

GENESCO INC  
Form 10-Q  
December 07, 2006

**Table of Contents**

**United States Securities and Exchange Commission  
Washington, D.C. 20549  
Form 10-Q**

(Mark One)

**Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934  
For Quarter Ended October 28, 2006**

**Transition Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934  
Commission File No. 1-3083**

**Genesco Inc.**

A Tennessee Corporation  
I.R.S. No. 62-0211340  
Genesco Park  
1415 Murfreesboro Road  
Nashville, Tennessee 37217-2895  
Telephone 615/367-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of `acceleratedfilerandlargeacceleratedfiler` in Rule 12b-2 of the Exchange Act (check one:)

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) Yes  No   
Common Shares Outstanding November 24, 2006 22,479,204

---

**INDEX**

	<b>Page</b>
<b><u>Part I. Financial Information</u></b>	
<b><u>Item 1. Financial Statements (unaudited):</u></b>	
<u>Condensed Consolidated Balance Sheets – October 28, 2006, January 28, 2006 and October 29, 2005</u>	3
<u>Condensed Consolidated Statements of Earnings – Three Months and Nine Months Ended October 28, 2006 and October 29, 2005</u>	5
<u>Condensed Consolidated Statements of Cash Flows – Three Months and Nine Months Ended October 28, 2006 and October 29, 2005</u>	6
<u>Condensed Consolidated Statements of Shareholders’ Equity – Fiscal Year Ended January 28, 2006 and Nine Months Ended October 28, 2006</u>	7
<u>Notes to Condensed Consolidated Financial Statements</u>	8
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	40
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	56
<u>Item 4. Controls and Procedures</u>	57
<b><u>Part II. Other Information</u></b>	
<u>Item 1. Legal Proceedings</u>	58
<u>Item 1A. Risk Factors</u>	58
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	58
<u>Item 6. Exhibits</u>	59
<u>Signature</u>	60
<u>Ex-10.1 Amendment No. 2 to Trademark License Agreement</u>	
<u>Ex-31.1 Section 302 Certification</u>	
<u>Ex-31.2 Section 302 Certification</u>	
<u>Ex-32.1 Section 906 Certification</u>	
<u>Ex-32.2 Section 906 Certification</u>	

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Genesco Inc.  
and Subsidiaries**

Condensed Consolidated Balance Sheets

(In Thousands, except share amounts)

	<b>October 28, 2006</b>	<b>January 28, 2006</b>	<b>October 29, 2005</b>
<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents	\$ 18,638	\$ 60,451	\$ 33,398
Accounts receivable, net of allowances of \$2,366 at October 28, 2006, \$1,439 at January 28, 2006 and \$1,933 at October 29, 2005	24,401	21,171	22,738
Inventories	344,309	230,648	292,798
Deferred income taxes	10,416	8,649	6,087
Prepays and other current assets	22,706	20,269	19,925
<b>Total current assets</b>	<b>420,470</b>	<b>341,188</b>	<b>374,946</b>
Property and equipment:			
Land	4,861	4,972	4,972
Buildings and building equipment	14,812	14,723	14,690
Computer hardware, software and equipment	68,820	60,289	58,978
Furniture and fixtures	73,822	67,036	63,420
Construction in progress	16,473	11,728	15,664
Improvements to leased property	216,118	187,083	174,562
Property and equipment, at cost	394,906	345,831	332,286
Accumulated depreciation	(180,932)	(157,784)	(150,656)
Property and equipment, net	213,974	188,047	181,630
Deferred income taxes	2,321	-0-	817
Goodwill	96,235	96,235	96,561
Trademarks	47,677	47,671	47,665
Other intangibles, net of accumulated amortization of \$5,677 at October 28, 2006, \$4,302 at January 28, 2006 and \$3,741 at October 29, 2005	2,909	4,284	4,845
Other noncurrent assets	8,969	8,693	9,241
<b>Total Assets</b>	<b>\$ 792,555</b>	<b>\$ 686,118</b>	<b>\$ 715,705</b>

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Condensed Consolidated Balance Sheets

(In Thousands, except share amounts)

	<b>October 28, 2006</b>	<b>January 28, 2006</b>	<b>October 29, 2005</b>
<b>Liabilities and Shareholders Equity</b>			
<b><i>Current Liabilities</i></b>			
Accounts payable	\$ 135,614	\$ 73,929	\$ 115,993
Accrued employee compensation	16,760	26,047	18,384
Accrued other taxes	9,746	12,129	9,128
Accrued income taxes	3,076	12,886	4,496
Other accrued liabilities	29,154	27,178	26,910
Provision for discontinued operations	4,126	4,033	3,753
Total current liabilities	<b>198,476</b>	156,202	178,664
Long-term debt	<b>158,250</b>	106,250	151,250
Pension liability	<b>21,923</b>	23,222	24,230
Deferred rent and other long-term liabilities	<b>54,987</b>	50,013	48,218
Provision for discontinued operations	<b>1,812</b>	1,680	1,628
Total liabilities	<b>435,448</b>	337,367	403,990
Commitments and contingent liabilities			
<b><i>Shareholders Equity</i></b>			
Non-redeemable preferred stock	<b>6,615</b>	6,695	6,704
Common shareholders equity:			
Common stock, \$1 par value:			
Authorized: 80,000,000 shares			
Issued/Outstanding:			
October 28, 2006 22,960,065/22,471,601			
January 28, 2006 23,748,134/23,259,670			
October 29, 2005 23,357,359/22,868,895	<b>22,960</b>	23,748	23,357
Additional paid-in capital	<b>99,430</b>	123,137	118,592
Retained earnings	<b>271,338</b>	239,232	208,010
Accumulated other comprehensive loss	<b>(25,379)</b>	(26,204)	(27,091)
Treasury shares, at cost	<b>(17,857)</b>	(17,857)	(17,857)
Total shareholders equity	<b>357,107</b>	348,751	311,715
<b>Total Liabilities and Shareholders Equity</b>	<b>\$ 792,555</b>	\$ 686,118	\$ 715,705

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Condensed Consolidated Statements of Earnings

(In Thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
Net sales	\$ 364,298	\$ 316,336	\$ 983,617	\$ 877,589
Cost of sales	182,844	154,825	487,404	430,567
Selling and administrative expenses	150,992	133,225	433,477	385,429
Restructuring and other, net	1,083	(789)	1,672	2,255
Earnings from operations	29,379	29,075	61,064	59,338
Interest expense, net				
Interest expense	2,964	2,871	7,505	8,748
Interest income	(16)	(202)	(483)	(807)
Total interest expense, net	2,948	2,669	7,022	7,941
Earnings before income taxes from continuing operations	26,431	26,406	54,042	51,397
Income taxes	10,456	10,168	21,457	19,967
Earnings from continuing operations	15,975	16,238	32,585	31,430
Provision for discontinued operations, net	(98)	(95)	(287)	(30)
<b>Net Earnings</b>	<b>\$ 15,877</b>	<b>\$ 16,143</b>	<b>\$ 32,298</b>	<b>\$ 31,400</b>
Basic earnings per common share:				
Continuing operations	\$ .71	\$ .71	\$ 1.42	\$ 1.38
Discontinued operations	\$ .00	\$ .00	\$ (.01)	\$ .00
Net earnings	\$ .71	\$ .71	\$ 1.41	\$ 1.38
Diluted earnings per common share:				
Continuing operations	\$ .62	\$ .62	\$ 1.26	\$ 1.22
Discontinued operations	\$ .00	\$ (.01)	\$ (.01)	\$ .00
Net earnings	\$ .62	\$ .61	\$ 1.25	\$ 1.22

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

**Table of Contents****Genesco Inc.  
and Subsidiaries**Condensed Consolidated Statements of Cash Flows  
(In Thousands)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>October</b>	<b>October</b>	<b>October</b>	<b>October</b>
	<b>28,</b>	<b>29,</b>	<b>28,</b>	<b>29,</b>
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Net earnings	\$ 15,877	\$ 16,143	\$ 32,298	\$ 31,400
Tax benefit of stock options exercised	(360)	850	(518)	2,350
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:				
Depreciation	10,112	8,743	29,289	25,630
Provision for legal settlement	-0-	(891)	-0-	1,680
Deferred income taxes	(3,890)	(2,157)	(5,215)	(2,679)
Provision for losses on accounts receivable	42	55	296	39
Impairment of long-lived assets	1,031	39	1,579	376
Share-based compensation and restricted stock	1,545	118	5,049	286
Provision for discontinued operations	160	157	471	51
Other	674	1,272	1,558	2,598
Effect on cash of changes in working capital and other assets and liabilities:				
Accounts receivable	(5,150)	(5,030)	(3,526)	(4,870)
Inventories	(12,870)	(22,109)	(113,661)	(85,601)
Prepays and other current assets	(376)	(77)	(1,154)	(1,876)
Accounts payable	(6,201)	990	54,455	45,274
Other accrued liabilities	9,475	8,972	(19,614)	(3,151)
Other assets and liabilities	2,925	3,831	4,773	2,731
Net cash provided by (used in) operating activities	12,994	10,906	(13,920)	14,238
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Capital expenditures	(21,146)	(18,040)	(57,559)	(41,184)
Proceeds from sale of property and equipment	5	18	5	19
Net cash used in investing activities	(21,141)	(18,022)	(57,554)	(41,165)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Payments of long-term debt	-0-	-0-	-0-	(10,000)
Payments of capital leases	-0-	(77)	-0-	(267)
Tax benefit of stock options exercised	360	-0-	518	-0-
Shares repurchased	(20,113)	-0-	(31,842)	-0-
Change in overdraft balances	(3,139)	166	7,230	5,120

Edgar Filing: GENESCO INC - Form 10-Q

Revolver borrowings, net	<b>29,000</b>	-0-	<b>52,000</b>	-0-
Dividends paid on non-redeemable preferred stock	<b>(64)</b>	(67)	<b>(192)</b>	(209)
Exercise of stock options	<b>1,381</b>	1,644	<b>1,947</b>	5,613
Net cash provided by financing activities	<b>7,425</b>	1,666	<b>29,661</b>	257
<b>Net Cash Flow</b>	<b>(722)</b>	(5,450)	<b>(41,813)</b>	(26,670)
Cash and cash equivalents at beginning of period	<b>19,360</b>	38,848	<b>60,451</b>	60,068
<b>Cash and cash equivalents at end of period</b>	<b>\$ 18,638</b>	\$ 33,398	<b>\$ 18,638</b>	\$ 33,398

**Supplemental Cash Flow Information:**

Net cash paid for:

Interest	<b>\$ 1,258</b>	\$ 1,711	<b>\$ 5,308</b>	\$ 6,884
Income taxes	<b>10,061</b>	5,413	<b>37,328</b>	20,948

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.



**Table of Contents****Genesco Inc.  
and Subsidiaries**Condensed Consolidated Statements of Shareholders' Equity  
(In Thousands)

	<b>Total Non-Redeemable Preferred Stock</b>	<b>Common Stock</b>	<b>Additional Paid-In Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Loss</b>	<b>Treasury Stock</b>	<b>Comprehensive Income</b>	<b>Total Share- holders Equity</b>
<b>Balance January 29, 2005</b>	<b>\$ 7,474</b>	<b>\$ 22,926</b>	<b>\$ 109,005</b>	<b>\$ 176,819</b>	<b>\$ (26,302)</b>	<b>\$ (17,857)</b>		<b>\$ 272,065</b>
Net earnings	-0-	-0-	-0-	62,686	-0-	-0-	\$ 62,686	62,686
Dividends paid on non-redeemable preferred stock	-0-	-0-	-0-	(273)	-0-	-0-	-0-	(273)
Exercise of stock options	-0-	547	8,297	-0-	-0-	-0-	-0-	8,844
Employee restricted stock	-0-	229	400	-0-	-0-	-0-	-0-	629
Issue shares Employee Stock Purchase Plan	-0-	25	483	-0-	-0-	-0-	-0-	508
Tax benefit of stock options exercised	-0-	-0-	3,850	-0-	-0-	-0-	-0-	3,850
Conversion of Series 4 preferred stock	(723)	11	712	-0-	-0-	-0-	-0-	-0-
Loss on foreign currency forward contracts (net of tax benefit of \$0.7 million)	-0-	-0-	-0-	-0-	(1,047)	-0-	(1,047)	(1,047)
Gain on interest rate swaps (net of tax of \$0.1 million)	-0-	-0-	-0-	-0-	61	-0-	61	61
Minimum pension liability adjustment (net of tax of \$0.7 million)	-0-	-0-	-0-	-0-	1,084	-0-	1,084	1,084
Other	(56)	10	390	-0-	-0-	-0-	-0-	344
Comprehensive income							\$ 62,784	
<b>Balance January 28, 2006</b>	<b>6,695</b>	<b>23,748</b>	<b>123,137</b>	<b>239,232</b>	<b>(26,204)</b>	<b>(17,857)</b>		<b>348,751</b>
Net earnings	-0-	-0-	-0-	32,298	-0-	-0-	32,298	32,298
Dividends paid on non-redeemable preferred stock	-0-	-0-	-0-	(192)	-0-	-0-	-0-	(192)
Exercise of stock options	-0-	88	1,538	-0-	-0-	-0-	-0-	1,626
Issue shares Employee Stock Purchase Plan	-0-	10	311	-0-	-0-	-0-	-0-	321
Shares repurchased	-0-	(1,062)	(31,026)	-0-	-0-	-0-	-0-	(32,088)
Employee and non-employee restricted stock	-0-	154	1,700	-0-	-0-	-0-	-0-	1,854
Share-based compensation	-0-	-0-	3,195	-0-	-0-	-0-	-0-	3,195
Tax benefit of stock options exercised	-0-	-0-	518	-0-	-0-	-0-	-0-	518
Gain on foreign currency forward contracts (net of tax of \$0.6 million)	-0-	-0-	-0-	-0-	872	-0-	872	872
Loss on interest rate swaps (net of tax benefit of \$0.1 million)	-0-	-0-	-0-	-0-	(96)	-0-	(96)	(96)
Foreign currency translation adjustment	-0-	-0-	-0-	-0-	49	-0-	49	49
Other	(80)	22	57	-0-	-0-	-0-	-0-	(1)
Comprehensive income*							\$ 33,123	

**Balance October 28, 2006**                      **\$ 6,615**   **\$ 22,960**   **\$ 99,430**   **\$ 271,338**   **\$ (25,379)**   **\$ (17,857)**                      **\$ 357,107**

\* Comprehensive income was \$15.8 million for both the third quarter ended October 28, 2006 and the third quarter ended October 29, 2005.

Comprehensive income was \$30.6 million for the nine month period ended October 29, 2005.

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies**

***Interim Statements***

The condensed consolidated financial statements contained in this report of Genesco Inc., a Tennessee corporation (together with its subsidiaries, the Company), are unaudited but reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the results for the interim periods of the fiscal year ending February 3, 2007 (Fiscal 2007) and of the fiscal year ended January 28, 2006 (Fiscal 2006). The results of operations for any interim period are not necessarily indicative of results for the full year. The interim financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's annual report on Form 10-K.

***Nature of Operations***

The Company's businesses include the design or sourcing, marketing and distribution of footwear, principally under the *Johnston & Murphy* and *Dockers* brands and the operation at October 28, 2006 of 1,925 *Journeys*, *Journeys Kidz*, *Shi by Journeys*, *Johnston & Murphy*, *Underground Station*, *Jarman*, *Hat World*, *Lids*, *Hat Zone*, *Cap Connection*, *Lids Kids* and *Head Quarters* retail footwear and headwear stores.

***Principles of Consolidation***

All subsidiaries are consolidated in the condensed consolidated financial statements. All significant intercompany transactions and accounts have been eliminated.

***Financial Statement Reclassifications***

Certain reclassifications have been made to conform prior years' data to the current year presentation.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant areas requiring management estimates or judgments include the following key financial areas:

***Inventory Valuation***

The Company values its inventories at the lower of cost or market.

In its wholesale operations, cost is determined using the first-in, first-out (FIFO) method. Market is determined using a system of analysis which evaluates inventory at the stock number level based on factors such as inventory turn, average selling price, inventory level, and selling prices reflected in future orders. The Company provides reserves when the inventory has not been marked down to market based on current selling prices or when the inventory is not turning and is not expected to turn at levels satisfactory to the Company.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies, Continued**

In its retail operations, other than the Hat World segment, the Company employs the retail inventory method, applying average cost-to-retail ratios to the retail value of inventories. Under the retail inventory method, valuing inventory at the lower of cost or market is achieved as markdowns are taken or accrued as a reduction of the retail value of inventories.

Inherent in the retail inventory method are subjective judgments and estimates, including merchandise mark-on, markups, markdowns, and shrinkage. These judgments and estimates, coupled with the fact that the retail inventory method is an averaging process, could produce a range of cost figures. To reduce the risk of inaccuracy and to ensure consistent presentation, the Company employs the retail inventory method in multiple subclasses of inventory with similar gross margin, and analyzes markdown requirements at the stock number level based on factors such as inventory turn, average selling price, and inventory age. In addition, the Company accrues markdowns as necessary. These additional markdown accruals reflect all of the above factors as well as current agreements to return products to vendors and vendor agreements to provide markdown support. In addition to markdown provisions, the Company maintains provisions for shrinkage and damaged goods based on historical rates.

The Hat World segment employs the moving average cost method for valuing inventories and applies freight using an allocation method. The Company provides a valuation allowance for slow-moving inventory based on negative margins and estimated shrink based on historical experience and specific analysis, where appropriate.

Inherent in the analysis of both wholesale and retail inventory valuation are subjective judgments about current market conditions, fashion trends, and overall economic conditions. Failure to make appropriate conclusions regarding these factors may result in an overstatement or understatement of inventory value.

*Impairment of Definite-Lived Long-Lived Assets*

The Company periodically assesses the realizability of its definite-lived long-lived assets and evaluates such assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Asset impairment is determined to exist if estimated future cash flows, undiscounted and without interest charges, are less than the carrying amount. Inherent in the analysis of impairment are subjective judgments about future cash flows. Failure to make appropriate conclusions regarding these judgments may result in an overstatement of the value of held and used definite-lived long-lived assets (see Note 2).

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies, Continued**

*Environmental and Other Contingencies*

The Company is subject to certain loss contingencies related to environmental proceedings and other legal matters, including those disclosed in Note 8 to the Company's Condensed Consolidated Financial Statements. The Company monitors these matters on an ongoing basis and, on a quarterly basis, management reviews the Company's reserves and accruals in relation to each of them, adjusting provisions as management deems necessary in view of changes in available information. Changes in estimates of liability are reported in the periods when they occur. Consequently, management believes that its reserve in relation to each proceeding is a best estimate of probable loss connected to the proceeding, or in cases in which no best estimate is possible, the minimum amount in the range of estimated losses, based upon its analysis of the facts and circumstances as of the close of the most recent fiscal quarter. However, because of uncertainties and risks inherent in litigation generally and in environmental proceedings in particular, there can be no assurance that future developments will not require additional reserves to be set aside, that some or all reserves will be adequate or that the amounts of any such additional reserves or any such inadequacy will not have a material adverse effect upon the Company's financial condition or results of operations.

*Revenue Recognition*

Retail sales are recorded at the point of sale and are net of estimated returns. Catalog and internet sales are recorded at time of delivery to the customer and are net of estimated returns. Wholesale revenue is recorded net of estimated returns and allowances for markdowns, damages and miscellaneous claims when the related goods have been shipped and legal title has passed to the customer. Shipping and handling costs charged to customers are included in net sales. Estimated returns are based on historical returns and claims. Actual amounts of markdowns have not differed materially from estimates. Actual returns and claims in any future period may differ from historical experience.

*Pension Plan Accounting*

In December 2003, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits. This statement revised employers' disclosures about pension plans and other post retirement benefit plans. It did not change the measurement or recognition of those plans required by SFAS No. 87, Employers' Accounting for Pensions. The Company accounts for the defined benefit pension plans using SFAS No. 87, Employers' Accounting for Pensions ( SFAS No. 87 ). Under SFAS No. 87, pension expense is recognized on an accrual basis over employees' approximate service periods. The calculation of pension expense and the corresponding liability requires the use of a number of critical assumptions, including the expected long-term rate of return on plan assets and the assumed discount rate, as well as the recognition of actuarial gains and losses. Changes in these assumptions can result in different expense and liability amounts, and future actual experience can differ from these assumptions.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1****Summary of Significant Accounting Policies, Continued*****Cash and Cash Equivalents***

Included in cash and cash equivalents at October 28, 2006, January 28, 2006 and October 29, 2005 are cash equivalents of \$2.9 million, \$48.5 million and \$17.7 million, respectively. Cash equivalents are highly-liquid financial instruments having an original maturity of three months or less. The majority of payments due from banks for customer credit card transactions process within 24 - 48 hours and are accordingly classified as cash and cash equivalents.

At October 28, 2006, January 28, 2006 and October 29, 2005, outstanding checks drawn on zero-balance accounts at certain domestic banks exceeded book cash balances at those banks by approximately \$24.5 million, \$17.2 million and \$22.8 million, respectively. These amounts are included in accounts payable.

***Concentration of Credit Risk and Allowances on Accounts Receivable***

The Company's footwear wholesaling business sells primarily to independent retailers and department stores across the United States. Receivables arising from these sales are not collateralized. Customer credit risk is affected by conditions or occurrences within the economy and the retail industry. Two customers accounted for 12% and 11%, respectively, of the Company's trade receivables balance as of October 28, 2006, and no other customer accounted for more than 9% of the Company's trade receivables balance as of October 28, 2006.

The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information, as well as company-specific factors. The Company also establishes allowances for sales returns, customer deductions and co-op advertising based on specific circumstances, historical trends and projected probable outcomes.

***Property and Equipment***

Property and equipment are recorded at cost and depreciated or amortized over the estimated useful life of related assets. Depreciation and amortization expense are computed principally by the straight-line method over the following estimated useful lives:

Buildings and building equipment	20-45 years
Computer hardware, software and equipment	3-10 years
Furniture and fixtures	10 years

***Leases***

Leasehold improvements and properties under capital leases are amortized on the straight-line method over the shorter of their useful lives or their related lease terms and the charge to earnings is included in selling and administrative expenses in the Condensed Consolidated Statements of Earnings.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies, Continued**

Certain leases include rent increases during the initial lease term. For these leases, the Company recognizes the related rental expense on a straight-line basis over the term of the lease (which includes any rent holidays and the pre-opening period of construction, renovation, fixturing and merchandise placement) and records the difference between the amounts charged to operations and amounts paid as a rent liability.

The Company occasionally receives reimbursements from landlords to be used towards construction of the store the Company intends to lease. Leasehold improvements are recorded at their gross costs including items reimbursed by landlords. The reimbursements are amortized as a reduction of rent expense over the initial lease term.

***Goodwill and Other Intangibles***

Under the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, ( SFAS No. 142 ), goodwill and intangible assets with indefinite lives are not amortized, but tested at least annually for impairment. SFAS No. 142 also requires that intangible assets with finite lives be amortized over their respective lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ( SFAS No. 144 ).

Intangible assets of the Company with indefinite lives are primarily goodwill and identifiable trademarks acquired in connection with the acquisition of Hat World Corporation on April 1, 2004. The Company tests for impairment of intangible assets with an indefinite life, at a minimum on an annual basis, relying on a number of factors including operating results, business plans and projected future cash flows. The impairment test for identifiable assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying amount.

Identifiable intangible assets of the Company with finite lives are primarily leases and customer lists. They are subject to amortization based upon their estimated useful lives. Finite-lived intangible assets are evaluated for impairment using a process similar to that used to evaluate other definite-lived long-lived assets, a comparison of the fair value of the intangible asset with its carrying amount. An impairment loss is recognized for the amount by which the carrying value exceeds the fair value of the asset.

***Post-retirement Benefits***

Substantially all full-time employees, except employees in the Hat World segment, are covered by a defined benefit pension plan. The Company froze the defined benefit pension plan effective January 1, 2005. The Company also provides certain former employees with limited medical and life insurance benefits. The Company funds at least the minimum amount required by the Employee Retirement Income Security Act.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies, Continued**

***Cost of Sales***

For the Company's retail operations, the cost of sales includes actual product cost, the cost of transportation to the Company's warehouses from suppliers and the cost of transportation from the Company's warehouses to the stores. Additionally, the cost of its distribution facilities allocated to its retail operations is included in cost of sales. For the Company's wholesale operations, the cost of sales includes the actual product cost and the cost of transportation to the Company's warehouses from suppliers.

***Selling and Administrative Expenses***

Selling and administrative expenses include all operating costs of the Company excluding (i) those related to the transportation of products from the supplier to the warehouse, (ii) for its retail operations, those related to the transportation of products from the warehouse to the store and (iii) costs of its distribution facilities which are allocated to its retail operations. Wholesale and unallocated retail costs of distribution are included in selling and administrative expenses in the amounts of \$1.2 million and \$1.1 million for the third quarter of Fiscal 2007 and 2006, respectively, and \$2.6 million and \$3.2 million for the first nine months of Fiscal 2007 and 2006, respectively.

***Buying, Merchandising and Occupancy Costs***

The Company records buying and merchandising and occupancy costs in selling and administrative expense. Because the Company does not include these costs in cost of sales, the Company's gross margin may not be comparable to other retailers that include these costs in the calculation of gross margin.

***Shipping and Handling Costs***

Shipping and handling costs related to inventory purchased from suppliers is included in the cost of inventory and is charged to cost of sales in the period that the inventory is sold. All other shipping and handling costs are charged to cost of sales in the period incurred except for wholesale and unallocated retail costs of distribution, which are included in selling and administrative expenses.

***Preopening Costs***

Costs associated with the opening of new stores are expensed as incurred, and are included in selling and administrative expenses on the accompanying Condensed Consolidated Statements of Earnings.



**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies, Continued**

***Store Closings and Exit Costs***

From time to time, the Company makes strategic decisions to close stores or exit locations or activities. If stores or operating activities to be closed or exited constitute components, as defined by SFAS No. 144, and will not result in a migration of customers and cash flows, these closures will be considered discontinued operations when the related assets meet the criteria to be classified as held for sale, or at the cease-use date, whichever occurs first. The results of operations of discontinued operations are presented retroactively, net of tax, as a separate component on the Statement of Earnings, if material individually or cumulatively.

Assets related to planned store closures or other exit activities are reflected as assets held for sale and recorded at the lower of carrying value or fair value less costs to sell when the required criteria, as defined by SFAS No. 144, are satisfied. Depreciation ceases on the date that the held for sale criteria are met.

Assets related to planned store closures or other exit activities that do not meet the criteria to be classified as held for sale are evaluated for impairment in accordance with the Company's normal impairment policy, but with consideration given to revised estimates of future cash flows. In any event, the remaining depreciable useful lives are evaluated and adjusted as necessary.

Exit costs related to anticipated lease termination costs, severance benefits and other expected charges are accrued for and recognized in accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities.

***Advertising Costs***

Advertising costs are predominantly expensed as incurred. Advertising costs were \$7.5 million and \$7.0 million for the third quarter of Fiscal 2007 and 2006, respectively, and \$22.9 million and \$21.1 million for the first nine months of Fiscal 2007 and 2006, respectively. Direct response advertising costs for catalogs are capitalized, in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position No. 93-7, Reporting on Advertising Costs. Such costs are amortized over the estimated future revenues realized from such advertising, not to exceed six months. The Condensed Consolidated Balance Sheets include prepaid assets for direct response advertising costs of \$1.0 million, \$0.9 million and \$0.9 million at October 28, 2006, January 28, 2006 and October 29, 2005, respectively.

***Consideration to Resellers***

The Company does not have any written buy-down programs with retailers, but the Company has provided certain retailers with markdown allowances for obsolete and slow moving products that are in the retailer's inventory. The Company estimates these allowances and provides for them as reductions to revenues at the time revenues are recorded. Markdowns are negotiated with retailers and changes are made to the estimates as agreements are reached. Actual amounts for markdowns have not differed materially from estimates.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies, Continued**

***Cooperative Advertising***

Cooperative advertising funds are made available to all of the Company's wholesale customers. In order for retailers to receive reimbursement under such programs, the retailer must meet specified advertising guidelines and provide appropriate documentation of expenses to be reimbursed. The Company's cooperative advertising agreements require that wholesale customers present documentation or other evidence of specific advertisements or display materials used for the Company's products by submitting the actual print advertisements presented in catalogs, newspaper inserts or other advertising circulars, or by permitting physical inspection of displays. Additionally, the Company's cooperative advertising agreements require that the amount of reimbursement requested for such advertising or materials be supported by invoices or other evidence of the actual costs incurred by the retailer. The Company accounts for these cooperative advertising costs as selling and administrative expenses, in accordance with Emerging Issues Task Force (EITF) Issue No. 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products).

Cooperative advertising costs recognized in selling and administrative expenses were \$0.8 million and \$0.6 million for the third quarter of Fiscal 2007 and 2006, respectively, and \$1.9 million and \$1.6 million for the first nine months of Fiscal 2007 and 2006, respectively. During the first nine months of Fiscal 2007 and 2006, the Company's cooperative advertising reimbursements paid did not exceed the fair value of the benefits received under those agreements.

***Vendor Allowances***

From time to time, the Company negotiates allowances from its vendors for markdowns taken or expected to be taken. These markdowns are typically negotiated on specific merchandise and for specific amounts. These specific allowances are recognized as a reduction in cost of sales in the period in which the markdowns are taken. Markdown allowances not attached to specific inventory on hand or already sold are applied to concurrent or future purchases from each respective vendor.

The Company receives support from some of its vendors in the form of reimbursements for cooperative advertising and catalog costs for the launch and promotion of certain products. The reimbursements are agreed upon with vendors and represent specific, incremental, identifiable costs incurred by the Company in selling the vendor's products. Such costs and the related reimbursements are accumulated and monitored on an individual vendor basis, pursuant to the respective cooperative advertising agreements with vendors. Such cooperative advertising reimbursements are recorded as a reduction of selling and administrative expenses in the same period in which the associated expense is incurred. If the amount of cash consideration received exceeds the costs being reimbursed, such excess amount would be recorded as a reduction of cost of sales.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies, Continued**

Vendor reimbursements of cooperative advertising costs recognized as a reduction of selling and administrative expenses were \$0.2 million and \$0.3 million for the third quarter of Fiscal 2007 and 2006, respectively, and \$2.5 million and \$2.2 million for the first nine months of Fiscal 2007 and 2006, respectively. During the first nine months of Fiscal 2007 and 2006, the Company's cooperative advertising reimbursements received were not in excess of the costs reimbursed.

***Environmental Costs***

Environmental expenditures relating to current operations are expensed or capitalized as appropriate. Expenditures relating to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when environmental assessments and/or remedial efforts are probable and the costs can be reasonably estimated and are evaluated independently of any future claims for recovery. Generally, the timing of these accruals coincides with completion of a feasibility study or the Company's commitment to a formal plan of action. Costs of future expenditures for environmental remediation obligations are not discounted to their present value.

***Income Taxes***

Deferred income taxes are provided for all temporary differences and operating loss and tax credit carryforwards are limited, in the case of deferred tax assets, to the amount the Company believes is more likely than not to be realized in the foreseeable future.

***Earnings Per Common Share***

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities to issue common stock were exercised or converted to common stock (see Note 6).

***Other Comprehensive Income***

SFAS No. 130, Reporting Comprehensive Income, requires, among other things, the Company's minimum pension liability adjustment, unrealized gains or losses on foreign currency forward contracts, unrealized gains and losses on interest rate swaps and foreign currency translation adjustments to be included in other comprehensive income net of tax. Accumulated other comprehensive loss at October 28, 2006 consisted of \$25.9 million of cumulative minimum pension liability adjustments, net of tax, cumulative net gains of \$0.2 million on foreign currency forward contracts, net of tax, cumulative net gains of \$0.1 million on interest rate swaps, net of tax, and a foreign currency translation adjustment of \$0.2 million.

***Business Segments***

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires that companies disclose operating segments based on the way management disaggregates the Company for making internal operating decisions (see Note 9).

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1****Summary of Significant Accounting Policies, Continued*****Derivative Instruments and Hedging Activities***

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of SFAS No. 133, SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities and SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, (collectively SFAS 133 ) require an entity to recognize all derivatives as either assets or liabilities in the consolidated balance sheet and to measure those instruments at fair value. Under certain conditions, a derivative may be specifically designated as a fair value hedge or a cash flow hedge. The accounting for changes in the fair value of a derivative are recorded each period in current earnings or in other comprehensive income depending on the intended use of the derivative and the resulting designation.

***New Accounting Principles***

Effective January 29, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment ( SFAS No. 123(R) ), using the modified prospective transition method. Under the modified prospective transition method, compensation cost recognized for the three months and nine months ended October 28, 2006 includes (i) compensation cost for all share-based payments granted prior to, but not yet vested as of January 29, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123 Accounting for Stock-Based Compensation ( SFAS No. 123 ); and (ii) compensation cost for all share-based payments granted on or after January 29, 2006, based on the grant date fair value estimated in accordance with SFAS No. 123(R). In accordance with the modified prospective method, the Company has not restated prior period results. See Note 7 to the Company s Condensed Consolidated Financial Statements for additional information on the Company s share-based compensation plans and adoption of SFAS No. 123(R).

In March 2006, the Emerging Issues Task Force ( EITF ) reached a consensus on EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, gross versus net presentation), which allows companies to adopt a policy of presenting taxes in the income statement on either a gross or net basis. Taxes within the scope of this EITF would include taxes that are imposed on a revenue transaction between a seller and a customer, for example, sales taxes, use taxes, value-added taxes and some types of excise taxes. EITF No. 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. EITF No. 06-3 will not impact the method for recording and reporting these sales taxes in the Company s Condensed Consolidated Financial Statements as the Company s policy is to exclude all such taxes from revenue.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of SFAS No. 109 ( FIN 48 ). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes that a company should use a more-likely-than-not recognition threshold based on the technical merits of the tax position taken. Tax positions that meet the more-likely-than-not recognition threshold should be measured in order to determine the tax benefit to be recognized in the financial statements. FIN 48 is effective in fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact that the adoption of FIN 48 will have on its results of operations and financial position.

**Table of Contents**

Genesco Inc.

**and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 1**

**Summary of Significant Accounting Policies, Continued**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (fiscal year 2009 for the Company), and interim periods within those fiscal years. The Company is currently evaluating the impact that the adoption of SFAS No. 157 will have, if any, on its results of operations and financial position.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) ( SFAS No. 158 ). SFAS No. 158 requires companies to recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in comprehensive income in the year in which the changes occur. This requirement of SFAS No. 158 is effective as of the end of the fiscal year ending after December 15, 2006 (fiscal year 2007 for the Company). SFAS No. 158 also requires companies to measure the funded status of a plan as of the date of its fiscal year end. This requirement of SFAS No. 158 is effective for fiscal years ending after December 15, 2008 (fiscal year 2009 for the Company). The Company does not believe the adoption of SFAS No. 158 will have a material impact on the Company's results of operations or financial position.

**Note 2**

**Restructuring and Other Charges and Discontinued Operations**

**Restructuring and Other Charges**

In accordance with Company policy, assets are determined to be impaired when the revised estimated future cash flows were insufficient to recover the carrying costs. Impairment charges represent the excess of the carrying value over the fair value of those assets.

Asset impairment charges are reflected as a reduction of the net carrying value of property and equipment, and in restructuring and other, net in the accompanying Condensed Consolidated Statements of Earnings.

The Company recorded a pretax charge to earnings of \$1.1 million (\$0.7 million net of tax) in the third quarter of Fiscal 2007. The charge was primarily for retail store asset impairments and the lease termination of one Jarman store. The lease termination was the continuation of a plan previously announced by the Company in Fiscal 2004.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 2****Restructuring and Other Charges and Discontinued Operations, Continued**

The Company recorded a pretax charge to earnings of \$0.5 million (\$0.3 million net of tax) in the second quarter of Fiscal 2007. The charge was primarily for retail store asset impairments.

The Company recorded a pretax charge to earnings of \$0.1 million in the first quarter of Fiscal 2007. The charge was primarily for retail store asset impairments.

The Company recorded a pretax credit to earnings of \$0.8 million (\$0.5 million net of tax) in the third quarter of Fiscal 2006. The credit was primarily for the recognition of a gain of \$0.9 million associated with the conclusion of the settlement of a California employment class action more favorably than originally anticipated, when the charge associated with the settlement was originally taken in the first quarter of Fiscal 2006 (see Note 8), offset by a \$0.1 million charge for retail store asset impairments and lease terminations of four Jarman stores.

The Company recorded a pretax charge to earnings of \$0.2 million (\$0.1 million net of tax) in the second quarter of Fiscal 2006. The charge was primarily for retail store asset impairments and lease terminations of two Jarman stores.

The Company recorded a pretax charge to earnings of \$2.9 million (\$1.8 million net of tax) in the first quarter of Fiscal 2006. The charge included \$2.6 million for settlement of a California employment class action (see Note 8), \$0.2 million for retail store asset impairments and \$0.1 million for lease terminations of two Jarman stores.

**Accrued Provision for Discontinued Operations**

<b>In thousands</b>	<b>Facility Shutdown Costs</b>	<b>Other</b>	<b>Total</b>
Balance January 29, 2005	\$ 5,800	\$ 3	\$ 5,803
Excess provision Fiscal 2006	(98)	-0-	(98)
Charges and adjustments, net	8	-0-	8
Balance January 28, 2006	5,710	3	5,713
Additional provision Fiscal 2007	471	-0-	471
Charges and adjustments, net	(243)	(3)	(246)
Balance October 28, 2006*	5,938	-0-	5,938
<b>Current provision for discontinued operations</b>	<b>4,126</b>	<b>-0-</b>	<b>4,126</b>
<b>Total Noncurrent Provision for Discontinued Operations</b>	<b>\$ 1,812</b>	<b>\$ -0-</b>	<b>\$ 1,812</b>

\* Includes \$5.7 million environmental provision including \$3.9 million in current provision for discontinued operations.



**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 3****Inventories**

<b>In thousands</b>	<b>October 28, 2006</b>	<b>January 28, 2006</b>
Raw materials	\$ 203	\$ 203
Wholesale finished goods	29,367	30,392
Retail merchandise	314,739	200,053
<b>Total Inventories</b>	<b>\$ 344,309</b>	<b>\$ 230,648</b>

**Note 4****Derivative Instruments and Hedging Activities**

In order to reduce exposure to foreign currency exchange rate fluctuations in connection with inventory purchase commitments for its Johnston & Murphy division, the Company enters into foreign currency forward exchange contracts for Euro to make Euro denominated payments with a maximum hedging period of twelve months. Derivative instruments used as hedges must be effective at reducing the risk associated with the exposure being hedged. The settlement terms of the forward contracts correspond with the payment terms for the merchandise inventories. As a result, there is no hedge ineffectiveness to be reflected in earnings. The notional amount of such contracts outstanding at October 28, 2006 and January 28, 2006 was \$7.6 million and \$7.5 million, respectively. Forward exchange contracts have an average remaining term of approximately two and one-third months. The loss based on spot rates under these contracts at October 28, 2006 was \$2,000, and the gain based on spot rates under these contracts at January 28, 2006 was \$15,000. For the nine months ended October 28, 2006, the Company recorded an unrealized gain on foreign currency forward contracts of \$1.4 million in accumulated other comprehensive loss, before taxes. The Company monitors the credit quality of the major national and regional financial institutions with which it enters into such contracts.

The Company estimates that the majority of net hedging gains related to forward exchange contracts will be reclassified from accumulated other comprehensive loss into earnings through lower cost of sales over the succeeding year.

The Company uses interest rate swaps as a cash flow hedge to manage interest costs and the risk associated with changing interest rates of long-term debt. During the first quarter ended May 1, 2004, the Company entered into three separate forward-starting interest rate swap agreements as a means of managing its interest rate exposure on its \$100.0 million variable rate term loan. All three agreements were effective beginning on October 1, 2004 and are designed to swap a variable rate of three-month LIBOR (5.38% at October 2, 2006, the day the rate was set) for a fixed rate ranging from 2.52% to 3.32%. The aggregate notional amount of the swaps was \$65.0 million. Of the three agreements, the swap agreement with a \$15.0 million notional amount expired on October 1, 2005. The swap agreement with a \$20.0 million notional amount expired on July 1, 2006, but it was terminated early in January 2006. The swap agreement with an original \$30.0 million notional amount expires on April 1, 2007 and has a \$20.0 million notional amount as of October 28, 2006. The fixed rate on the remaining swap agreement is 3.32%. These agreements have the effect of converting certain of the Company's variable rate obligations to fixed rate obligations. The Company received \$0.3 million in Fiscal 2006 as a result of early termination of some of the interest rate swap agreements.



**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 4****Derivative Instruments and Hedging Activities, Continued**

In order to ensure continued hedge effectiveness, the Company intends to elect the three-month LIBOR option for its variable rate interest payments on its term loan as of each interest payment date. Since the interest payment dates coincide with the swap reset dates, the hedges are expected to be perfectly effective. However, because the swaps do not qualify for the short-cut method, the Company will evaluate quarterly the continued effectiveness of the hedge and will reflect any ineffectiveness in the results of operations. As long as the hedge continues to be perfectly effective, net amounts paid or received will be reflected as an adjustment to interest expense and the changes in the fair value of the derivative will be reflected in other comprehensive income.

At October 28, 2006, the net gain of these interest rate swap agreements was \$0.1 million, net of tax, representing the change in fair value of the derivative instruments.

**Note 5****Defined Benefit Pension Plans and Other Benefit Plans*****Components of Net Periodic Benefit Cost***

	<b>Pension Benefits</b>			
	Three Months Ended		Nine Months Ended	
<b>In thousands</b>	<b>October 28, 2006</b>	October 29, 2005	<b>October 28, 2006</b>	October 29, 2005
Service cost	\$ 63	\$ 61	\$ 189	\$ 188
Interest cost	1,605	1,656	4,818	4,982
Expected return on plan assets	(1,944)	(1,920)	(5,836)	(5,781)
Amortization:				
Losses	1,105	1,087	3,375	3,416
Net amortization	1,105	1,087	3,375	3,416
<b>Net Periodic Benefit Cost</b>	<b>\$ 829</b>	<b>\$ 884</b>	<b>\$ 2,546</b>	<b>\$ 2,805</b>

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 5****Defined Benefit Pension Plans and Other Benefit Plans, Continued**

	<b>Other Benefits</b>			
	Three Months Ended		Nine Months Ended	
<b>In thousands</b>	<b>October 28, 2006</b>	October 29, 2005	<b>October 28, 2006</b>	October 29, 2005
Service cost	\$ 54	\$ 37	\$ 162	\$ 111
Interest cost	50	44	150	132
Amortization: Losses	22	14	66	42
Net amortization	22	14	66	42
<b>Net Periodic Benefit Cost</b>	<b>\$ 126</b>	<b>\$ 95</b>	<b>\$ 378</b>	<b>\$ 285</b>

While there was no cash requirement projected for the plan in 2006, the Company made a \$4.0 million contribution to the plan in March 2006.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 6****Earnings Per Share**

(In thousands, except per share amounts)	For the Three Months Ended October 28, 2006			For the Three Months Ended October 29, 2005		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Earnings from continuing operations	\$ 15,975			\$ 16,238		
Less: Preferred stock dividends	(64)			(67)		
<b>Basic EPS</b>						
Income available to common shareholders	15,911	22,284	\$ .71	16,171	22,797	\$ .71
<b>Effect of Dilutive Securities</b>						
Options		315			521	
Convertible preferred stock <sup>(1)</sup>	42	67		42	67	
4 1/8% Convertible Subordinated Debentures	604	3,899		617	3,899	
Employees preferred stock <sup>(2)</sup>		59			62	
<b>Diluted EPS</b>						
Income available to common shareholders plus assumed conversions	\$ 16,557	26,624	\$ .62	\$ 16,830	27,346	\$ .62

(1) The amount of the dividends on the Series 1 and 3 convertible preferred stock per common share obtainable on conversion of the convertible preferred stock is less than basic

earnings per share for all periods presented. Therefore, conversion of these preferred shares was included in diluted earnings per share. The amount of the dividend on the Series 4 convertible preferred stock per common share obtainable on conversion of the convertible preferred stock is higher than basic earnings per share for all periods presented. Therefore, conversion of the Series 4 preferred stock is not reflected in diluted earnings per share, because it would have been antidilutive. The shares convertible to common stock for Series 4 preferred stock would have been 13,960.

- (2) The Company's  
Employees  
Subordinated  
Convertible  
Preferred Stock

is convertible  
one for one to  
the Company's  
common stock.  
Because there  
are no dividends  
paid on this  
stock, these  
shares are  
assumed to be  
converted.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 6****Earnings Per Share, Continued**

(In thousands, except per share amounts)	For the Nine Months Ended October 28, 2006			For the Nine Months Ended October 29, 2005		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Earnings from continuing operations	\$ 32,585			\$ 31,430		
Less: Preferred stock dividends	(192)			(209)		
<b>Basic EPS</b>						
Income available to common shareholders	<b>32,393</b>	<b>22,771</b>	<b>\$ 1.42</b>	31,221	22,675	\$ 1.38
<b>Effect of Dilutive Securities</b>						
Options		<b>381</b>			469	
Convertible preferred stock <sup>(1)</sup>	<b>-0-</b>	<b>-0-</b>		-0-	-0-	
4 1/8% Convertible Subordinated Debentures	<b>1,811</b>	<b>3,899</b>		1,850	3,899	
Employees preferred stock <sup>(2)</sup>		<b>60</b>			63	
<b>Diluted EPS</b>						
Income available to common shareholders plus assumed conversions	<b>\$ 34,204</b>	<b>27,111</b>	<b>\$ 1.26</b>	\$ 33,071	27,106	\$ 1.22

(1) The amount of the dividend on the convertible preferred stock per common share obtainable on conversion of the convertible preferred stock is higher than

basic earnings per share for all periods presented. Therefore, conversion of the convertible preferred stock is not reflected in diluted earnings per share, because it would have been antidilutive. The shares convertible to common stock for Series 1, 3 and 4 preferred stock would have been 29,917, 37,263 and 13,960, respectively.

- (2) The Company's Subordinated Convertible Preferred Stock is convertible one for one to the Company's common stock. Because there are no dividends paid on this stock, these shares are assumed to be converted.

The weighted shares outstanding reflects the effect of stock buy back programs. In a series of authorizations from Fiscal 1999-2003, the Company's board of directors authorized the repurchase of up to 7.5 million shares. In June 2006, the board authorized an additional \$20.0 million in stock repurchases. In August 2006, the board authorized an additional \$30.0 million in stock repurchases. The Company repurchased 629,400 shares at a cost of \$18.5 million in the third quarter ended October 28, 2006. Of the \$18.5 million repurchased during the third quarter this year, \$0.2 million was not paid in the quarter but included in other accrued liabilities in the Condensed Consolidated Balance Sheet. For the nine months ended October 28, 2006, the Company has repurchased 1,062,400 shares at a cost of \$32.1 million. In total, the Company has repurchased 8.2 million shares at a cost of \$103.4 million from all authorizations as of October 28, 2006.





**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 7****Share-Based Compensation Plans**

The Company's stock-based compensation plans, as of October 28, 2006, are described below. Prior to January 29, 2006, the Company accounted for these plans under the recognition and measurement provisions of APB No. 25,

Accounting for Stock Issued to Employees, and related interpretations, as permitted by SFAS No. 123.

Effective January 29, 2006, the Company adopted SFAS No. 123(R), using the modified prospective transition method. Under the modified prospective transition method, compensation cost recognized for the three months and nine months ended October 28, 2006 includes (i) compensation cost for all share-based payments granted prior to, but not yet vested as of January 29, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123; and (ii) compensation cost for all share-based payments granted on or after January 29, 2006, based on the grant date fair value estimated in accordance with SFAS No. 123(R). In accordance with the modified prospective method, the Company has not restated prior period results.

***Stock Incentive Plans***

The Company has two fixed stock incentive plans. Under the 2005 Equity Incentive Plan (the 2005 Plan), effective as of June 23, 2005, the Company may grant options, restricted shares and other stock-based awards to its management personnel as well as directors for up to 1.0 million shares of common stock. Under the 1996 Stock Incentive Plan (the 1996 Plan), the Company could grant options to its officers and other key employees of and consultants to the Company as well as directors for up to 4.4 million shares of common stock. There will be no future awards under the 1996 Stock Incentive Plan. Under both plans, the exercise price of each option equals the market price of the Company's stock on the date of grant and an option's maximum term is 10 years. Options granted under both plans vest 25% at the end of each year.

For the three months and nine months ended October 28, 2006, the Company recognized share-based compensation cost of \$1.1 million and \$3.2 million, respectively, for its fixed stock incentive plans included in selling and administrative expenses in the accompanying Condensed Consolidated Statements of Earnings. The Company also recognized a total income tax benefit for share-based compensation arrangements of \$0.3 million and \$0.5 million for the three months and nine months ended October 28, 2006, respectively. The Company did not capitalize any share-based compensation cost.

As a result of adopting SFAS No. 123(R), earnings before income taxes from continuing operations, earnings from continuing operations and net earnings for the three months and nine months ended October 28, 2006 were \$1.1 million, \$0.7 million, \$0.7 million, \$3.2 million, \$2.7 million and \$2.7 million lower, respectively, than if the Company had continued to account for share-based compensation under APB No. 25. The effect of adopting SFAS No. 123(R) on basic and diluted earnings per common share for the three months and nine months ended October 28, 2006 was \$0.03, \$0.03, \$0.12 and \$0.10, respectively.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 7****Share-Based Compensation Plans, Continued**

The following table illustrates the effect on net earnings per common share as if the Company had applied the fair value recognition provisions of SFAS No. 123 for the three months and nine months ended October 29, 2005:

	Three Months Ended October 29, 2005	Nine Months Ended October 29, 2005
(In thousands, except per share amounts)		
Net earnings, as reported	\$ 16,143	\$ 31,400
<i>Add:</i> stock-based employee compensation expense included in reported net earnings, net of related tax effects	73	229
<i>Deduct:</i> total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(778)	(2,257)
Pro forma net earnings	\$ 15,438	\$ 29,372
Earnings per share:		
Basic as reported	\$ .71	\$ 1.38
Basic pro forma	\$ .67	\$ 1.29
Diluted as reported	\$ .61	\$ 1.22
Diluted pro forma	\$ .59	\$ 1.14

Prior to adopting SFAS No. 123(R), the Company presented the tax benefit of stock option exercises as operating cash flows. SFAS No. 123(R) requires that the cash flows resulting from tax benefits for tax deductions in excess of the compensation cost recognized for those options (excess tax benefit) be classified as financing cash flows.

Accordingly, the Company classified excess tax benefits of \$0.3 million and \$0.5 million as financing cash inflows rather than as operating cash inflows on its Condensed Consolidated Statement of Cash Flows for the three months and nine months ended October 28, 2006.

SFAS No. 123(R) also requires companies to calculate an initial pool of excess tax benefits available at the adoption date to absorb any unused deferred tax assets that may be recognized under SFAS No. 123(R). The Company has elected to calculate the pool of excess tax benefits under the alternative transition method described in FASB Staff Position ( FSP ) No. 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards, which also specifies the method the Company must use to calculate excess tax benefits reported on the Condensed Consolidated Statements of Cash Flows.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 7****Share-Based Compensation Plans, Continued**

The Company granted 109,681 shares of fixed stock options for the three months and nine months ended October 28, 2006 and 78,595 shares of fixed stock options for the three months and nine months ended October 29, 2005. For the third quarter ended October 28, 2006, the Company estimated the fair value of each option award on the date of grant using a Black-Scholes option pricing model. The Company based expected volatility on historical term structures. The Company based the risk free rate on an interest rate for a bond with a maturity commensurate with the expected term estimate. The Company estimated the expected term of stock options using historical exercise and employee termination experience. The Company does not currently pay a dividend. The following table shows the weighted average assumptions used to develop the fair value estimates for the third quarter ended October 28, 2006:

	October 28, 2006
Volatility	42.5%
Risk Free Rate	4.6%
Expected Term (years)	4.9
Dividend yields	0.0%

A summary of fixed stock option activity and changes since the Company's most recent fiscal year-end is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands) (1)
Outstanding at January 28, 2006	1,464,486	\$ 20.84		
Granted	109,681	38.14		
Exercised	(88,648)	18.34		
Forfeited	(50,909)	23.32		
Outstanding, October 28, 2006	1,434,610	\$ 22.23	6.98	\$ 22,884
Exercisable, October 28, 2006	820,740	\$ 19.52	6.24	\$ 15,312

(1) Based upon the difference between the closing market price of the Company's common stock on the last trading day of

the quarter and  
the grant price  
of in-the-money  
options.

The total intrinsic value, which represents the difference between the underlying stock's market price and the option's exercise price, of options exercised during the three months and nine months ended October 28, 2006 and October 29, 2005 was \$1.0 million, \$2.4 million, \$1.5 million and \$6.5 million, respectively.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 7****Share-Based Compensation Plans, Continued**

A summary of the status of the Company's nonvested shares of its fixed stock incentive plans as of October 28, 2006, are presented below:

	Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 28, 2006		806,848	\$ 13.11
Granted		109,681	16.44
Vested		(251,750)	13.07
Forfeited		(50,909)	13.58
Nonvested at October 28, 2006		613,870	13.69

As of October 28, 2006, there were \$7.0 million of total unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the stock incentive plans discussed above. That cost is expected to be recognized over a weighted average period of 2.35 years.

Cash received from option exercises under all share-based payment arrangements for the three months and nine months ended October 28, 2006 and October 29, 2005 was \$1.0 million, \$1.1 million, \$1.6 million and \$5.1 million, respectively. The actual tax benefit realized for the tax deductions from option exercise of the share-based payment arrangements totaled \$0.3 million, \$0.8 million, \$0.5 million and \$2.3 million for the three months and nine months ended October 28, 2006 and October 29, 2005, respectively.

***Restricted Stock Incentive Plans***

The 1996 Plan provided for an automatic grant of restricted stock to non-employee directors on the date of the annual meeting of shareholders at which an outside director is first elected. The outside director restricted stock so granted was to vest with respect to one-third of the shares each year as long as the director is still serving as a director. Once the shares have vested, the director is restricted from selling, transferring, pledging or assigning the shares for an additional two years. The 2005 Plan includes no automatic grant provisions, but permits the board of directors to make awards to non-employee directors. The board granted restricted stock pursuant to the terms of the 2005 Plan to two new non-employee directors in Fiscal 2006 on substantially the same terms as the automatic awards under the 1996 Plan, except that transfer restrictions are to lapse after three years.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 7****Share-Based Compensation Plans, Continued**

In addition, under the 1996 Plan an outside director could elect irrevocably to receive all or a specified portion of his annual retainers for board membership and any committee chairmanship for the following fiscal year in a number of shares of restricted stock (the Retainer Stock ). Shares of the Retainer Stock were granted as of the first business day of the fiscal year as to which the election is effective, subject to forfeiture to the extent not earned upon the outside director's ceasing to serve as a director or committee chairman during such fiscal year. Once the shares were earned, the director was restricted from selling, transferring, pledging or assigning the shares for an additional four years. Under the 2005 Plan, Retainer Stock awards were made during Fiscal 2006 on substantially the same terms as the grants under the 1996 Plan, except that transfer restrictions are to lapse three years from the date of grant. For the nine months ended October 28, 2006 and October 29, 2005, the Company issued 3,022 shares and 2,465 shares, respectively, of Retainer Stock. There were no shares issued for the three months ended October 28, 2006 or October 29, 2005.

Also pursuant to the 1996 Plan, annually on the date of the annual meeting of shareholders, beginning in Fiscal 2004, each outside director received restricted stock valued at \$44,000 based on the average of stock prices for the first five days in the month of the annual meeting of shareholders. For Fiscal 2007, each outside director received restricted stock pursuant to the terms of the 2005 Plan valued at \$60,000 based on the average of stock prices for the first five days in the month of the annual meeting of shareholders. The outside director restricted stock vests with respect to one-third of the shares each year as long as the director is still serving as a director. Once the shares vest, the director is restricted from selling, transferring, pledging or assigning the shares for an additional two years. For the nine months ended October 28, 2006 and October 29, 2005, the Company issued 16,400 shares and 8,855 shares, respectively, of director restricted stock. There were no shares issued for the three months ended October 28, 2006 or October 29, 2005.

For the three months and nine months ended October 28, 2006 and October 29, 2005, the Company recognized \$0.2 million, \$0.1 million, \$0.4 million and \$0.3 million, respectively, of director restricted stock related share-based compensation in selling and administrative expenses in the accompanying Condensed Consolidated Statements of Earnings.

On April 24, 2002, the Company issued 36,764 shares of restricted stock to the President and CEO of the Company under the 1996 Plan. Pursuant to the terms of the grant, these shares vested on April 23, 2005, provided that on such date the grantee remained continuously employed by the Company since the date of the agreement. Compensation cost recognized in selling and administrative expenses in the accompanying Condensed Consolidated Statements of Earnings for these shares was \$0.1 million for the nine months ended October 29, 2005. The 36,764 shares were issued in April 2005.

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 7****Share-Based Compensation Plans, Continued**

Under the 2005 Plan, the Company issued 165,334 shares of restricted stock in the three months ended October 28, 2006. These shares vest 25% per year over four years, provided that on such date the grantee has remained continuously employed by the Company since the date of grant. The Company issued 228,594 shares of restricted stock in the three months ended October 29, 2005. There were 4,011 shares forfeited in the nine months ended October 28, 2006 related to the restricted stock issued in Fiscal 2006. Of the 224,583 restricted shares issued in Fiscal 2006, 106,445 shares vest at the end of three years and 118,138 shares vest 25% per year over four years, provided that on such date the grantee has remained continuously employed by the Company since the date of grant. During the three months ended October 28, 2006, 28,656 shares of restricted stock issued in Fiscal 2006 vested which includes 7,704 shares withheld to satisfy the minimum withholding requirement for federal taxes. The fair value of restricted stock is charged against income as compensation cost over the vesting period. Compensation cost recognized in selling and administrative expenses in the accompanying Condensed Consolidated Statements of Earnings for these shares was \$0.6 million, \$0.0, \$1.8 million and \$0.0 million for the three months and nine months ended October 28, 2006 and October 29, 2005, respectively.

***Employee Stock Purchase Plan***

Under the Employee Stock Purchase Plan, the Company is authorized to issue up to 1.0 million shares of common stock to qualifying full-time employees whose total annual base salary is less than \$90,000, effective October 1, 2002. Prior to October 1, 2002, the total annual base salary was limited to \$100,000. Under the terms of the Plan, employees could choose each year to have up to 15% of their annual base earnings or \$8,500, whichever is lower, withheld to purchase the Company's common stock. The purchase price of the stock was 85% of the closing market price of the stock on either the exercise date or the grant date, whichever was less. The Company's board of directors amended the Company's Employee Stock Purchase Plan effective October 1, 2005 to provide that participants may acquire shares under the Plan at a 5% discount from fair market value on the last day of the Plan year. Under SFAS No. 123(R), shares issued under the Plan as amended are non-compensatory. Under the Plan, the Company sold 9,787 shares and 24,978 shares to employees for the three months ended October 28, 2006 and October 29, 2005, respectively.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 8**

**Legal Proceedings**

**Environmental Matters**

*New York State Environmental Matters*

In August 1997, the New York State Department of Environmental Conservation (the Department) and the Company entered into a consent order whereby the Company assumed responsibility for conducting a remedial investigation and feasibility study ( RIFS ) and implementing an interim remediation measure ( IRM ) with regard to the site of a knitting mill operated by a former subsidiary of the Company from 1965 to 1969. The Company undertook the IRM and RIFS voluntarily, without admitting liability or accepting responsibility for any future remediation of the site. The Company estimates that the cost of conducting the RIFS and implementing the IRM will be in the range of \$6.6 million to \$6.8 million, net of insurance recoveries, \$3.7 million of which the Company has already paid. In the course of preparing the RIFS, the Company has identified remedial alternatives with estimated undiscounted costs ranging from \$-0- to \$24.0 million, excluding amounts previously expended or provided for by the Company, as described in this footnote.

The Company has not ascertained what responsibility, if any, it has for any contamination in connection with the facility or what other parties may be liable in that connection and is unable to predict the extent of its liability, if any, beyond that voluntarily assumed by the consent order. The Company's voluntary assumption of certain responsibility to date was based upon its judgment that such action was preferable to litigation to determine its liability, if any, for contamination related to the site. The Company intends to continue to evaluate the costs of further voluntary remediation versus the costs and uncertainty of litigation.

As part of its analysis of whether to undertake further voluntary action, the Company has assessed various methods of preventing potential future impact of contamination from the site on two public wells that are in the expected future path of the groundwater plume from the site. The Village of Garden City has proposed the installation at the supply wells of enhanced treatment measures at an estimated cost of approximately \$2.6 million, with estimated future costs of up to \$2.0 million. In the third quarter of Fiscal 2005, the Company provided for the estimated cost of a remedial alternative it considers adequate to prevent such impact and which it would be willing to implement voluntarily. The Village of Garden City has also asserted that the Company is liable for historical costs of treatment at the wells totaling approximately \$3.4 million. Because of evidence with regard to when contaminants from the site of the Company's former operations first reached the wells, the Company believes it should have no liability with respect to such historical costs.



**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 8****Legal Proceedings, Continued**

In December 2005, the U.S. Environmental Protection Agency ( EPA ) notified the Company that it considers the Company a potentially responsible party ( PRP ) with respect to contamination at two Superfund sites in New York State. The sites were used as landfills for process wastes generated by a glue manufacturer, which acquired tannery wastes from several tanners, allegedly including the Company s Whitehall tannery, for use as raw materials in the gluemaking process. The Company has no records indicating that it ever provided raw materials to the gluemaking operation and has not been able to establish whether EPA s substantive allegations are accurate. The Company has joined a joint defense group with other tannery PRP s with respect to one of the two sites. The joint defense group has developed an estimated cost of remediation for the site and proposed an allocation of liabilities among the PRP s that, if accepted, is estimated to result in liability to the Company of approximately \$100,000 with respect to the site. There is no assurance that the proposed allocation will be accepted or that the actual cost of remediation will not exceed the estimate. Additionally, the Company presently cannot estimate its liability, if any, with respect to the second site associated with the glue manufacturer s waste disposal.

*Whitehall Environmental Matters*

The Company has performed sampling and analysis of soil, sediments, surface water, groundwater and waste management areas at the Company s former Volunteer Leather Company facility in Whitehall, Michigan. The Company has submitted to the Michigan Department of Environmental Quality ( MDEQ ) and provided for certain costs associated with a remedial action plan (the Plan ) designed to bring the property into compliance with regulatory standards for non-industrial uses. The Company estimates that the costs of resolving environmental contingencies related to the Whitehall property range from \$1.3 million to \$5.6 million, and considers the cost of implementing the Plan to be the most likely cost within that range. While management believes that the Plan should be sufficient to satisfy applicable regulatory standards with respect to the site, until the Plan is finally approved by MDEQ, management cannot provide assurances that no further remediation will be required or that its estimate of the range of possible costs or of the most likely cost of remediation will prove accurate.

*Accrual for Environmental Contingences*

Related to all outstanding environmental contingencies, the Company had accrued \$5.7 million as of October 28, 2006, \$5.4 million as of January 28, 2006 and \$5.2 million as of October 29, 2005. All such provisions reflect the Company s estimates of the most likely cost (undiscounted, including both current and noncurrent portions) of resolving the contingencies, based on facts and circumstances as of the time they were made. There is no assurance that relevant facts and circumstances will not change, necessitating future changes to the provisions. Such contingent liabilities are included in the liability arising from provision for discontinued operations on the accompanying Condensed Consolidated Balance Sheets.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 8**

**Legal Proceedings, Continued**

**Other Matters**

*Patent Action*

In January 2003, the Company was named a defendant in an action filed in the United States District Court for the Eastern District of Pennsylvania, *Schoenhaus, et al. vs. Genesco Inc., et al.*, alleging that certain features of shoes in the Company's Johnston & Murphy line infringe the plaintiff's patent, misappropriate trade secrets and involve conversion of the plaintiff's proprietary information and unjust enrichment of the Company. On January 10, 2005, the court granted summary judgment to the Company on the patent claims, finding that the accused products do not infringe the plaintiff's patent. The plaintiffs appealed the summary judgment to the U.S. Court of Appeals for the Federal Circuit, pending which the trial court stayed the remainder of the case. On March 15, 2006, the Court of Appeals affirmed the summary judgment in the Company's favor. The trade secrets and other non-patent claims in the action remain unresolved.

*California Employment Matters*

On October 22, 2004, the Company was named a defendant in a putative class action filed in the Superior Court of the State of California, Los Angeles, *Schreiner vs. Genesco Inc., et al.*, alleging violations of California wages and hours laws, and seeking damages of \$40 million plus punitive damages. On May 4, 2005, the Company and the plaintiffs reached an agreement in principle to settle the action, subject to court approval and other conditions. In connection with the proposed settlement, to provide for the settlement payment to the plaintiff class and related expenses, the Company recognized a charge of \$2.6 million before taxes included in Restructuring and Other, net in the Condensed Consolidated Statements of Earnings for the first three months of Fiscal 2006. On May 25, 2005, a second putative class action, *Drake vs. Genesco Inc., et al.*, making allegations similar to those in the Schreiner complaint on behalf of employees of the Company's Johnston & Murphy division, was filed by a different plaintiff in the California Superior Court, Los Angeles. On November 22, 2005, the *Schreiner* court granted final approval of the settlement and the Company and the *Drake* plaintiff reached an agreement on November 17, 2005 to settle that action. The two matters were resolved more favorably to the Company than originally expected, as not all members of the plaintiff class in *Schreiner* submitted claims and because the court required that plaintiff's counsel bear the administrative expenses of the settlement. Consequently, the Company recognized income of \$0.9 million before tax, reflected in Restructuring and Other, net, in the Condensed Consolidated Statements of Earnings for the third quarter of Fiscal 2006.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 8**

**Legal Proceedings, Continued**

On November 4, 2005, a former employee gave notice to the California Labor Work Force Development Agency ( LWDA ) of a claim against Genesco for allegedly failing to provide a payroll check that is negotiable and payable in cash, on demand, without discount, at an established place of business in California, as required by the California Labor Code. LWDA is investigating the claim. On May 18, 2006, the same claimant filed a putative class, representative and private attorney general action alleging the same violations of the Labor Code in the Superior Court of California, Alameda County, seeking statutory penalties, damages, restitution, and injunctive relief. The Company disputes the material allegations of the complaint and intends to defend the matter vigorously.

34

---

**Table of Contents****Genesco Inc.  
and Subsidiaries**

## Notes to Condensed Consolidated Financial Statements

**Note 9****Business Segment Information**

The Company operates five reportable business segments (not including corporate): Journeys Group, comprised of the Journeys, Journeys Kidz and Shi by Journeys retail footwear chains, catalog and e-commerce operations; Underground Station Group, comprised of the Underground Station and Jarman retail footwear chains; Hat World Group, comprised of the Hat World, Lids, Hat Zone, Cap Connection, Lids Kids and Head Quarters retail headwear chains and e-commerce operations; Johnston & Murphy Group, comprised of Johnston & Murphy retail operations, catalog and e-commerce operations and wholesale distribution; and Licensed Brands, comprised primarily of Dockers® Footwear.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

The Company's reportable segments are based on the way management organizes the segments in order to make operating decisions and assess performance along types of products sold. Journeys Group, Underground Station Group and Hat World Group sell primarily branded products from other companies while Johnston & Murphy Group and Licensed Brands sell primarily the Company's owned and licensed brands.

Corporate assets include cash, deferred income taxes, deferred note expense and corporate fixed assets. The Company charges allocated retail costs of distribution to each segment and unallocated retail costs of distribution to the corporate segment. The Company does not allocate certain costs to each segment in order to make decisions and assess performance. These costs include corporate overhead, stock compensation, interest expense, interest income, restructuring charges and other, including severance and litigation.

<b>Three Months Ended</b>	<b>Underground</b>		<b>Hat</b>	<b>Johnston &amp; Murphy</b>	<b>Licensed</b>	<b>Corporate</b>	<b>Consolidated</b>
<b>October 28, 2006</b>	<b>Journeys</b>	<b>Station</b>	<b>World</b>	<b>Group</b>	<b>Brands</b>	<b>&amp; Other</b>	
<b>In thousands</b>	<b>Group</b>	<b>Group</b>	<b>Group</b>	<b>Group</b>	<b>Group</b>	<b>Group</b>	<b>Group</b>
Sales	\$ 184,391	\$ 34,981	\$ 77,503	\$ 44,467	\$ 22,905	\$ 112	\$ 364,359
Intercompany sales	-0-	-0-	-0-	-0-	(61)	-0-	(61)
<b>Net sales to external customers</b>	<b>\$ 184,391</b>	<b>\$ 34,981</b>	<b>\$ 77,503</b>	<b>\$ 44,467</b>	<b>\$ 22,844</b>	<b>\$ 112</b>	<b>\$ 364,298</b>
Segment operating income (loss)	\$ 25,260	\$ (631)	\$ 7,710	\$ 3,193	\$ 2,326	\$ (7,396)	\$ 30,462
Restructuring and other	-0-	-0-	-0-	-0-	-0-	(1,083)	(1,083)
<b>Earnings (loss) from operations</b>	<b>25,260</b>	<b>(631)</b>	<b>7,710</b>	<b>3,193</b>	<b>2,326</b>	<b>(8,479)</b>	<b>29,379</b>
Interest expense	-0-	-0-	-0-	-0-	-0-	(2,964)	(2,964)
Interest income	-0-	-0-	-0-	-0-	-0-	16	16
<b>Earnings (loss) before income taxes from continuing operations</b>	<b>\$ 25,260</b>	<b>\$ (631)</b>	<b>\$ 7,710</b>	<b>\$ 3,193</b>	<b>\$ 2,326</b>	<b>\$ (11,427)</b>	<b>\$ 26,431</b>

Edgar Filing: GENESCO INC - Form 10-Q

Total assets	\$ 243,565	\$ 68,806	\$ 287,191	\$ 68,997	\$ 27,118	\$ 96,878	\$ 792,555
Depreciation	4,133	1,160	2,640	730	16	1,433	10,112
Capital expenditures	9,549	1,057	6,953	2,556	12	1,019	21,146

---

35

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 9****Business Segment Information, Continued**

<b>Three Months Ended</b>	<b>Underground</b>			<b>Johnston &amp;</b>			
<b>October 29, 2005</b>	<b>Journeys</b>	<b>Station</b>	<b>Hat</b>	<b>Murphy</b>	<b>Licensed</b>	<b>Corporate</b>	
<b>In thousands</b>	<b>Group</b>	<b>Group</b>	<b>World</b>	<b>Group</b>	<b>Brands</b>	<b>&amp; Other</b>	<b>Consolidated</b>
Sales	\$ 153,109	\$ 38,395	\$ 68,330	\$ 38,981	\$ 17,548	\$ 64	\$ 316,427
Intercompany sales	-0-	-0-	-0-	-0-	(91)	-0-	(91)
<b>Net sales to external customers</b>	<b>\$ 153,109</b>	<b>\$ 38,395</b>	<b>\$ 68,330</b>	<b>\$ 38,981</b>	<b>\$ 17,457</b>	<b>\$ 64</b>	<b>\$ 316,336</b>
Segment operating income (loss)	\$ 21,551	\$ 1,965	\$ 7,615	\$ 1,404	\$ 1,781	\$ (6,030)	\$ 28,286
Restructuring and other	-0-	-0-	-0-	-0-	-0-	789	789
<b>Earnings (loss) from operations</b>	<b>21,551</b>	<b>1,965</b>	<b>7,615</b>	<b>1,404</b>	<b>1,781</b>	<b>(5,241)</b>	<b>29,075</b>
Interest expense	-0-	-0-	-0-	-0-	-0-	(2,871)	(2,871)
Interest income	-0-	-0-	-0-	-0-	-0-	202	202
<b>Earnings (loss) before income taxes from continuing operations</b>	<b>\$ 21,551</b>	<b>\$ 1,965</b>	<b>\$ 7,615</b>	<b>\$ 1,404</b>	<b>\$ 1,781</b>	<b>\$ (7,910)</b>	<b>\$ 26,406</b>
Total assets	\$ 202,105	\$ 65,897	\$ 258,002	\$ 63,123	\$ 20,934	\$ 105,644	\$ 715,705
Depreciation	3,289	1,078	2,348	713	12	1,303	8,743
Capital expenditures	7,756	2,998	6,215	602	17	452	18,040
<b>Nine Months Ended</b>	<b>Underground</b>			<b>Johnston &amp;</b>			
<b>October 28, 2006</b>	<b>Journeys</b>	<b>Station</b>	<b>Hat</b>	<b>Murphy</b>	<b>Licensed</b>	<b>Corporate</b>	
<b>In thousands</b>	<b>Group</b>	<b>Group</b>	<b>World</b>	<b>Group</b>	<b>Brands</b>	<b>&amp; Other</b>	<b>Consolidated</b>
Sales	\$ 462,560	\$ 105,854	\$ 226,697	\$ 130,414	\$ 58,381	\$ 333	\$ 984,239
Intercompany sales	-0-	-0-	-0-	-0-	(622)	-0-	(622)
<b>Net sales to external customers</b>	<b>\$ 462,560</b>	<b>\$ 105,854</b>	<b>\$ 226,697</b>	<b>\$ 130,414</b>	<b>\$ 57,759</b>	<b>\$ 333</b>	<b>\$ 983,617</b>

Edgar Filing: GENESCO INC - Form 10-Q

Segment operating income (loss)	\$ 46,346	\$ 27	\$ 22,334	\$ 8,500	\$ 5,390	\$ (19,861)	\$ 62,736
Restructuring and other	-0-	-0-	-0-	-0-	-0-	(1,672)	(1,672)
<b>Earnings (loss) from operations</b>	<b>46,346</b>	<b>27</b>	<b>22,334</b>	<b>8,500</b>	<b>5,390</b>	<b>(21,533)</b>	<b>61,064</b>
Interest expense	-0-	-0-	-0-	-0-	-0-	(7,505)	(7,505)
Interest income	-0-	-0-	-0-	-0-	-0-	483	483
<b>Earnings (loss) before income taxes from continuing operations</b>	<b>\$ 46,346</b>	<b>\$ 27</b>	<b>\$ 22,334</b>	<b>\$ 8,500</b>	<b>\$ 5,390</b>	<b>\$ (28,555)</b>	<b>\$ 54,042</b>
Total assets	\$ 243,565	\$ 68,806	\$ 287,191	\$ 68,997	\$ 27,118	\$ 96,878	\$ 792,555
Depreciation	11,780	3,395	7,758	2,138	45	4,173	29,289
Capital expenditures	25,502	3,847	19,009	5,021	39	4,141	57,559

36

**Table of Contents****Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 9****Business Segment Information, Continued**

Nine Months Ended October 29, 2005 In thousands	Underground			Johnston & Murphy Group		Licensed Brands	Corporate & Other Consolidated	
	Journeys Group	Station Group	Hat World Group					
Sales	\$ 400,881	\$ 110,417	\$ 199,532	\$ 121,497	\$ 45,417	\$	197	\$ 877,941
Intercompany sales	-0-	-0-	-0-	-0-	(352)	-0-		(352)
<b>Net sales to external customers</b>	\$ 400,881	\$ 110,417	\$ 199,532	\$ 121,497	\$ 45,065	\$	197	\$ 877,589
Segment operating income (loss)	\$ 42,270	\$ 3,900	\$ 22,355	\$ 6,352	\$ 3,545	\$	(16,829)	\$ 61,593
Restructuring and other	-0-	-0-	-0-	-0-	-0-		(2,255)	(2,255)
<b>Earnings (loss) from operations</b>	42,270	3,900	22,355	6,352	3,545		(19,084)	59,338
Interest expense	-0-	-0-	-0-	-0-	-0-		(8,748)	(8,748)
Interest income	-0-	-0-	-0-	-0-	-0-		807	807
<b>Earnings (loss) before income taxes from continuing operations</b>	\$ 42,270	\$ 3,900	\$ 22,355	\$ 6,352	\$ 3,545	\$	(27,025)	\$ 51,397
Total assets	\$ 202,105	\$ 65,897	\$ 258,002	\$ 63,123	\$ 20,934	\$	105,644	\$ 715,705
Depreciation	9,753	3,009	6,721	2,131	34		3,982	25,630
Capital expenditures	16,163	5,515	16,331	1,807	89		1,279	41,184

**Note 10****Subsequent Event**

On December 1, 2006, the Company entered into an Amended and Restated Credit Agreement (the Credit Facility) by and among the Company, certain subsidiaries of the Company party thereto, as other borrowers, the lenders party thereto and Bank of America, N.A., as administrative agent. The Credit Facility effectively replaces the Company's current \$105.0 million revolving credit facility.

The material terms of the Credit Facility are as follows:

*Availability*

The Credit Facility is a revolving credit facility in the aggregate principal amount of \$200.0 million, with a \$20 million swingline loan sublimit and a \$70.0 million sublimit for the issuance of standby letters of credit, and has a five-year term. Any swingline loans and letters of credit will reduce the availability under the Credit Facility on a dollar-for-dollar basis. In addition, the Company has an option to increase the availability under the Credit Facility by up to \$100.0 million (in increments no less than \$25.0 million) subject to, among other things, the receipt of



commitments for the increased amount. The aggregate amount of the loans made and letters of credit issued under the Restated Credit Agreement shall at no time exceed the lesser of the facility amount (\$200 million or, if increased at the Company's option, up to \$300 million) or the Borrowing Base, which generally is based on 85% of eligible inventory plus 85% of eligible accounts receivable less applicable reserves.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 10**

**Subsequent Event, Continued**

*Collateral*

The loans and other obligations under the Credit Facility are secured by substantially all of the presently owned and hereafter acquired non-real estate assets of the Company and certain subsidiaries of the Company.

*Interest and Fees*

The Company's borrowings under the Credit Facility bear interest at varying rates that, at the Company's option, can be based on either:

a base rate generally defined as the sum of the prime rate of Bank of America, N.A. and an applicable margin.

a LIBO rate generally defined as the sum of LIBOR (as quoted on the British Banking Association Telerate Page 3750) and an applicable margin.

The initial applicable margin for base rate loans is 0.00%, and the initial applicable margin for LIBOR loans is 1.00%. Thereafter, the applicable margin will be subject to adjustment based on Excess Availability for the prior quarter. The term Excess Availability means, as of any given date, the excess (if any) of the borrowing base over the outstanding credit extensions under the Credit Facility.

Interest on the Company's borrowings is payable monthly in arrears for base rate loans and at the end of each interest rate period (but not less often than quarterly) for LIBOR loans.

The Company is also required to pay a commitment fee on the difference between committed amounts and the aggregate amount (including the aggregate amount of letters of credit) of the credit extensions outstanding under the Credit Facility, which initially is 0.25% per annum, subject to adjustment in the same manner as the applicable margins for interest rates.

*Certain Covenants*

The Company is not required to comply with any financial covenants unless Adjusted Excess Availability is less than 10% of the total commitments under the Credit Facility (currently \$20.0 million). The term Adjusted Excess Availability means, as of any given date, the excess (if any) of (a) the lesser of the total commitments under the Credit Facility and the Borrowing Base over (b) the outstanding credit extensions under the Credit Facility. If and during such time as Adjusted Excess Availability is less than such amount, the Credit Facility requires the Company to meet a minimum fixed charge coverage ratio (EBITDA less capital expenditures less cash taxes divided by cash interest expense and schedule payments of principal indebtedness) of 1.00 to 1.00.

**Table of Contents**

**Genesco Inc.  
and Subsidiaries**

Notes to Condensed Consolidated Financial Statements

**Note 10**

**Subsequent Event, Continued**

In addition, the Credit Facility contains certain covenants that, among other things, restrict additional indebtedness, liens and encumbrances, loans and investments, acquisitions, dividends and other restricted payments, transactions with affiliates, asset dispositions, mergers and consolidations, prepayments or material amendments of other indebtedness and other matters customarily restricted in such agreements.

*Cash Dominion*

The Credit Facility also contains cash dominion provisions that apply in the event that the Company's Adjusted Excess Availability fails to meet certain thresholds or there is an event of default under the Credit Facility.

*Events of Default*

The Credit Facility contains customary events of default, including, without limitation, payment defaults, breaches of representations and warranties, covenant defaults, cross-defaults to certain other material indebtedness in excess of specified amounts, certain events of bankruptcy and insolvency, certain ERISA events, judgments in excess of specified amounts and change in control.

Certain of the lenders under the Credit Facility or their affiliates have provided, and may in the future provide, certain commercial banking, financial advisory, and investment banking services in the ordinary course of business for the Company, its subsidiaries and certain of its affiliates, for which they receive customary fees and commissions.

**Table of Contents**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Forward Looking Statements**

This discussion and the notes to the Condensed Consolidated Financial Statements include certain forward-looking statements, which include statements regarding our intent, belief or expectations and all statements other than those made solely with respect to historical fact. Actual results could differ materially from those reflected by the forward-looking statements in this discussion and a number of factors may adversely affect the forward looking statements and the Company's future results, liquidity, capital resources or prospects. These factors (some of which are beyond the Company's control) include:

Weakness in consumer demand for products sold by the Company.

Fashion trends that affect the sales or product margins of the Company's retail product offerings.

Changes in the timing of holidays or in the onset of seasonal weather affecting period to period sales comparisons.

Changes in buying patterns by significant wholesale customers.

Disruptions in product supply or distribution.

Unfavorable trends in foreign exchange rates and other factors affecting the cost of products.

Changes in business strategies by the Company's competitors (including pricing and promotional discounts), the entry of additional competitors into the Company's markets, and other competitive factors.

Effects of any demand-related factors in the Holiday selling season.

The Company's ability to open, staff and support additional retail stores on schedule and at acceptable sales and expense levels and to renew leases in existing stores on schedule and at acceptable expense levels.

The Company's ability to identify appropriate growth opportunities, including brand extensions, new concept launches, and acquisitions, and to execute its growth strategies.

Variations from expected pension-related charges caused by conditions in the financial markets.

The outcome of litigation and environmental matters involving the Company, including those discussed in Note 8 to the Condensed Consolidated Financial Statements.

Fluctuations in oil prices causing changes in gasoline and energy prices resulting in changes in consumer spending and utility and product costs.

In addition to the risks referenced above, additional risks are highlighted in the Company's Annual Report on Form 10-K for the year ended January 28, 2006 and this Quarterly Report under the heading "Item 1A. Risk Factors." Forward-looking statements reflect the expectations of the Company at the time they are made, and investors should rely on them only as expressions of opinion about what may happen in the future and only at the time they are made. The Company undertakes no obligation to update any forward-looking statement. Although the Company believes it has an appropriate business strategy and the resources necessary for its operations, predictions about future revenue and margin trends are inherently uncertain and the Company may alter its business strategies to address changing conditions.

**Table of Contents**

**Overview**

*Description of Business*

The Company is a leading retailer of branded footwear and of licensed and branded headwear, operating 1,901 retail footwear and headwear stores throughout the United States and Puerto Rico and 24 headwear stores in Canada as of October 28, 2006. The Company also designs, sources, markets and distributes footwear under its own Johnston & Murphy brand and under the licensed Dockers brand to more than 1,000 retail accounts in the United States, including a number of leading department, discount, and specialty stores.

The Company operates five reportable business segments (not including corporate): Journeys Group, comprised of the Journeys, Journeys Kidz and Shi by Journeys retail footwear chains, catalog and e-commerce operations; Underground Station Group, comprised of the Underground Station and Jarman retail footwear chains; Hat World Group, comprised of the Hat World, Lids, Hat Zone, Cap Connection, Lids Kids and Head Quarters retail headwear chains and e-commerce operations; Johnston & Murphy Group, comprised of Johnston & Murphy retail operations, catalog and e-commerce operations and wholesale distribution; and Licensed Brands, comprised primarily of Dockers® Footwear.

The Journeys retail footwear stores sell footwear and accessories primarily for 13 to 22 year old men and women. The stores average approximately 1,775 square feet. The Journeys Kidz retail footwear stores sell footwear primarily for younger children, ages five to 12. These stores average approximately 1,400 square feet. Shi by Journeys retail footwear stores, the first of which opened in November 2005, sell footwear and accessories to fashionable women in their early 20 s to mid 30 s. These stores average approximately 2,000 square feet.

The Underground Station Group retail footwear stores sell footwear and accessories primarily for men and women in the 20 to 35 age group. The Underground Station Group stores average approximately 1,700 square feet. In the fourth quarter of Fiscal 2004, the Company made the strategic decision to close 34 Jarman stores subject to its ability to negotiate lease terminations. These stores are not suitable for conversion to Underground Station stores. The Company intends to convert the remaining Jarman stores to Underground Station stores and close the remaining Jarman stores not closed in Fiscal 2005 as quickly as it is financially feasible, subject to landlord approval. During the first nine months of Fiscal 2007, ten Jarman stores were closed and three Jarman stores were converted to Underground Station stores. During Fiscal 2006, 13 Jarman stores were closed and two Jarman stores were converted to Underground Station stores.

The Hat World, Lids, Hat Zone, Cap Connection, Lids Kids and Head Quarters retail stores sell licensed and branded headwear to men and women primarily in the mid-teen to mid-20 s age group. These stores average approximately 750 square feet and are located in malls, airports, street level stores and factory outlet stores throughout the United States and in Canada.

Johnston & Murphy retail shops sell a broad range of men s footwear and accessories. These shops average approximately 1,350 square feet and are located primarily in better malls nationwide. Johnston & Murphy shoes are also distributed through the Company s wholesale operations to better department and independent specialty stores. In addition, the Company sells Johnston & Murphy footwear and accessories in factory stores located in factory outlet malls. These stores average approximately 2,400 square feet.

**Table of Contents**

The Company entered into an exclusive license with Levi Strauss and Company to market men's footwear in the United States under the Dockers® brand name in 1991. The Dockers license agreement was renewed November 1, 2006. The Dockers license agreement, as amended, expires on December 31, 2009 with a Company option to renew through December 31, 2012, subject to certain conditions. The Company uses the Dockers name to market casual and dress casual footwear to men aged 30 to 55 through many of the same national retail chains that carry Dockers slacks and sportswear and in department and specialty stores across the country.

*Strategy*

The Company's strategy is to seek long-term, organic growth by: 1) increasing the Company's store base, 2) increasing retail square footage, 3) improving comparable store sales, 4) increasing operating margin and 5) enhancing the value of its brands. Our future results are subject to various risks, uncertainties and other challenges, including those discussed under the caption *Forward Looking Statements*, above and those discussed in Item 1A., *Risk Factors* in the Company's Annual Report on Form 10-K for the year ended January 28, 2006. Among the most important of these factors are those related to consumer demand. Conditions in the external economy can affect demand, resulting in changes in sales and, as prices are adjusted to drive sales and control inventories, in gross margins. Because fashion trends influencing many of the Company's target customers (particularly customers of Journeys Group, Underground Station Group and Hat World Group) can change rapidly, the Company believes that its ability to detect and respond quickly to those changes has been important to its success. Even when the Company succeeds in aligning its merchandise offerings with consumer preferences, those preferences may affect results by, for example, driving sales of products with lower average selling prices. Moreover, economic factors, such as high fuel prices may reduce the consumer's disposable income and reduce demand for the Company's merchandise, regardless of the Company's skill in detecting and responding to fashion trends. The Company believes its experience and discipline in merchandising and the buying power associated with its relative size in the industry are important to its ability to mitigate risks associated with changing customer preferences and other reductions in consumer demand. Also important to the Company's long-term prospects are the availability and cost of appropriate locations for the Company's retail concepts. The Company is opening stores in airports and on streets in major cities, tourist venues and college campuses, among other locations in an effort to broaden its selection of locations for additional stores beyond the malls that have traditionally been the dominant venue for its retail concepts. The Company will also consider acquisitions to supplement its organic growth.

*Summary of Operating Results*

The Company's net sales increased 15.2% during the third quarter of Fiscal 2007 compared to the third quarter of Fiscal 2006. The increase was driven primarily by the addition of new stores, a 4% increase in comparable store sales and a 31% increase in Licensed Brands sales. Gross margin decreased slightly as a percentage of net sales during the third quarter of Fiscal 2007, primarily due to decreases related to promotional activity in the Hat World Group and increased markdowns in the Journeys Group and Underground Station Group businesses. Gross margin as a percentage of net sales also declined in the Licensed Brands business primarily due to changes in product mix. Selling and administrative expenses decreased as a percentage of net sales during the third quarter of Fiscal 2007 due to decreased expenses as a percentage of net sales in Journeys Group, Johnston & Murphy Group and Licensed Brands businesses. Operating income decreased as a percentage of net sales during the third quarter of Fiscal 2007 primarily due to decreased operating income in the Underground Station Group and decreased operating income as a percentage of net sales in the Journeys and Hat World Group businesses, partially offset by an increase in operating income in the

**Table of Contents**

Johnston & Murphy Group business. Operating margin for Licensed Brands was flat for the third quarter ended October 28, 2006.

**Significant Developments**

*Amended Revolving Credit Facility*

On December 1, 2006, the Company entered into an Amended and Restated Credit Agreement, (the Credit Facility ) by and among the Company, certain subsidiaries of the Company party thereto, as other borrowers, the lenders party thereto and Bank of America, N.A., as administrative agent. The Credit Facility effectively replaces the Company s current \$105.0 million revolving credit facility. The Credit Facility is a revolving credit facility in the aggregate principal amount of \$200.0 million, with a \$20 million swingline loan sublimit and a \$70.0 million sublimit for the issuance of standby letters of credit, and has a five-year term. The loans and other obligations under the Credit Facility are secured by substantially all of the presently owned and hereafter acquired non-real estate assets of the Company and certain subsidiaries of the Company. Borrowings under the credit facility bear interest at a variable rate determined based upon the level of availability under the credit facility. If availability falls below specified levels, the Company would then be subject to certain financial covenants. In addition, if availability falls below \$20 million and the fixed charge coverage ratio is less than 1.0 to 1, the Company would be in default. For additional information, see Note 10 to the Condensed Consolidated Financial Statements.

*Restructuring and Other Charges*

The Company recorded a pretax charge to earnings of \$1.1 million (\$0.7 million net of tax) in the third quarter of Fiscal 2007. The charge was primarily for retail store asset impairments and the lease termination of one Jarman store. The lease termination was the continuation of a plan previously announced by the Company in Fiscal 2004.

The Company recorded a pretax charge to earnings of \$0.5 million (\$0.3 million net of tax) in the second quarter of Fiscal 2007. The charge was primarily for retail store asset impairments.

The Company recorded a pretax charge to earnings of \$0.1 million in the first quarter of Fiscal 2007. The charge was primarily for retail store asset impairments.

The Company recorded a pretax credit to earnings of \$0.8 million (\$0.5 million net of tax) in the third quarter of Fiscal 2006. The credit was primarily for the recognition of a gain of \$0.9 million associated with the conclusion of the settlement of a California employment class action more favorably than originally anticipated, when the charge associated with the settlement was originally taken in the first quarter of Fiscal 2006 (see Note 8), offset by a \$0.1 million charge for retail store asset impairments and lease terminations of four Jarman stores.

The Company recorded a pretax charge to earnings of \$0.2 million (\$0.1 million net of tax) in the second quarter of Fiscal 2006. The charge was primarily for retail store asset impairments and lease terminations of two Jarman stores.

The Company recorded a pretax charge to earnings of \$2.9 million (\$1.8 million net of tax) in the first quarter of Fiscal 2006. The charge included \$2.6 million for settlement of a California employment class action (see Note 8), \$0.2 million for retail store asset impairments and \$0.1 million for lease terminations of two Jarman stores.

**Table of Contents****Results of Operations Third Quarter Fiscal 2007 Compared to Fiscal 2006**

The Company's net sales in the third quarter ended October 28, 2006 increased 15.2% to \$364.3 million from \$316.3 million in the third quarter ended October 29, 2005. Gross margin increased 12.3% to \$181.5 million in the third quarter this year from \$161.5 million in the same period last year and decreased slightly as a percentage of net sales from 51.1% to 49.8%. Selling and administrative expenses in the third quarter this year increased 13.3% from the third quarter last year but decreased as a percentage of net sales from 42.1% to 41.4%. The Company records buying and merchandising and occupancy costs in selling and administrative expense. Because the Company does not include these costs in cost of sales, the Company's gross margin may not be comparable to other retailers that include these costs in the calculation of gross margin. Explanations of the changes in results of operations are provided by business segment in discussions following these introductory paragraphs.

Earnings before income taxes from continuing operations (pretax earnings) of \$26.4 million for the third quarter ended October 28, 2006 were flat compared to the same period last year. Pretax earnings for the third quarter ended October 28, 2006 included restructuring and other charges of \$1.1 million (\$0.7 million net of tax), primarily for retail store asset impairments and the lease termination of one Jarman store, representing the continuation of a plan previously announced by the Company in Fiscal 2004 to close or convert the remaining Jarman stores. Pretax earnings for the third quarter ended October 29, 2005 included a restructuring and other credit of \$0.8 million, primarily due to a favorable adjustment to a litigation settlement in the third quarter, offset by retail store asset impairments and lease terminations of four Jarman stores.

Net earnings for the third quarter ended October 28, 2006 were \$15.9 million (\$0.62 diluted earnings per share) compared to \$16.1 million (\$0.61 diluted earnings per share) for the third quarter ended October 29, 2005. Net earnings for the third quarter ended October 28, 2006 included a \$0.1 million (\$0.00 diluted earnings per share) charge to earnings (net of tax) primarily for additional environmental costs. Net earnings for the third quarter ended October 29, 2005 included a \$0.1 million (\$0.01 diluted earnings per share) charge to earnings (net of tax) primarily for additional environmental costs. The Company recorded an effective income tax rate of 39.6% in the third quarter this year compared to 38.5% in the same period last year.

*Journeys Group*

	Three Months Ended		
	October 28, 2006	October 29, 2005	% Change
	(dollars in thousands)		
Net sales	\$ 184,391	\$ 153,109	20.4%
Operating income	\$ 25,260	\$ 21,551	17.2%
Operating margin	13.7%	14.1%	

Net sales from Journeys Group increased 20.4% for the third quarter ended October 28, 2006 compared to the same period last year. The increase reflects primarily a 14% increase in average Journeys Group stores operated (i.e., the sum of the number of stores open on the first day of the fiscal quarter and the last day of each fiscal month during the quarter divided by four) and a 9% increase in comparable store sales. The comparable sales increase reflected an increase of 18% in footwear unit comparable sales, offset by a 6% decline in the average price per pair of shoes



**Table of Contents**

related to changes in product mix and increased markdowns. Unit sales increased 32% during the same period. Journeys Group operated 829 stores at the end of the third quarter of Fiscal 2007, including 68 Journeys Kidz stores and 10 Shi by Journeys stores, compared to 724 stores at the end of the third quarter last year, including 41 Journeys Kidz stores.

Journeys Group operating income for the third quarter ended October 28, 2006 increased 17.2% to \$25.3 million compared to \$21.6 million for the third quarter ended October 29, 2005. The increase was due to increased net sales and decreased expenses as a percentage of net sales, reflecting the strong comparable store sales increase of 9%.

*Underground Station Group*

	Three Months Ended		
	October	October	%
	28,	29,	
	2006	2005	Change
	(dollars in thousands)		
Net sales	\$ 34,981	\$ 38,395	(8.9)%
Operating income (loss)	\$ (631)	\$ 1,965	NM
Operating margin	(1.8)%	5.1%	

Net sales from the Underground Station Group (comprised of Underground Station and Jarman retail stores) decreased 8.9% for the third quarter ended October 28, 2006 compared to the same period last year. Sales for Underground Station stores decreased 4% for the third quarter ended October 28, 2006. Sales for Jarman retail stores decreased 30% for the third quarter this year, reflecting a 32% decrease in the average number of Jarman stores operated related to the Company's strategy of closing Jarman stores or converting them to Underground Station stores. Comparable store sales decreased 11% for the Underground Station Group, 11% for Underground Station stores and 10% for Jarman retail stores. The decrease in comparable store sales was primarily due to weak demand for athletic shoes and what management believes was overall softness in the urban market. The average price per pair of shoes for Underground Station Group decreased 6% in the third quarter of Fiscal 2007, and unit sales decreased 1% during the same period. The average price per pair of shoes at Underground Station stores decreased 7% in the third quarter of Fiscal 2007, reflecting changes in product mix and increased markdowns, while unit sales increased 7%. Underground Station Group operated 229 stores at the end of the third quarter of Fiscal 2007, including 193 Underground Station stores, compared to 230 stores at the end of the third quarter last year, including 176 Underground Station stores.

Underground Station Group operating loss for the third quarter ended October 28, 2006 was \$(0.6) million compared to operating income of \$2.0 million in the third quarter ended October 29, 2005. The decrease was due to decreased net sales, decreased gross margin as a percentage of net sales, reflecting changes in product mix and increased markdowns and to increased expenses as a percentage of net sales due to the negative leverage from the decline in comparable store sales as store related expenses grew faster than sales.

**Table of Contents***Hat World Group*

	Three Months Ended		% Change
	October 28, 2006	October 29, 2005	
	(dollars in thousands)		
Net sales	\$ 77,503	\$ 68,330	13.4%
Operating income	\$ 7,710	\$ 7,615	1.2%
Operating margin	9.9%	11.1%	

Net sales from Hat World Group increased 13.4% for the third quarter ended October 28, 2006 compared to the same period last year, reflecting primarily a 15% increase in average stores operated. Hat World Group comparable store sales decreased 1% for the third quarter ended October 28, 2006. The comparable store sales were impacted by softness in the urban market and softer sales in NCAA headwear. This was partially offset by strength in core and fashion-oriented Major League Baseball products, as well as branded action and performance headwear. Hat World Group operated 718 stores at the end of the third quarter of Fiscal 2007, including 24 stores in Canada and three Lids Kids, compared to 621 stores at the end of the third quarter last year, including 18 stores in Canada.

Hat World Group operating income for the third quarter ended October 28, 2006 increased 1.2% to \$7.7 million compared to \$7.6 million for the third quarter ended October 29, 2005. The increase in operating income was primarily due to increased net sales offset by decreased gross margin as a percentage of net sales reflecting increased promotional activity.

*Johnston & Murphy Group*

	Three Months Ended		% Change
	October 28, 2006	October 29, 2005	
	(dollars in thousands)		
Net sales	\$ 44,467	\$ 38,981	14.1%
Operating income	\$ 3,193	\$ 1,404	127.4%
Operating margin	7.2%	3.6%	

Johnston & Murphy Group net sales increased 14.1% to \$44.5 million for the third quarter ended October 28, 2006 from \$39.0 million for the third quarter ended October 29, 2005, reflecting primarily a 6% increase in comparable store sales, a 4% increase in average retail stores operated and a 25% increase in Johnston & Murphy wholesale sales. Unit sales for the Johnston & Murphy wholesale business increased 22% in the third quarter of Fiscal 2007 and the average price per pair of shoes increased 1% for the same period. Retail operations accounted for 70.6% of Johnston & Murphy Group sales in the third quarter this year, down from 73.1% in the third quarter last year. The average price per pair of shoes for Johnston & Murphy retail operations decreased 2% (flat in the Johnston and Murphy shops) in the third quarter this year, primarily due to changes in product mix, while footwear unit sales increased 9% during the same period. The store count for Johnston & Murphy retail operations at the end of the third quarter of Fiscal 2007 included 149 Johnston & Murphy shops and factory stores compared to 143 Johnston & Murphy shops and factory stores at the end of the third quarter of Fiscal 2006.

**Table of Contents**

Johnston & Murphy Group operating income for the third quarter ended October 28, 2006 more than doubled to \$3.2 million compared to \$1.4 million for the same period last year, primarily due to increased net sales, increased gross margin as a percentage of net sales, reflecting improvement in the retail business due to lower markdowns and changes in product mix, and to decreased expenses as a percentage of net sales reflecting the strong comparable store sales increase and wholesale sales increase.

*Licensed Brands*

	Three Months Ended		% Change
	October 28, 2006	October 29, 2005	
	(dollars in thousands)		
Net sales	\$ 22,844	\$ 17,457	30.9%
Operating income	\$ 2,326	\$ 1,781	30.6%
Operating margin	10.2%	10.2%	

Licensed Brands net sales increased 30.9% to \$22.8 million for the third quarter ended October 28, 2006, from \$17.5 million for the third quarter ended October 29, 2005. The sales increase reflects the increase in sales of Dockers Footwear, which performed well at retail, combined with increased shelf space in existing accounts. Unit sales for Dockers Footwear increased 31% for the third quarter this year while the average price per pair of shoes decreased 2% compared to the same period last year.

Licensed Brands operating income for the third quarter ended October 28, 2006 increased 30.6% from \$1.8 million for the third quarter ended October 29, 2005 to \$2.3 million, primarily due to increased net sales and to decreased expenses as a percentage of net sales.

*Corporate, Interest Expenses and Other Charges*

Corporate and other expenses for the third quarter ended October 28, 2006 were \$8.5 million compared to \$5.2 million for the third quarter ended October 29, 2005. Corporate expenses in the third quarter this year included share-based compensation and restricted stock expense of approximately \$1.8 million and retail store asset impairments of \$1.0 million. Last year's third quarter results included restricted stock expense of \$0.1 million and a credit of \$0.8 million primarily from the settlement of a California employment class action more favorably than originally anticipated.

Interest expense increased 3.2% from \$2.9 million in the third quarter ended October 29, 2005 to \$3.0 million for the third quarter ended October 28, 2006, primarily due to increased revolver borrowings. There was an average of \$30.4 million of revolver borrowings under the Company's revolving credit facility during the three months ended October 28, 2006. There were no borrowings under the Company's revolving credit facility during the three months ended October 29, 2005. Interest income decreased 92.1% from \$0.2 million to \$16,000 for the third quarter ended October 28, 2006 due to the decrease in average short-term investments.

**Results of Operations - Nine Months Fiscal 2007 Compared to Fiscal 2006**

The Company's net sales in the nine months ended October 28, 2006 increased 12.1% to \$983.6 million from \$877.6 million in the nine months ended October 29, 2005. Gross margin increased

**Table of Contents**

11.0% to \$496.2 million in the nine months ended October 28, 2006 from \$447.0 million in the nine months ended October 29, 2005 and decreased as a percentage of net sales from 50.9% to 50.4%. Selling and administrative expenses in the nine months ended October 28, 2006 increased 12.5% from the nine months ended October 29, 2005 and increased as a percentage of net sales from 43.9% to 44.1%. The Company records buying and merchandising and occupancy costs in selling and administrative expense. Because the Company does not include these costs in cost of sales, the Company's gross margin may not be comparable to other retailers that include these costs in the calculation of gross margin. Explanations of the changes in results of operations are provided by business segment in discussions following these introductory paragraphs.

Earnings before income taxes from continuing operations (pretax earnings) for the nine months ended October 28, 2006 were \$54.0 million compared to \$51.4 million for the nine months ended October 29, 2005. Pretax earnings for the nine months ended October 28, 2006 included restructuring and other charges of \$1.7 million, primarily for retail store asset impairments and lease terminations of ten Jarman stores. These lease terminations were the continuation of a plan previously announced by the Company in Fiscal 2004. Pretax earnings for the nine months ended October 29, 2005 included restructuring and other charges of \$2.3 million, primarily \$1.7 million for an anticipated settlement of a previously announced class action lawsuit (see Note 8), retail store asset impairments and lease terminations of eight Jarman stores.

Net earnings for the nine months ended October 28, 2006 were \$32.3 million (\$1.25 diluted earnings per share) compared to \$31.4 million (\$1.22 diluted earnings per share) for the nine months ended October 29, 2005. Net earnings for the nine months ended October 28, 2006 included a \$0.3 million (\$0.01 diluted earnings per share) charge to earnings (net of tax) primarily for additional environmental costs. The Company recorded an effective income tax rate of 39.7% for the nine months ended October 28, 2006 compared to 38.8% in the same period last year. This year's income tax expense includes a \$0.2 million adjustment relating to changes in state tax laws.

*Journeys Group*

	Nine Months Ended		
	<b>October 28, 2006</b>	October 29, 2005	% Change
	(dollars in thousands)		
Net sales	<b>\$ 462,560</b>	\$ 400,881	15.4%
Operating income	<b>\$ 46,346</b>	\$ 42,270	9.6%
Operating margin	<b>10.0%</b>	10.5%	

Net sales from Journeys Group increased 15.4% for the nine months ended October 28, 2006 compared to the same period last year. The increase reflects primarily a 13% increase in average Journeys Group stores operated (i.e., the sum of the number of stores open on the first day of the fiscal year and the last day of each fiscal month during the nine months divided by ten) and an increase in comparable store sales of 5% for the nine months ended October 28, 2006. Unit sales increased 22% for the nine months ended October 28, 2006 while the average price per pair of shoes decreased 4% during the same period.

Journeys Group operating income for the nine months ended October 28, 2006 increased 9.6% to \$46.3 million compared to \$42.3 million for the nine months ended October 29, 2005. The

**Table of Contents**

increase was due to increased net sales partially offset by decreased gross margin as a percentage of net sales, reflecting changes in product mix.

*Underground Station Group*

	Nine Months Ended		
	<b>October 28, 2006</b>	October 29, 2005	% Change
	(dollars in thousands)		
Net sales	<b>\$ 105,854</b>	\$ 110,417	(4.1)%
Operating income	<b>\$ 27</b>	\$ 3,900	(99.3)%
Operating margin	<b>0.0%</b>	3.5%	

Net sales from the Underground Station Group (comprised of Underground Station and Jarman retail stores) decreased 4.1% for the nine months ended October 28, 2006 compared to the same period last year. Sales for Underground Station stores increased 2% for the nine months ended October 28, 2006. Sales for Jarman retail stores decreased 27% for the nine months ended this year, reflecting a 25% decrease in the average number of Jarman stores operated related to the Company's strategy of closing Jarman stores or converting them to Underground Station stores. Comparable store sales decreased 7% for the Underground Station Group, 6% for Underground Station stores and 10% for Jarman retail stores. The average price per pair of shoes for Underground Station Group decreased 2% in the first nine months of Fiscal 2007, and unit sales decreased 4% during the same period. The average price per pair of shoes at Underground Station stores decreased 3% in the first nine months of Fiscal 2007, while unit sales increased 4%. Underground Station Group operating income for the nine months ended October 28, 2006 decreased 99.3% to \$27,000 compared to \$3.9 million in the first nine months ended October 29, 2005. The decrease was due to decreased net sales and decreased gross margin as a percentage of net sales, reflecting increased markdowns, and to increased expenses as a percentage of net sales due to the negative leverage from negative comparable store sales as store related expenses grew faster than sales.

During the first quarter this year, the Company was notified that Nike products will no longer be distributed through Underground Station stores. Nike made up approximately 13% of the Underground Station Group sales in Fiscal 2006. Underground Station received a full allocation of Nike product for back-to-school in the second quarter this year. Nike product has historically not had a significant impact on fourth quarter sales at Underground Station. Therefore, the Company does not anticipate a material impact from this decision in Fiscal 2007. It intends to expand its product offering to include additional brands and categories and a wider assortment of existing brands and categories in Fiscal 2008 in response to the Nike decision.

*Hat World Group*

	Nine Months Ended		
	<b>October 28, 2006</b>	October 29, 2005	% Change
	(dollars in thousands)		
Net sales	<b>\$ 226,697</b>	\$ 199,532	13.6%
Operating income	<b>\$ 22,334</b>	\$ 22,355	(0.1)%
Operating margin	<b>9.9%</b>	11.2%	

**Table of Contents**

Net sales from Hat World Group increased 13.6% for the nine months ended October 28, 2006 compared to the same period last year, reflecting primarily a 16% increase in average stores operated. Hat World Group comparable store sales were flat for the nine months ended October 28, 2006.

Hat World Group operating income for the nine months ended October 28, 2006 decreased 0.1% to \$22.3 million compared to \$22.4 million for the nine months ended October 29, 2005. The decrease in operating income was due to decreased gross margin as a percentage of net sales, reflecting increased promotional activity, and to increased expenses as a percentage of net sales resulting from negative leverage due to flat comparable store sales, as store related expenses grew faster than the sales increase.

*Johnston & Murphy Group*

	Nine Months Ended		% Change
	<b>October 28, 2006</b>	October 29, 2005	
	(dollars in thousands)		
Net sales	<b>\$ 130,414</b>	\$ 121,497	7.3%
Operating income	<b>\$ 8,500</b>	\$ 6,352	33.8%
Operating margin	<b>6.5%</b>	5.2%	

Johnston & Murphy Group net sales increased 7.3% to \$130.4 million for the nine months ended October 28, 2006 from \$121.5 million for the nine months ended October 29, 2005, reflecting primarily a 15% increase in Johnston & Murphy wholesale sales and a 2% increase in comparable store sales for Johnston & Murphy retail operations. Unit sales for the Johnston & Murphy wholesale business increased 13% in the first nine months of Fiscal 2007 and the average price per pair of shoes increased 1% for the same period. Retail operations accounted for 72.6% of Johnston & Murphy segment sales in the nine months this year, down from 74.3% in the first nine months last year. The average price per pair of shoes for Johnston & Murphy retail operations decreased 2% (2% in the Johnston and Murphy shops) in the first nine months this year, primarily due to changes in product mix, while footwear unit sales increased 4% during the same period.

Johnston & Murphy Group operating income for the nine months ended October 28, 2006 increased 33.8% to \$8.5 million compared to \$6.4 million for the same period last year, primarily due to increased net sales and increased gross margin as a percentage of net sales, primarily due to lower markdowns in the retail business and improvement in the wholesale business due to shipments of less off-priced product, and to decreased expenses as a percentage of net sales.

**Table of Contents***Licensed Brands*

	Nine Months Ended		% Change
	October 28, 2006	October 29, 2005	
	(dollars in thousands)		
Net sales	\$ 57,759	\$ 45,065	28.2%
Operating income	\$ 5,390	\$ 3,545	52.0%
Operating margin	9.3%	7.9%	

Licensed Brands net sales increased 28.2% to \$57.8 million for the nine months ended October 28, 2006, from \$45.1 million for the nine months ended October 29, 2005. The sales increase reflects the increase in sales of Dockers Footwear, including replenishment sales of Dockers products, in particular the proStyle® and Stain Defender® footwear, which performed well at retail. Dockers sales increase also reflected sell-in related to increasing shelf space in existing accounts. Unit sales for Dockers Footwear increased 27% for the nine months ended October 28, 2006 and the average price per pair of shoes was flat compared to the nine months ended October 29, 2005.

Licensed Brands operating income for the nine months ended October 28, 2006 increased 52.0% from \$3.5 million for the nine months ended October 29, 2005 to \$5.4 million, primarily due to increased net sales and to decreased expenses as a percentage of net sales.

*Corporate, Interest Expenses and Other Charges*

Corporate and other expenses for the nine months ended October 28, 2006 were \$21.5 million compared to \$19.1 million for the nine months ended October 29, 2005. Corporate expenses in the nine months ended October 28, 2006 included share-based compensation and restricted stock expense of approximately \$5.3 million partially offset by decreased bonus accruals this year. The nine months ended October 29, 2005 results included restricted stock expense of \$0.3 million.

Interest expense decreased 14.2% from \$8.7 million in the nine months ended October 29, 2005 to \$7.5 million for the nine months ended October 28, 2006, primarily due to the decrease in the term loan outstanding from \$65 million at the end of the nine months last year to \$20 million at the end of the nine months this year. There was an average of \$11.1 million of revolver borrowings under the Company's revolving credit facility during the nine months ended October 28, 2006. There were no borrowings under the Company's revolving credit facility during the nine months ended October 29, 2005. Interest income decreased 40.1% to \$0.5 million for the nine months ended October 28, 2006 from \$0.8 million for the nine months ended October 29, 2005, primarily due to the decrease in average short-term investments.

The nine months ended October 28, 2006 included \$1.7 million in restructuring and other charges, primarily for retail store asset impairments and lease terminations of ten Jarman stores. The nine months ended October 29, 2005 included \$2.3 million in restructuring and other charges, primarily for settlement of a California employment class action, retail store asset impairments and lease terminations of eight Jarman stores.

**Table of Contents****Liquidity and Capital Resources**

The following table sets forth certain financial data at the dates indicated.

	<b>October 28, 2006</b>	January 28, 2006 (dollars in millions)	October 29, 2005
Cash and cash equivalents	\$ <b>18.6</b>	\$ 60.5	\$ 33.4
Working capital	\$ <b>222.0</b>	\$ 185.0	\$ 196.3
Long-term debt	\$ <b>158.3</b>	\$ 106.3	\$ 151.3

*Working Capital*

The Company's business is somewhat seasonal, with the Company's investment in inventory and accounts receivable normally reaching peaks in the spring and fall of each year. Historically, cash flow from operations has been generated principally in the fourth quarter of each fiscal year.

Cash used in operating activities was \$13.9 million in the first nine months of Fiscal 2007 compared to cash provided by operating activities of \$14.2 million in the first nine months of Fiscal 2006. The \$28.1 million decrease in cash flow from operating activities from last year reflects primarily a decrease in cash flow from changes in inventory and other accrued liabilities of \$28.1 million and \$16.5 million, respectively, offset by an increase in cash flow from changes in accounts payable of \$9.2 million and share-based compensation of \$4.8 million. The \$28.1 million decrease in cash flow from inventory was due to seasonal increases in retail inventory and growth in our retail businesses to support the net increase of 152 stores in the first nine months of Fiscal 2007 versus 100 stores in the first nine months of Fiscal 2006. The \$16.5 million decrease in cash flow from other accrued liabilities was due to a \$16.4 million increase in income taxes paid for the first nine months this year compared to the same period last year and increased bonus payments. The \$9.2 million increase in cash flow from accounts payable was due to changes in buying patterns and increased inventory purchases.

The \$113.7 million increase in inventories at October 28, 2006 from January 28, 2006 levels reflects seasonal increases in retail inventory and inventory purchased to support the net increase of 152 stores in the first nine months this year.

Accounts receivable at October 28, 2006 increased \$3.5 million compared to January 28, 2006 due primarily to increased wholesale sales.

Cash provided (or used) due to changes in accounts payable and accrued liabilities are as follows:

	Nine Months Ended	
	<b>October 28, 2006</b>	October 29, 2005
	(in thousands)	
Accounts payable	\$ <b>54,455</b>	\$ 45,274
Accrued liabilities	<b>(19,614)</b>	(3,151)
	<b>\$ 34,841</b>	\$ 42,123



**Table of Contents**

The fluctuations in cash provided due to changes in accounts payable for the first nine months this year from the first nine months last year are due to changes in buying patterns and payment terms negotiated with individual vendors and increased inventory purchases. The change in cash provided due to changes in accrued liabilities for the first nine months this year from the first nine months last year was due primarily to increased tax payments and bonus payments in the first nine months of Fiscal 2007.

There was an average of \$11.1 million of revolving credit borrowings during the first nine months ended October 28, 2006 and no revolving credit borrowings during the first nine months ended October 29, 2005, as cash generated from operations and cash on hand funded most of the seasonal working capital requirements and capital expenditures for the first nine months of Fiscal 2007.

The Company's contractual obligations over the next five years have increased from January 28, 2006. Long-term debt increased to \$158 million from \$106 million due to increased revolver borrowings as a result of stock repurchases. Operating lease obligations increased to \$984 million from \$843 million due to new store openings.

*Capital Expenditures*

Total capital expenditures in Fiscal 2007 are expected to be approximately \$67.9 million. These include expected retail capital expenditures of \$61.5 million to open approximately 61 Journeys stores, 24 Journeys Kidz stores, 12 Shi by Journeys stores, 13 Johnston & Murphy shops and factory stores, 11 Underground Station stores and 101 Hat World stores and to complete 119 major store renovations, including three conversions of Jarman stores to Underground Station stores. The amount of capital expenditures in Fiscal 2007 for other purposes is expected to be approximately \$6.4 million, including approximately \$1.1 million for new systems to improve customer service and support the Company's growth.

*Future Capital Needs*

The Company expects that cash on hand and cash provided by operations will be sufficient to fund all of its planned capital expenditures through Fiscal 2007, although the Company plans to borrow under its revolving credit facility from time to time, particularly in the fall, to support seasonal working capital requirements. The approximately \$4.1 million of costs associated with discontinued operations that are expected to be incurred during the next twelve months are also expected to be funded from cash on hand and borrowings under the revolving credit facility.

The Company's board of directors authorized the repurchase, from time to time, of up to 7.5 million shares of the Company's common stock under a series of authorizations in Fiscal 1999-2003. Purchases were funded from available cash and borrowings under the revolving credit facility. The Company repurchased 7.1 million shares at a cost of \$72.1 million under those authorizations. In June 2006, the board authorized an additional \$20 million in stock repurchases. In August 2006, the board authorized an additional \$30 million in stock repurchases. The Company repurchased 629,400 shares at a cost of \$18.5 million during the third quarter of Fiscal 2007, leaving \$18.7 million remaining to be repurchased under these authorizations as of October 28, 2006. In total, the Company has repurchased 8.2 million shares at a cost of \$103.4 million at an average price of \$12.66 per share from all authorizations as of October 28, 2006.

There were \$11.0 million of letters of credit outstanding and \$52.0 million revolver borrowings outstanding under the revolving credit facility at October 28, 2006, leaving availability under the

**Table of Contents**

revolving credit facility of \$42.0 million. The revolving credit agreement requires the Company to meet certain financial ratios and covenants, including minimum tangible net worth, fixed charge coverage and lease adjusted debt to EBITDAR ratios. The Company was in compliance with these financial covenants at October 28, 2006.

The Company's revolving credit agreement restricts the payment of dividends and other payments with respect to common stock, including repurchases. The aggregate of annual dividend requirements on the Company's Subordinated Serial Preferred Stock, \$2.30 Series 1, \$4.75 Series 3 and \$4.75 Series 4, and on its \$1.50 Subordinated Cumulative Preferred Stock is \$256,000.

**Environmental and Other Contingencies**

The Company is subject to certain loss contingencies related to environmental proceedings and other legal matters, including those disclosed in Note 8 to the Company's Condensed Consolidated Financial Statements. The Company has made accruals for certain of these contingencies, including approximately \$0.6 million in the first nine months of Fiscal 2007, \$0.8 million reflected in Fiscal 2006 and \$0.9 million reflected in Fiscal 2005. The Company monitors these matters on an ongoing basis and, on a quarterly basis, management reviews the Company's reserves and accruals in relation to each of them, adjusting provisions as management deems necessary in view of changes in available information. Changes in estimates of liability are reported in the periods when they occur. Consequently, management believes that its reserve in relation to each proceeding is a reasonable estimate of the probable loss connected to the proceeding, or in cases in which no reasonable estimate is possible, the minimum amount in the range of estimated losses, based upon its analysis of the facts and circumstances as of the close of the most recent fiscal quarter.

However, because of uncertainties and risks inherent in litigation generally and in environmental proceedings in particular, there can be no assurance that future developments will not require additional reserves to be set aside, that some or all reserves may not be adequate or that the amounts of any such additional reserves or any such inadequacy will not have a material adverse effect upon the Company's financial condition or results of operations.

**Financial Market Risk**

The following discusses the Company's exposure to financial market risk related to changes in interest rates and foreign currency exchange rates.

**Outstanding Debt of the Company** The Company's outstanding long-term debt of \$86.3 million 4 1/8% Convertible Subordinated Debentures due June 15, 2023 bears interest at a fixed rate. Accordingly, there would be no immediate impact on the Company's interest expense due to fluctuations in market interest rates. The Company's \$20.0 million outstanding under the term loan bears interest according to a pricing grid providing margins over LIBOR or Alternate Base Rate. The Company entered into three separate interest rate swap agreements as a means of managing its interest rate exposure on the original term loan. The notional amount of the one remaining swap agreement is \$20.0 million. At October 28, 2006, the net gain on this interest rate swap was \$0.1 million.

**Cash and Cash Equivalents** The Company's cash and cash equivalent balances are invested in financial instruments with original maturities of three months or less. The Company does not have significant exposure to changing interest rates on invested cash at October 28, 2006. As a result, the Company considers the interest rate market risk implicit in these investments at October 28, 2006 to be low.

**Table of Contents**

**Foreign Currency Exchange Rate Risk** Most purchases by the Company from foreign sources are denominated in U.S. dollars. To the extent that import transactions are denominated in other currencies, it is the Company's practice to hedge its risks through the purchase of forward foreign exchange contracts. At October 28, 2006, the Company had \$7.6 million of forward foreign exchange contracts for Euro. The Company's policy is not to speculate in derivative instruments for profit on the exchange rate price fluctuation and it does not hold any derivative instruments for trading purposes. Derivative instruments used as hedges must be effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the contract. The unrealized loss on contracts outstanding at October 28, 2006 was \$2,000 based on current spot rates. As of October 28, 2006, a 10% adverse change in foreign currency exchange rates from market rates would decrease the fair value of the contracts by approximately \$0.8 million.

**Accounts Receivable** The Company's accounts receivable balance at October 28, 2006 is concentrated in its two wholesale businesses, which sell primarily to department stores and independent retailers across the United States. Two customers accounted for 12% and 11%, respectively, of the Company's trade accounts receivable balance as of October 28, 2006 and no other customer accounted for more than 9% of the Company's trade receivables balance as of October 28, 2006. The Company monitors the credit quality of its customers and establishes an allowance for doubtful accounts based upon factors surrounding credit risk, historical trends and other information; however, credit risk is affected by conditions or occurrences within the economy and the retail industry, as well as company-specific information.

**Summary** Based on the Company's overall market interest rate and foreign currency rate exposure at October 28, 2006, the Company believes that the effect, if any, of reasonably possible near-term changes in interest rates or foreign currency exchange rates on the Company's consolidated financial position, results of operations or cash flows for Fiscal 2007 would not be material.

**New Accounting Principles**

On January 29, 2006, the Company adopted SFAS No.123(R) using the modified prospective transition method. Under the modified prospective transition method, recognized compensation cost for the nine months ended October 28, 2006 includes (i) compensation cost for all share-based payments granted prior to, but not yet vested as of January 29, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123; and (ii) compensation cost for all share-based payments granted on or after January 29, 2006, based on the grant date fair value estimated in accordance with SFAS No. 123(R). In accordance with the modified prospective method, the Company has not restated prior period results. SFAS No. 123(R) requires the Company to measure and recognize compensation expense for all share-based payment awards based on estimated fair values at the date of grant. Determining the fair value of share-based awards at the grant date requires judgment in developing assumptions, which involve a number of variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards and expected stock option exercise behavior. In addition, the Company also uses judgment in estimating the number of share-based awards that are expected to be forfeited. For the nine months ended October 28, 2006 and October 29, 2005, the Company estimated the fair value of each option award on the date of grant using a Black-Scholes option pricing model. As a result of adopting SFAS No. 123(R), earnings before income taxes from continuing operations, earnings from continuing operations and net earnings for the three months and nine months ended October 28, 2006 were \$1.1 million, \$0.7 million, \$0.7 million, \$3.2 million, \$2.7 million and \$2.7 million lower, respectively, than if the Company had continued to account for share-based

**Table of Contents**

compensation under APB No. 25. The effect of adopting SFAS No. 123(R) on basic and diluted earnings per common share for the three months and nine months ended October 28, 2006 was \$0.03, \$0.03, \$0.12 and \$0.10, respectively. In March 2006, the Emerging Issues Task Force ( EITF ) reached a consensus on EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, gross versus net presentation), which allows companies to adopt a policy of presenting taxes in the income statement on either a gross or net basis. Taxes within the scope of this EITF would include taxes that are imposed on a revenue transaction between a seller and a customer, for example, sales taxes, use taxes, value-added taxes and some types of excise taxes. EITF No. 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. EITF No. 06-3 will not impact the method for recording and reporting these sales taxes in the Company's Condensed Consolidated Financial Statements as the Company's policy is to exclude all such taxes from revenue.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of SFAS No. 109 ( FIN 48 ). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes that a company should use a more-likely-than-not recognition threshold based on the technical merits of the tax position taken. Tax positions that meet the more-likely-than-not recognition threshold should be measured in order to determine the tax benefit to be recognized in the financial statements. FIN 48 is effective in fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact that the adoption of FIN 48 will have on its results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (fiscal year 2009 for the Company), and interim periods within those fiscal years. The Company is currently evaluating the impact that the adoption of SFAS No. 157 will have on its results of operations and financial position.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires companies to recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in comprehensive income in the year in which the changes occur. This requirement of SFAS No. 158 is effective as of the end of the fiscal year ending after December 15, 2006 (fiscal year 2007 for the Company). SFAS No. 158 also requires companies to measure the funded status of a plan as of the date of its fiscal year end. This requirement of SFAS No. 158 is effective for fiscal years ending after December 15, 2008 (fiscal year 2009 for the Company). The Company does not believe the adoption of SFAS No. 158 will have a material impact on the Company's results of operations or financial position.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The Company incorporates by reference the information regarding market risk appearing under the heading Financial Market Risk in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Table of Contents**

**Item 4. Controls and Procedures**

- (a) Evaluation of disclosure controls and procedures. We have established disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to the officers who certify the Company's financial reports and to other members of senior management and the Board of Directors.

Based on their evaluation as of October 28, 2006, the principal executive officer and principal financial officer of the Company have concluded that, the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within time periods specified in SEC rules and forms and (ii) accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

- (b) Changes in internal control over financial reporting. There were no changes in the Company's internal control over financial reporting that occurred during the Company's third fiscal quarter that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

The Company incorporates by reference the information regarding legal proceedings in Note 8 of the Company's Condensed Consolidated Financial Statements.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors disclosed in Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended January 28, 2006.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(c) Repurchases (shown in 000's except share and per share amounts):

**ISSUER PURCHASES OF EQUITY SECURITIES**

Period	(a) Total of Number of Shares (or Units Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1) (in thousands)
August 2006 7-30-06 to 8-26-06	65,000	\$ 27.24	65,000	\$ 5,455
September 2006 8-27-06 to 9-23-06	463,700	\$ 28.38	463,700	\$ 22,296
October 2006 9-24-06 to 10-28-06 10-25-06 <sup>(2)</sup>	100,700 7,704	\$ 35.30 \$ 37.72	100,700 -0-	\$ 18,741 -0-

(1) The Company's Board of Directors authorized the repurchase, from time to time, of up to 7.5 million shares of the Company's common stock under a series of authorizations in Fiscal 1999-2003. The Company repurchased

7.1 million shares at a cost of \$72.1 million under those authorizations.

On June 28, 2006, the Company's Board of Directors authorized an additional \$20.0 million in stock repurchases. On August 30, 2006, the Board of Directors authorized an additional \$30.0 million in stock repurchases. As of October 28, 2006, the Company had repurchased and retired a total of 8.2 million shares of common stock at an aggregate cost of approximately \$103.4 million.

- (2) These shares represent shares withheld from vested restricted stock to satisfy the minimum withholding requirement for federal taxes.

**Table of Contents**

**Item 6. Exhibits**

**Exhibits**

- (10.1) Amendment No. 2 (Renewal) to Trademark License Agreement, dated November 1, 2006, between Levi Strauss & Co. and Genesco. Inc.\*
- (10.2) Amended and Restated Credit agreement, dated as of December 1, 2006, by and among the Company, certain subsidiaries of the Company party thereto, as other borrowers, the lenders party thereto and Bank of America, N.A., as administrative agent. Incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed December 5, 2006 (File No. 1-3083).
- (31.1) Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- (31.2) Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- (32.1) Certification of the 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 the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Certain information has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portion.



**Table of Contents**

**SIGNATURE**

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

Genesco Inc.

/s/ James S. Gulmi

James S. Gulmi

Chief Financial Officer

December 7, 2006