal 2010, 2009 and 2008, respectively.

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The following table summarizes information about stock options and stock appreciation rights outstanding at January 1, 2011:

	Stock Options and Stock Appreciation Rights Outstanding			Stock Options and Stock Appreciation Rights Exercisable		
Range of Exercise Prices	Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price
1.00 2.50	542,913	6.4	$ 1.88	465,654	5.8	$ 1.90
2.51 5.00	1,268,692	6.1	2.97			
5.01 10.00	179,658	3.4	7.26	266,777	4.7	7.18
10.01 20.00	180,268	3.6	17.96	360,618	5.4	17.72
20.01 26.67	324,867	4.1	23.57	538,567	4.5	23.07
	2,496,398	5.5	$ 6.81	1,631,616	5.1	$ 6.52

Restricted Stock

Certain of the restricted stock awards carry a performance-based vesting feature which allows for accelerating vesting if the targets are met. If the targets are not met, the awards vest after periods of between two and five years.

The following table summarizes activity for restricted stock awards:

	Fiscal 2010		Fiscal 2009	
	Number of Shares	**Weighted Average Grant Date Fair Value**	**Number of Shares**	**Weighted Average Grant Date Fair Value**
Outstanding at beginning of period	526,734	$ 5.40	162,535	$ 11.86
Activity:				
Granted	609,552	2.39	473,852	2.15
Vested	169,079	3.77	20,244	10.38
Cancelled	159,651	5.87	89,409	5.84
Outstanding at end of period	807,556	$ 3.01	526,734	$ 5.40

9. Retirement Plan

The Company had established a 401(k) savings plan (the 401(k) Plan) for eligible employees. Participation in the 401(k) Plan is voluntary and available to any employee who is at least 21 years of age and has completed a three month eligibility period. Participants may elect to contribute up to 100 percent of their eligible compensation. In accordance with the provisions of the 401(k) Plan, the Company, at its discretion can make a matching contribution to the account of each participant in an amount equal to 25 percent of the first six percent of eligible compensation contributed by each participant with a maximum annual match of $1,500. The Company s matching contribution expense for fiscal year 2008 was $0.2 million. Effective with the first payroll of 2009, the Company indefinitely suspended the matching contribution.

10. Commitments and Contingencies

Commitments

The Company leases its retail stores and some vehicles under non-cancelable operating leases. Most store leases have an average initial term of ten years, with three five year renewal options, and provide for predetermined escalations in future minimum annual rent or additional rent contingent upon store sales levels. Rent escalations are amortized over the initial term commencing on the date the Company takes possession. The pro rata portion of rent holidays and scheduled rent escalations has been included in accrued lease liabilities in the accompanying balance sheet. For fiscal 2010, 2009 and 2008, the amount of rent paid over the amount of rent expense recognized was $2.9 million, $1.8 million and $2.1 million, respectively.

Rent expense under operating leases consists of:

		Fiscal	
(In thousands)	**2010**	**2009**	**2008**
Minimum rentals	$ 38,725	$ 38,097	$ 40,508
Contingent payments	9	68	46
	$ 38,734	$ 38,165	$ 40,554

As of January 1, 2011, the Company had entered into two lease agreements for stores scheduled to open in 2011. Future minimum lease payments (including those for unopened stores) as of January 1, 2011 for non-cancelable operating leases with terms in excess of one year are as follows (in thousands):

Fiscal Year	**Rent Obligation**
2011	$ 42,752
2012	39,232
2013	33,624
2014	28,234
2015	21,613
Thereafter	45,189
Total minimum future rentals	$ 210,644

Contingencies

The Company is involved in legal proceedings from time to time in the ordinary course of business. Management believes that none of these legal proceedings will have a materially adverse effect on the Company s financial condition or results of operations. However, there can be no assurance that future costs of such litigation would not be material to our financial condition, results of operations or cash flows.

11. Related Party Transactions

Neil A. McLachlan, a director of the Company since February 2007, is President of the Consumer & Office Products Group of MeadWestvaco Corporation. The Company purchased $0, $78,994 and $322,233, respectively of merchandise to sell in its stores from MeadWestvaco Corporation in the fiscal years ended January 1, 2011, January 2, 2010 and January 3, 2009. Mr. McLachlan was not involved in these transactions and did not receive any compensation for these transactions.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

We had no changes in or disagreements with accountants on accounting and financial disclosure of the type referred to in Item 304(b) of Regulation S-K.

ITEM 9A. CONTROLS AND PROCEDURES.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

We carried out an evaluation, with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures as of January 1, 2011. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of January 1, 2011, our disclosure controls and procedures, as defined in Rule 13a-15(e), were effective to ensure that (i) information required to be disclosed by the issuer in the reports that it files or submits under the Securities Exchange Act of 1934 (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we carried out an evaluation of the effectiveness of our internal control over financial reporting as of January 1, 2011 based on the criteria described in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of January 1, 2011, based on criteria in Internal Control- Integrated Framework issued by the COSO.

The effectiveness of the Company s internal control over financial reporting as of January 1, 2011 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

Incorporated by reference from our Proxy Statement relating to our 2011 Annual Meeting of Shareholders to be filed in accordance with General Instruction G(3) to this Annual Report on Form 10-K, except information concerning our executive officers which is set forth in Part I of this Annual Report on Form 10-K and which is incorporated herein by reference.

Code of Ethical Business Conduct

We have adopted a Code of Ethical Business Conduct that applies to all of our directors and employees including, without limitation, our principal executive officer, our principal financial officer, our principal accounting officer and all of our employees performing similar functions. Our *Code of Ethical Business Conduct* is available on our website, located at www.acmoore.com under About Us then Corporate Profile. We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or a waiver from, a provision of our Code of Ethical Business Conduct by posting such information on our website at the location specified above.

ITEM 11. EXECUTIVE COMPENSATION.

Incorporated by reference from our Proxy Statement relating to our fiscal 2011 Annual Meeting of Shareholders to be filed in accordance with General Instruction G(3) to Form 10-K.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Incorporated by reference from our Proxy Statement relating to our fiscal 2011 Annual Meeting of Shareholders to be filed in accordance with General Instruction G(3) to Form 10-K.

Equity Compensation Plan Information

The following table summarizes information regarding our existing equity compensation plans as of January 1, 2011:

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders [1]	2,496,398	$ 6.81	2,532,822
Equity compensation plans not approved by security holders			
Total	2,496,398	$ 6.81	2,532,822

(1) These plans are our 1997 Employee, Director and Consultant Stock Option Plan, 2002 Stock Option Plan and 2007 Stock Incentive Plan.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

Incorporated by reference from our Proxy Statement relating to our fiscal 2011 Annual Meeting of Shareholders to be filed in accordance with General Instruction G(3) to Annual Report on Form 10-K.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

Incorporated by reference from our Proxy Statement relating to our fiscal 2011 Annual Meeting of Shareholders to be filed in accordance with General Instruction G(3) to Annual Report on Form 10-K.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE.

(a) The following documents are filed as part of this Annual Report on Form 10-K:

(1) Financial Statements:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets at January 1, 2011 and January 2, 2010

Consolidated Statements of Operations for each of the three fiscal years in the period ended January 1, 2011

Consolidated Statements of Changes in Shareholders Equity for each of the three fiscal years in the period ended January 1, 2011

Consolidated Statements of Cash Flows for each of the three fiscal years in the period ended January 1, 2011

Notes to Consolidated Financial Statements

(2) Financial Statement Schedule:

Schedule II Valuation and Qualifying Accounts

All other schedules have been omitted because they are not applicable, not required or the information is included elsewhere herein.

(3) Exhibits:

The exhibits filed as part of this report are listed under exhibits at subsection (b) of this Item 15.

(b) Exhibits:

Exhibit Number	Description
3.1(1)	Articles of Incorporation.
3.1.1(2)	Amendment to Articles of Incorporation.
3.1.2(3)	Amendment to Articles of Incorporation.
3.2(4)	Amended and Restated Bylaws.

Exhibit Number	Description
4.1[18]	Registration Rights Agreement, dated May 27, 2009.
+10.1[1]	1997 Employee, Director and Consultant Stock Option Plan.
+10.2[1]	Form of Incentive Stock Option Agreement under the 1997 Employee, Director and Consultant Stock Option Plan.
+10.3[5]	2002 Stock Option Plan.
+10.4[6]	Form of Incentive Stock Option/Non-Qualified Option Agreement under the 2002 Stock Option Plan.
+10.5[7]	2007 Annual Incentive Plan.
+10.6[8]	2007 Stock Incentive Plan.
+10.6.1[19]	Amendment to 2007 Stock Incentive Plan.
+10.7[8]	Form of Stock Unit Agreement under the 2007 Stock Incentive Plan.
+10.8[8]	Form of Nonqualified Stock Option Agreement under the 2007 Stock Incentive Plan.
+10.9[8]	Form of Incentive Stock Option Agreement under the 2007 Stock Incentive Plan.
+10.10[8]	Form of Stock Appreciation Rights Agreement under the 2007 Stock Incentive Plan.
+10.11[8]	Form of Restricted Stock Agreement under the 2007 Stock Incentive Plan.
10.12[9]	Amended and Restated Loan Agreement, dated as of May 31, 2008, between the Company and Wachovia Bank, National Association (Wachovia).
10.13[9]	Amendment to Loan Documents, dated as of May 31, 2008, between the Company and Wachovia.
10.14[9]	Amended and Restated Promissory Note, dated as of May 31, 2008, between the Company and Wachovia.
10.15[10]	Promissory Note and Loan Modification, dated as of September 18, 2008, between the Company and Wachovia Bank, National Association.
10.16[11]	Amended and Restated Swap Transaction Confirmation, signed on December 8, 2006 and effective as of November 27, 2006.

Exhibit Number	Description
10.17[11]	Amended and Restated Swap Transaction Confirmation, signed on December 8, 2006 and effective as of November 27, 2006.
10.18[20]	Credit Agreement, dated as of January 15, 2009, among A.C. Moore Incorporated, as the Lead Borrower, the Borrowers now or hereafter party thereto, the Guarantors now or hereafter party thereto, each lender from time to time party thereto, and Wells Fargo Retail Finance, LLC, as Administrative Agent, Collateral Agent and Swing Line Lender.
10.19[12]	Security Agreement, dated as of January 15, 2009, by and among A.C. Moore Incorporated, A.C. Moore Arts & Crafts, Inc., Moorestown Finance, Inc., Blackwood Assets, Inc., and Wells Fargo Retail Finance, LLC, as collateral agent.
10.20[12]	Guaranty, dated as of January 15, 2009, by A.C. Moore Arts & Crafts, Inc., Moorestown Finance, Inc., and Blackwood Assets, Inc. in favor of Wells Fargo Retail Finance, LLC, as administrative agent and collateral agent, and the Credit Parties.
10.20.1[26]	First Amendment, dated as of March 4, 2011, to the Credit Agreement, dated as of January 15, 2009, between the Company and Wells Fargo Retail Finance, LLC.
+10.21[13]	Employment Agreement, effective as of June 1, 2006, between the Company and Rick A. Lepley.
+10.22[13]	Form of Option Agreement between the Company and Rick A. Lepley.
+10.23[14]	First Amendment, dated as of November 15, 2006, to the Employment Agreement, dated as of June 1, 2006, between the Company and Rick A. Lepley.
+10.24[3]	Second Amendment, dated as of November 19, 2007, to the Employment Agreement, dated as of June 1, 2006, between the Company and Rick A. Lepley, as amended by the First Amendment, dated as of November 15, 2006.
+10.25[21]	Third Amendment, dated as of December 3, 2008, to the Employment Agreement, dated as of June 1, 2006, between the Company and Rick A. Lepley, as amended by the First Amendment, dated as of November 15, 2006, and by the Second Amendment, dated as of November 19, 2007.
+10.25.1[22]	Agreement and Release, dated as of March 31, 2010, between the Company and Rick A. Lepley.
+10.26[15]	Letter Agreement, dated November 28, 2007, between the Company and Joseph A. Jeffries.
+10.27[9]	First Amendment, dated August 6, 2008, to Employment Letter dated November 28, 2007, between the Company and Joseph A. Jeffries.
+10.27.1[20]	Amended and Restated Employment Letter, dated as of August 10, 2009, between the Company and Joseph A. Jeffries.
+10.27.2[22]	Special Award Agreement, dated March 29, 2010, between the Company and Joseph A. Jeffries.

+10.27.3[23]	Amended and Restated Employment Letter, dated August 19, 2010, between the Company and Joseph A. Jeffries.
+10.29[2]	Employment Agreement, effective as of July 24, 2006, between the Company and Amy Rhoades.

Exhibit Number	Description
+10.30[2]	First Amendment, dated as of November 15, 2006, to the Employment Agreement, dated as of July 24, 2006, between the Company and Amy Rhoades.
+10.31[3]	Second Amendment, dated as of November 19, 2007, to the Employment Agreement, dated as of July 24, 2006, by and between the Company and Amy Rhoades, as amended by the First Amendment, dated as of November 15, 2006.
+10.31.1	Third Amendment, dated as of March 28, 2011, to the Employment Agreement, dated as of July 24, 2006, by and between the Company and Amy Rhoades, as amended by the First Amendment, dated as of November 15, 2006, and the Second Amendment, dated as of November 19, 2007.
+10.32[16]	Form of Special Retention Award Agreement.
+10.33[20]	Employment Letter, dated as of May 17, 2009, between the Company and David Abelman.
+10.33.1[25]	Amendment One, dated as of March 16, 2010, to Employment Letter, dated as of May 7, 2009, between the Company and David Abelman.
+10.33.2	Amendment Two, dated as of March 28, 2011, between the Company and David Abelman.
+10.34[20]	Employment Letter, dated as of May 13, 2009, between the Company and David Stern.
+10.34.1[25]	Special Award Agreement, dated as of November 24, 2009, between the Company and David Stern.
+10.35[24]	Letter agreement, dated December 6, 2010, between the Company and Rodney Schriver.
10.36[18]	Securities Purchase Agreement, dated May 27, 2009.
18.1[17]	Preferability letter provided by PricewaterhouseCoopers LLC, our independent registered public accounting firm to change our method of accounting for valuing store inventories to weighted average cost.
21.1	Subsidiaries of the Company.
23.1	Consent of PricewaterhouseCoopers LLP.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a 14(a) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a 14(a) promulgated under the Exchange Act.

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Exhibit Number	Description
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\+ Management contract or compensatory plan or arrangement.

(1) Incorporated by reference to the Company s Registration Statement on Form S-1 (File No. 333-32859) filed on August 5, 1997.

(2) Incorporated by reference to the Company s Form 10-K for the year ended December 31, 2006.

(3) Incorporated by reference to the Company s Form 8-K filed on November 21, 2007.

(4) Incorporated by reference to the Company s Form 8-K filed on September 1, 2010.

(5) Incorporated by reference to the Company s Definitive Proxy Statement filed on April 22, 2002.

(6) Incorporated by reference to the Company s Form 8-K filed on August 9, 2006.

(7) Incorporated by reference to the Company s Definitive Proxy Statement filed on April 30, 2007.

(8) Incorporated by reference to the Company s Registration Statement on Form S-8 (File No. 333-143612) filed on June 8, 2007.

(9) Incorporated by reference to the Company s Form 10-Q for the quarter ended June 30, 2008.

(10) Incorporated by reference to the Company s Form 10-Q for the quarter ended September 30, 2008.

(11) Incorporated by reference to the Company s Form 8-K filed on December 14, 2006.

(12) Incorporated by reference to the Company s Form 8-K filed on January 22, 2009.

(13) Incorporated by reference to the Company s Form 8-K filed on June 7, 2006.

(14) Incorporated by reference to the Company s Form 8-K filed on November 16, 2006.

(15) Incorporated by reference to the Company s Form 8-K filed on November 28, 2007.

(16) Incorporated by reference to the Company s Form 8-K filed on April 4, 2008.

(17) Incorporated by reference to the Company s Form 10-Q for the quarter ended March 31, 2008.

(18) Incorporated by reference to the Company s Form 8-K filed May 27, 2009. .

(19) Incorporated by reference to the Company s Definitive Proxy Statement filed on July 24, 2009.

(20) Incorporated by reference to the Company s Form 10-Q for the fiscal quarter ended July 4, 2009.

(21) Incorporated by reference to the Company s Form 10-K for the fiscal year ended January 3, 2009.

(22) Incorporated by reference to the Company s Form 8-K filed on March 29, 2010.

(23) Incorporated by reference to the Company s Form 8-K filed on August 25, 2010.

(24) Incorporated by reference to the Company s Form 8-K filed on December 16, 2010.

(25) Incorporated by reference to the Company s Form 10-K filed on March 18, 2010.

(26) Incorporated by reference to the Company s Form 8-K filed on March 10, 2011.

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SCHEDULE II
A.C. MOORE ARTS & CRAFTS, INC.
Valuation and Qualifying Accounts
(In thousands)

Column A	Column B	Column C		Column D	Column E
Description	Balance at Beginning of	Additions - Charged to	Additions - Charged to Other	Deductions - Write-offs, Payments and Other	Balance at End
Income Tax Valuation Allowance	Period	Expense	Accounts	Adjustments	of Period
2010	$ 19,564	$	$ 12,157(a)	$	$ 31,721
2009	12,520		13,080(a)	6,036	19,564
2008	3,007	10,474		961	12,520

(a) Represents additions to net deferred tax assets against which the Company records a valuation allowance.

Description	Balance at Beginning of	Additions - Charged to	Additions - Charged to Other	Deductions - Write-offs, Payments and Other	Balance at End
Sales Returns Allowance	Period	Expense	Accounts	Adjustments	of Period
2010	$ 231	$	$	$ 5	$ 226
2009	206	25			231
2008	227			21	206

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

A.C. MOORE ARTS & CRAFTS, INC.

Date: March 31, 2011

By: /s/ Joseph A. Jeffries
Joseph A. Jeffries
Chief Executive Officer
(Principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Capacity	Date
/s/ Joseph A. Jeffries Joseph A. Jeffries	Chief Executive Officer (Principal Executive Officer)	March 31, 2011
/s/ Rodney B. Schriver Rodney B. Schriver	Vice President and Controller (Principal Accounting Officer)	March 31, 2011
/s/ Michael J. Joyce Michael J. Joyce	Chairman of the Board of Directors	March 31, 2011
/s/ Joseph F. Coradino Joseph F. Coradino	Director	March 31, 2011
/s/ Neil A. McLachlan Neil A. McLachlan	Director	March 31, 2011
/s/ Thomas S. Rittenhouse Thomas S. Rittenhouse	Director	March 31, 2011
/s/ Lori J. Schafer Lori J. Schafer	Director	March 31, 2011

Exhibit Index

Exhibit Number	Description
3.1[1]	Articles of Incorporation.
3.1.1[2]	Amendment to Articles of Incorporation.
3.1.2[3]	Amendment to Articles of Incorporation.
3.2[4]	Amended and Restated Bylaws.
4.1[18]	Registration Rights Agreement, dated May 27, 2009.
+10.1[1]	1997 Employee, Director and Consultant Stock Option Plan.
+10.2[1]	Form of Incentive Stock Option Agreement under the 1997 Employee, Director and Consultant Stock Option Plan.
+10.3[5]	2002 Stock Option Plan.
+10.4[6]	Form of Incentive Stock Option/Non-Qualified Option Agreement under the 2002 Stock Option Plan.
+10.5[7]	2007 Annual Incentive Plan.
+10.6[8]	2007 Stock Incentive Plan.
+10.6.1[19]	Amendment to 2007 Stock Incentive Plan.
+10.7[8]	Form of Stock Unit Agreement under the 2007 Stock Incentive Plan.
+10.8[8]	Form of Nonqualified Stock Option Agreement under the 2007 Stock Incentive Plan.
+10.9[8]	Form of Incentive Stock Option Agreement under the 2007 Stock Incentive Plan.
+10.10[8]	Form of Stock Appreciation Rights Agreement under the 2007 Stock Incentive Plan.
+10.11[8]	Form of Restricted Stock Agreement under the 2007 Stock Incentive Plan.
10.12[9]	Amended and Restated Loan Agreement, dated as of May 31, 2008, between the Company and Wachovia Bank, National Association (Wachovia).

Exhibit Number	Description
10.13[9]	Amendment to Loan Documents, dated as of May 31, 2008, between the Company and Wachovia.
10.14[9]	Amended and Restated Promissory Note, dated as of May 31, 2008, between the Company and Wachovia.
10.15[10]	Promissory Note and Loan Modification, dated as of September 18, 2008, between the Company and Wachovia Bank, National Association.
10.16[11]	Amended and Restated Swap Transaction Confirmation, signed on December 8, 2006 and effective as of November 27, 2006.
10.17[11]	Amended and Restated Swap Transaction Confirmation, signed on December 8, 2006 and effective as of November 27, 2006.
10.18[20]	Credit Agreement, dated as of January 15, 2009, among A.C. Moore Incorporated, as the Lead Borrower, the Borrowers now or hereafter party thereto, the Guarantors now or hereafter party thereto, each lender from time to time party thereto, and Wells Fargo Retail Finance, LLC, as Administrative Agent, Collateral Agent and Swing Line Lender.
10.19[12]	Security Agreement, dated as of January 15, 2009, by and among A.C. Moore Incorporated, A.C. Moore Arts & Crafts, Inc., Moorestown Finance, Inc., Blackwood Assets, Inc., and Wells Fargo Retail Finance, LLC, as collateral agent.
10.20[12]	Guaranty, dated as of January 15, 2009, by A.C. Moore Arts & Crafts, Inc., Moorestown Finance, Inc., and Blackwood Assets, Inc. in favor of Wells Fargo Retail Finance, LLC, as administrative agent and collateral agent, and the Credit Parties.
10.20.1[26]	First Amendment, dated as of March 4, 2011, to the Credit Agreement, dated as of January 15, 2009, between the Company and Wells Fargo Retail Finance, LLC.
+10.21[13]	Employment Agreement, effective as of June 1, 2006, between the Company and Rick A. Lepley.
+10.22[13]	Form of Option Agreement between the Company and Rick A. Lepley.
+10.23[14]	First Amendment, dated as of November 15, 2006, to the Employment Agreement, dated as of June 1, 2006, between the Company and Rick A. Lepley.
+10.24[3]	Second Amendment, dated as of November 19, 2007, to the Employment Agreement, dated as of June 1, 2006, between the Company and Rick A. Lepley, as amended by the First Amendment, dated as of November 15, 2006.
+10.25[21]	Third Amendment, dated as of December 3, 2008, to the Employment Agreement, dated as of June 1, 2006, between the Company and Rick A. Lepley, as amended by the First Amendment, dated as of November 15, 2006, and by the Second Amendment, dated as of November 19, 2007.

Exhibit Number	Description
+10.25.1[22]	Agreement and Release, dated as of March 31, 2010, between the Company and Rick A. Lepley.
+10.26[15]	Letter Agreement, dated November 28, 2007, between the Company and Joseph A. Jeffries.
+10.27[9]	First Amendment, dated August 6, 2008, to Employment Letter dated November 28, 2007, between the Company and Joseph A. Jeffries.
+10.27.1[20]	Amended and Restated Employment Letter, dated as of August 10, 2009, between the Company and Joseph A. Jeffries.
+10.27.2[22]	Special Award Agreement, dated March 29, 2010, between the Company and Joseph A. Jeffries.
+10.27.3[23]	Amended and Restated Employment Letter, dated August 19, 2010, between the Company and Joseph A. Jeffries.
+10.29[2]	Employment Agreement, effective as of July 24, 2006, between the Company and Amy Rhoades.
+10.30[2]	First Amendment, dated as of November 15, 2006, to the Employment Agreement, dated as of July 24, 2006, between the Company and Amy Rhoades.
+10.31[3]	Second Amendment, dated as of November 19, 2007, to the Employment Agreement, dated as of July 24, 2006, by and between the Company and Amy Rhoades, as amended by the First Amendment, dated as of November 15, 2006.
+10.31.1	Third Amendment, dated as of March 28, 2011, to the Employment Agreement, dated as of July 24, 2006, by and between the Company and Amy Rhoades, as amended by the First Amendment, dated as of November 15, 2006, and the Second Amendment, dated as of November 19, 2007.
+10.32[16]	Form of Special Retention Award Agreement.
+10.33[20]	Employment Letter, dated as of May 17, 2009, between the Company and David Abelman.
+10.33.1[25]	Amendment One, dated as of March 16, 2010, to Employment Letter, dated as of May 7, 2009, between the Company and David Abelman.
+10.33.2	Amendment Two, dated as of March 28, 2011, between the Company and David Abelman.
+10.34[20]	Employment Letter, dated as of May 13, 2009, between the Company and David Stern.
+10.34.1[25]	Special Award Agreement, dated as of November 24, 2009, between the Company and David Stern.
+10.35[24]	Letter agreement, dated December 6, 2010, between the Company and Rodney Schriver.
10.38[18]	Securities Purchase Agreement, dated May 27, 2009.

18.1[17]	Preferability letter provided by PricewaterhouseCoopers LLC, our independent registered public accounting firm to change our method of accounting for valuing store inventories to weighted average cost.
21.1	Subsidiaries of the Company.

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Exhibit Number	Description
23.1	Consent of PricewaterhouseCoopers LLP.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a 14(a) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a 14(a) promulgated under the Exchange Act.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\+ Management contract or compensatory plan or arrangement.

(1) Incorporated by reference to the Company s Registration Statement on Form S-1 (File No. 333-32859) filed on August 5, 1997.

(2) Incorporated by reference to the Company s Form 10-K for the year ended December 31, 2006.

(3) Incorporated by reference to the Company s Form 8-K filed on November 21, 2007.

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