

**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 the quarterly period ended October 29, 2005**

**OR**

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

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

**Commission file number 1-14035**

**Stage Stores, Inc.**

**(Exact name of registrant as specified in its charter)**

**NEVADA**

**(State or other jurisdiction of incorporation or  
organization)**

**91-1826900**

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

**10201 Main Street, Houston, Texas**

**(Address of principal executive offices)**

**77025**

**(Zip Code)**

**(800) 579-2302**

**Registrant's telephone number, including area code**

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

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

Yes  No

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

Yes  No

**APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

As of November 25, 2005, there were 26,462,754 shares of the registrant's common stock outstanding.

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*References to a particular year are to Stage Stores, Inc.'s fiscal year, which is the 52 or 53 week period ending on the Saturday closest to January 31st of the following calendar year. For example, a reference to "2004" is a reference to the fiscal year ended January 29, 2005 and a reference to "2005" is a reference to the fiscal year ending January 28, 2006. Fiscal years 2004 and 2005 consist of 52 weeks.*

**PART I - FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**Stage Stores, Inc.**  
**Condensed Consolidated Balance Sheets**  
(in thousands, except par values)  
(unaudited)

|  | October 29, 2005 | January 29, 2005 |
|--|------------------|------------------|
| <u>ASSETS</u>  |                  |                  |
| Cash and cash equivalents  | \$ 15,570        | \$ 40,455        |
| Merchandise inventories, net   | 386,943          | 281,588          |
| Current deferred taxes   | 23,549           | 24,031           |
| Prepaid expenses and other current assets  | 29,652           | 22,278           |
| Total current assets   | 455,714          | 368,352          |
| <br>   |                  |                  |
| Property, equipment and leasehold improvements, net  | 238,821          | 212,179          |
| Goodwill   | 79,353           | 79,353           |
| Intangible asset   | 14,910           | 14,910           |
| Other non-current assets, net  | 14,461           | 12,205           |
| Total assets   | \$ 803,259       | \$ 686,999       |
| <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>  |                  |                  |
| Accounts payable   | \$ 112,832       | \$ 74,957        |
| Income taxes payable   | 2,469            | 11,024           |
| Current portion of debt obligations  | 72               | 130              |
| Accrued expenses and other current liabilities   | 68,017           | 57,080           |
| Total current liabilities  | 183,390          | 143,191          |
| <br>   |                  |                  |
| Debt obligations   | 76,460           | 3,048            |
| Deferred taxes   | 9,912            | 11,527           |
| Other long-term liabilities  | 55,779           | 47,960           |
| Total liabilities  | 325,541          | 205,726          |
| <br>   |                  |                  |
| Commitments and contingencies  |                  |                  |
| <br>   |                  |                  |
| Common stock, par value \$0.01, 50,000 shares authorized,<br>32,633 and 32,107 shares issued, respectively | 326              | 321              |
| Additional paid-in capital   | 405,855          | 396,229          |
| Less treasury stock - at cost, 6,448 and 4,625 shares, respectively  | (143,515)        | (94,828)         |
| Minimum pension liability adjustment   | (451)            | (451)            |
| Retained earnings  | 215,503          | 180,002          |
| Stockholders' equity   | 477,718          | 481,273          |
| Total liabilities and stockholders' equity   | \$ 803,259       | \$ 686,999       |

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

**Stage Stores, Inc.**  
**Condensed Consolidated Statements of Income**  
(in thousands, except earnings per share)  
(unaudited)

|  | <u>Thirteen Weeks Ended</u> |                         | <u>Thirty-nine Weeks Ended</u> |                         |
|--|-----------------------------|-------------------------|--------------------------------|-------------------------|
|  | <u>October 29, 2005</u>     | <u>October 30, 2004</u> | <u>October 29, 2005</u>        | <u>October 30, 2004</u> |
| Net sales  | \$ 306,044                  | \$ 285,296              | \$ 925,534                     | \$ 854,826              |
| Cost of sales and related buying, occupancy<br>and distribution expenses   | <u>215,329</u>              | <u>201,170</u>          | <u>647,888</u>                 | <u>601,574</u>          |
| Gross profit   | 90,715                      | 84,126                  | 277,646                        | 253,252                 |
| Selling, general and administrative expenses   | 73,933                      | 68,160                  | 215,144                        | 197,832                 |
| Store pre-opening costs  | 1,293                       | 1,065                   | 2,987                          | 1,561                   |
| Interest expense, net of income of \$8 and \$0 for the<br>thirteen weeks and \$136 and \$13 for the thirty-nine<br>weeks, respectively | <u>972</u>                  | <u>774</u>              | <u>2,085</u>                   | <u>1,831</u>            |
| Income before income tax   | 14,517                      | 14,127                  | 57,430                         | 52,028                  |
| Income tax expense   | <u>5,371</u>                | <u>5,227</u>            | <u>21,249</u>                  | <u>19,250</u>           |
| Net income   | <u>\$ 9,146</u>             | <u>\$ 8,900</u>         | <u>\$ 36,181</u>               | <u>\$ 32,778</u>        |
| <br><i>Basic earnings per share data:</i>  |                             |                         |                                |                         |
| Basic earnings per share   | <u>\$ 0.34</u>              | <u>\$ 0.33</u>          | <u>\$ 1.33</u>                 | <u>\$ 1.19</u>          |
| Basic weighted average shares outstanding  | <u>27,030</u>               | <u>26,794</u>           | <u>27,240</u>                  | <u>27,491</u>           |
| <br><i>Diluted earnings per share data:</i>  |                             |                         |                                |                         |
| Diluted earnings per share   | <u>\$ 0.31</u>              | <u>\$ 0.30</u>          | <u>\$ 1.22</u>                 | <u>\$ 1.09</u>          |
| Diluted weighted average shares outstanding  | <u>29,502</u>               | <u>29,246</u>           | <u>29,688</u>                  | <u>30,072</u>           |

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

**Stage Stores, Inc.**  
**Condensed Consolidated Statements of Cash Flows**  
(in thousands)  
(unaudited)

|   | Thirty-nine<br>Weeks Ended<br><u>October 29, 2005</u> | Thirty-nine<br>Weeks Ended<br><u>October 30, 2004</u> |
|---|---|---|
| <i>Cash flows from operating activities:</i>                                      |   |   |
| Net income  | \$ 36,181   | \$ 32,778   |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |   |
| Depreciation and amortization   | 30,043  | 26,724  |
| Deferred income taxes   | (1,133)   | 3,773   |
| Amortization of debt issue costs  | 335   | 335   |
| Deferred stock compensation   | 592   | 173   |
| Provision for bad debts   | -   | 311   |
| Construction allowances received from landlords                                   | 9,583   | 2,058   |
| Proceeds from sale of private label credit card portfolio, net                    | -   | 34,764  |
| Changes in operating assets and liabilities:                                      |   |   |
| Decrease in accounts receivable and retained interest in receivables sold         | -   | 2,880   |
| Increase in merchandise inventories   | (105,355)   | (99,563)  |
| (Increase) decrease in other assets   | (8,549)   | 5,323   |
| Increase in accounts payable and other liabilities                                | <u>38,493</u>   | <u>43,101</u>   |
| Total adjustments   | <u>(35,991)</u>                                       | <u>19,879</u>   |
| Net cash provided by operating activities   | <u>190</u>  | <u>52,657</u>   |
| <i>Cash flows from investing activities:</i>                                      |   |   |
| Additions to property, equipment and leasehold improvements                       | (58,492)  | (32,260)  |
| Proceeds from sale of fixtures and equipment                                      | <u>391</u>  | <u>16</u>   |
| Net cash used in investing activities   | <u>(58,101)</u>                                       | <u>(32,244)</u>                                       |
| <i>Cash flows from financing activities:</i>                                      |   |   |
| Proceeds from (payments on):  |   |   |
| Borrowings under revolving credit facility, net                                   | 73,462  | 34,210  |
| Finance lease obligations   | -   | 1,650   |
| Repurchases of common stock   | (48,687)  | (61,701)  |
| Debt obligations  | (108)   | (832)   |
| Exercise of stock options and warrants  | 9,039   | 6,392   |
| Payments of cash dividends  | <u>(680)</u>  | <u>-</u>  |
| Net cash provided by (used in) financing activities                               | <u>33,026</u>   | <u>(20,281)</u>                                       |
| Net increase (decrease) in cash and cash equivalents                              | (24,885)  | 132   |
| Cash and cash equivalents:  |   |   |
| Beginning of period   | <u>40,455</u>   | <u>14,733</u>   |
| End of period   | <u>\$ 15,570</u>                                      | <u>\$ 14,865</u>                                      |
| <i>Supplemental disclosures:</i>  |   |   |
| Interest paid   | <u>\$ 1,737</u>                                       | <u>\$ 1,319</u>                                       |
| Income taxes paid   | <u>\$ 27,499</u>                                      | <u>\$ 8,189</u>                                       |

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

**Stage Stores, Inc.**  
**Condensed Consolidated Statement of Stockholders' Equity**  
**For the Thirty-nine Weeks Ended October 29, 2005**  
(in thousands)  
(unaudited)

|  | Common Stock  |               | Additional Paid-in Capital | Treasury Stock |                     | Retained Earnings | Accumulated Other Comprehensive Loss | Total             |
|--|---------------|---------------|----------------------------|----------------|---------------------|-------------------|--------------------------------------|-------------------|
|  | Shares        | Amount        |                            | Shares         | Amount              |                   | Loss                                 |                   |
| Balance, January 29, 2005                        | 32,107        | \$ 321        | \$ 396,229                 | (4,625)        | \$ (94,828)         | \$ 180,002        | \$ (451)                             | \$ 481,273        |
| Net income                                       | -             | -             | -                          | -              | -                   | 36,181            | -                                    | 36,181            |
| Dividends on common stock<br>(\$0.025 per share) | -             | -             | -                          | -              | -                   | (680)             | -                                    | (680)             |
| Repurchases of common stock                      | -             | -             | -                          | (1,823)        | (48,687)            | -                 | -                                    | (48,687)          |
| Stock options and<br>warrants exercised          | 526           | 5             | 9,034                      | -              | -                   | -                 | -                                    | 9,039             |
| Deferred stock compensation                      | -             | -             | 592                        | -              | -                   | -                 | -                                    | 592               |
| Balance, October 29, 2005                        | <u>32,633</u> | <u>\$ 326</u> | <u>\$ 405,855</u>          | <u>(6,448)</u> | <u>\$ (143,515)</u> | <u>\$ 215,503</u> | <u>\$ (451)</u>                      | <u>\$ 477,718</u> |

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

**Stage Stores, Inc.**  
**Notes to Unaudited Condensed Consolidated Financial Statements**  
**(Unaudited)**

**1. Basis of Presentation**

The accompanying Unaudited Condensed Consolidated Financial Statements of Stage Stores, Inc. ("Stage Stores" or the "Company") have been prepared in accordance with Rule 10-01 of Regulation S-X and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Those adjustments that are, in the opinion of management, necessary for a fair presentation of the results of the interim periods have been made. The results of operations for such interim periods are not necessarily indicative of the results of operations for a full year. The Unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Audited Consolidated Financial Statements and notes thereto filed with Stage Stores' Annual Report on Form 10-K for the year ended January 29, 2005. References to a particular year are to Stage Stores' fiscal year, which is the 52 or 53 week period ending on the Saturday closest to January 31<sup>st</sup> of the following calendar year. For example, references to "2004" mean the fiscal year ended January 29, 2005 and a reference to "2005" is a reference to the fiscal year ending January 28, 2006.

Stage Stores, through its wholly-owned subsidiaries Specialty Retailers (TX) LP and SRI Limited Partner LLC, operates family apparel stores under the Stage, Bealls and Palais Royal names throughout the South Central states, and under the Peebles name throughout the Mid-Atlantic, Southeastern and Midwestern states. The Company offers moderately priced, nationally recognized brand name and private label apparel, accessories, cosmetics and footwear for the entire family. As of October 29, 2005, the Company operated 548 stores in 31 states.

**Stock Split:** On July 5, 2005, the Company's Board of Directors approved a 3-for-2 stock split of the Company's common stock, \$.01 par value, which was paid in the form of a stock dividend on August 19, 2005 to shareholders of record of the Company's common stock at the close of business on August 4, 2005. The Company issued approximately 10.8 million shares of common stock as a result of the stock split. The share and per share information included in these condensed consolidated financial statements have been restated to reflect the stock split for all periods presented.

**Recent Accounting Standards:** In November 2004, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards No. 151 *"Inventory Costs, an Amendment of ARB No. 43, Chapter 4"* ("SFAS 151"). SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material and requires that these items be recognized as current period charges. SFAS 151 applies only to inventory costs incurred during periods beginning after the effective date and also requires that the allocation of fixed production overhead to conversion costs be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS 151 is not expected to have a material impact on the Company's financial position or results of operations.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004) *"Share-Based Payment"* ("SFAS 123(R)"), which is a revision of Statement of Financial Accounting Standards No. 123, *"Accounting for Stock-Based Compensation"* ("SFAS 123") and is effective for reporting periods beginning after June 15, 2005. On April 14, 2005, the SEC announced the effective date of SFAS 123(R) was deferred until the beginning of the next fiscal year after June 15, 2005. SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25, *"Accounting for Stock Issued to Employees,"* and amends Statement of Financial Accounting Standards No. 95, *"Statement of Cash Flows"*. SFAS 123(R) requires an entity to recognize compensation expense in an amount equal to the fair value of share-based payments granted to employees, as opposed to merely disclosing what the expense would have been if recognized. The Company expects to adopt SFAS 123(R) in the first quarter of 2006.

In March 2005, the FASB issued FASB Interpretation No. 47, *"Accounting for Conditional Asset Retirement Obligations"* ("FIN 47"). FIN 47 clarifies the term "conditional asset retirement obligation" as used in Statement of Financial Accounting Standards No. 143, *"Accounting for Asset Retirement Obligations."* Conditional asset retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. The adoption is not expected to have a material effect on the Company's financial position or results of operations.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections—a Replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS 154"). SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle and corrections of errors. SFAS 154 is effective for fiscal years beginning after December 15, 2005.

## 2. Stock-Based Compensation

The Company accounts for stock-based compensation using the intrinsic value method, prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations. No stock-based employee compensation cost related to stock options is reflected in net income, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. Net income, as reported, does include the compensation expense related to performance shares, stock appreciation rights and non-vested stock granted to members of senior management. Compensation expense for the performance shares and stock appreciation rights, recognized ratably over the performance period, is primarily based on the anticipated number of shares of the Company's common stock and the related market value to be awarded at the end of the performance period. Compensation expense for the shares of stock granted is being recognized ratably over the vesting period and is based on the market value at the date of grant.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 for the grant of stock-based compensation (in thousands, except per share amounts).

|   | Thirteen Weeks Ended |                  | Thirty-nine Weeks Ended |                  |
|---|----------------------|------------------|-------------------------|------------------|
|   | October 29, 2005     | October 30, 2004 | October 29, 2005        | October 30, 2004 |
| Net income, as reported   | \$ 9,146             | \$ 8,900         | \$ 36,181               | \$ 32,778        |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects                                  | 154                  | 56               | 373                     | 128              |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (636)                | (778)            | (1,880)                 | (2,148)          |
| Pro forma net income  | <u>\$ 8,664</u>      | <u>\$ 8,178</u>  | <u>\$ 34,674</u>        | <u>\$ 30,758</u> |
| Earnings per share:   |                      |                  |                         |                  |
| Basic - as reported   | \$ 0.34              | \$ 0.33          | \$ 1.33                 | \$ 1.19          |
| Basic - pro forma   | 0.32                 | 0.31             | 1.27                    | 1.12             |
| Diluted - as reported   | \$ 0.31              | \$ 0.30          | \$ 1.22                 | \$ 1.09          |
| Diluted - pro forma   | 0.29                 | 0.28             | 1.17                    | 1.02             |

The following table provides the significant weighted average assumptions used in the determination of the estimated fair value under the Black-Scholes option-pricing model of grants through the third quarter of the current and prior year.

|                          | Thirty-nine Weeks Ended |                  |
|--------------------------|-------------------------|------------------|
|                          | October 29, 2005        | October 30, 2004 |
| Expected volatility      | 33.1%-33.9%             | 27.8%-36.0%      |
| Risk free rate           | 3.7%-4.2%               | 1.9%-3.6%        |
| Expected life (in years) | 4.0                     | 3.0-4.0          |
| Expected dividend yield  | 0.0%-0.3%               | 0%               |



### 3. Sale of Peebles' Private Label Credit Card Program

On November 4, 2003, the Company acquired Peebles Inc. ("Peebles"), a privately held, similarly focused retail company headquartered in South Hill, Virginia, which then operated 136 stores in 17 Mid-Atlantic, Southeastern and Midwestern states under the Peebles name. With this acquisition, the Company also acquired Peebles' private label credit card portfolio. On March 5, 2004, the Company sold this private label credit card portfolio to World Financial Network National Bank (the "Bank"). At closing, the Company received consideration of approximately \$34.8 million, which approximated the amount of account balances outstanding at the time of closing. Under the terms of the Amended and Restated Program Agreement dated March 5, 2004, the Company is obligated to reimburse the Bank up to a total of \$3.5 million, based on the non-attainment of a defined net yield for the Peebles portfolio during the first three years after the sale (the "measurement period"), with a calculation of the cumulative amount due related to this obligation on each of the first three anniversary dates of the agreement. At the time of the sale, a liability of \$3.5 million was recorded for this estimated obligation. The Company paid the Bank approximately \$0.5 million on the initial anniversary date after the sale, which reduced the recorded liability to \$3.0 million, as a result of the actual net portfolio yield falling below the defined net portfolio yield during the initial year of the measurement period. Based on the improving trend in the actual net portfolio yield in the first and second quarters of 2005, the Company estimated that the total amount to be paid under the obligation could range from a refund of the approximately \$0.5 million paid to the Bank on the initial anniversary date to a \$2.3 million payment. To reduce the recorded liability to the \$2.3 million estimate at July 30, 2005, the Company recorded a benefit of \$0.7 million in the twenty-six weeks ended July 30, 2005. However, based on the further improvement in the current trend of the defined portfolio yield in the third quarter of 2005, the Company now anticipates that no additional amounts will be due and the approximately \$0.5 million already paid to the Bank may be recovered after the second anniversary date reconciliation. Accordingly, the Company recorded a benefit of \$2.3 million in the thirteen weeks ended October 29, 2005 to reverse the remaining recorded liability. The total benefit recognized in the thirty-nine weeks ended October 29, 2005 was \$3.0 million.

### 4. Debt Obligations

Debt obligations consist of the following (in thousands):

|   | <u>October 29, 2005</u> | <u>January 29, 2005</u> |
|---|-------------------------|-------------------------|
| Revolving Credit Facility                 | \$ 73,462               | \$ -                    |
| Capital and finance lease obligations     | <u>3,070</u>            | <u>3,178</u>            |
| Subtotal                                  | 76,532                  | 3,178                   |
| Less: Current portion of debt obligations | <u>72</u>               | <u>130</u>              |
| Total                                     | <u>\$ 76,460</u>        | <u>\$ 3,048</u>         |

The Company has a senior secured revolving credit facility (the "Revolving Credit Facility"), which matures on August 21, 2008, that provides for borrowings up to a maximum of \$250.0 million. Borrowings under the Revolving Credit Facility are limited to the availability under a borrowing base that is determined principally on eligible inventory as defined by the Revolving Credit Facility agreement. The daily interest rates under the Revolving Credit Facility are equal to the applicable prime rate or Eurodollar rate plus an applicable margin as set forth in the Revolving Credit Facility agreement. Inventory and cash and cash equivalents are pledged as collateral under the Revolving Credit Facility. The Revolving Credit Facility is used by the Company to provide financing for working capital, capital expenditures, interest payments and other general corporate purposes, as well as to support its outstanding letters of credit requirements. The outstanding borrowings at October 29, 2005 were \$73.5 million. Excess borrowing availability under the Revolving Credit Facility at October 29, 2005, net of letters of credit outstanding of \$23.1 million, was \$153.4 million. During the first nine months of 2005, the weighted average interest rate on outstanding borrowings, and the average daily borrowings under the Revolving Credit Facility were 5.4% and \$11.3 million, respectively.

The Revolving Credit Facility contains covenants which, among other things, restrict (i) the amount of additional debt or capital lease obligations, (ii) the amount of capital expenditures, payment of dividends and repurchase of common stock under certain circumstances, and (iii) related party transactions. At October 29, 2005, the Company was in compliance with all of the debt covenants of the Revolving Credit Facility.

While infrequent in occurrence, the Company is occasionally responsible for the construction of leased stores and for paying project costs. Emerging Issues Task Force ("EITF") Issue 97-10, *The Effect of Lessee Involvement in Asset Construction*, requires the Company to be considered the owner (for accounting purposes) of this type of project during the construction period.

Such leases are accounted for as finance lease obligations with the amounts received from the landlord being recorded in debt obligations. Interest expense is recognized at a rate that will amortize the finance lease obligations over the initial term of the lease. As a result, the Company has recorded approximately \$3.1 million as finance lease obligations on its Unaudited Condensed Consolidated Balance Sheet as of October 29, 2005, with interest rates ranging from 12.3% to 16.9% related to two store leases where EITF 97-10 was applicable.

## 5. Income Taxes

The provision for income taxes is computed based on the pretax income included in the Unaudited Condensed Consolidated Statements of Income. The asset and liability approach is used to recognize deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts for financial reporting purposes and the tax basis of assets and liabilities. The classification of the tax provision between current and deferred taxes on the interim period financials is based on the expected relationship of these classifications on the tax provision for the full fiscal year.

## 6. Earnings per Share

Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares and all of the potentially dilutive common share equivalents outstanding during the period.

The following table illustrates the components used to determine total diluted shares (shares in thousands):

|   | Thirteen weeks ended |                  | Thirty-nine Weeks Ended |                  |
|---|----------------------|------------------|-------------------------|------------------|
|   | October 29, 2005     | October 30, 2004 | October 29, 2005        | October 30, 2004 |
| Basic weighted average shares outstanding   | 27,030               | 26,794           | 27,240                  | 27,491           |
| Effect of dilutive securities:              |                      |                  |                         |                  |
| Stock options                               | 1,137                | 1,336            | 1,126                   | 1,407            |
| Warrants                                    | 1,320                | 1,101            | 1,307                   | 1,170            |
| Non-vested stock grant                      | 15                   | 15               | 15                      | 4                |
| Diluted weighted average shares outstanding | <u>29,502</u>        | <u>29,246</u>    | <u>29,688</u>           | <u>30,072</u>    |
| Weighted average market price               | \$27.45              | \$22.79          | \$27.14                 | \$24.07          |

The following table illustrates the number of stock options that were outstanding but not included in the computation of diluted weighted average shares outstanding because the exercise price of the stock options was greater than the weighted average market price of the Company's common stock for each applicable period (in thousands):

|   | Thirteen weeks ended |                  | Thirty-nine Weeks Ended |                  |
|---|----------------------|------------------|-------------------------|------------------|
|   | October 29, 2005     | October 30, 2004 | October 29, 2005        | October 30, 2004 |
| Number of anti-dilutive options outstanding | <u>237</u>           | <u>468</u>       | <u>238</u>              | <u>308</u>       |

## 7. Stock Repurchase Program

On October 1, 2003, the Company's Board of Directors approved a stock repurchase program (the "2003 Stock Repurchase Program") authorizing the Company to repurchase up to \$50.0 million of its outstanding common stock. On July 5, 2005, the Company's Board of Directors approved an additional stock repurchase program (the "2005 Stock Repurchase Program") authorizing the Company to repurchase up to \$30.0 million of its outstanding common stock, specifically intended to help mitigate the dilutive impact on earnings per share that is expected to occur from the future exercise of the Company's Series A and B warrants prior to their expiration on August 23, 2006. Additional amounts of outstanding common stock could be repurchased under these programs using proceeds of the exercise of employee stock options.

During 2004, the Company repurchased approximately 2,502,000 shares of its common stock at a cost of \$61.7 million, funded by the completion of the \$50.0 million portion of the 2003 Stock Repurchase Program plus proceeds from the exercise of employee stock options. During the thirty-nine weeks ended October 29, 2005, the Company repurchased approximately 1,823,000 shares of its common stock at a cost of approximately \$48.7 million, which included the completion of the \$30.0 million portion of the 2005 Stock Repurchase Program and \$18.7 million funded using the proceeds from the exercise of employee stock options. At October 29, 2005, approximately \$2.9 million was available to the Company for stock repurchases from the proceeds of employee stock option exercises.

**8. Retirement Plans**

The Company sponsors two defined benefit plans. One was frozen effective June 30, 1998, and the other was closed to new participants at February 1, 1998 (the "Retirement Plans"). Information regarding the Retirement Plans is as follows (in thousands):

*Components of Net Periodic Pension Costs*

|                                | Thirteen Weeks Ended |                  | Thirty-nine Weeks Ended |                  |
|--------------------------------|----------------------|------------------|-------------------------|------------------|
|                                | October 29, 2005     | October 30, 2004 | October 29, 2005        | October 30, 2004 |
| Service cost                   | \$ 12                | \$ 14            | \$ 36                   | \$ 42            |
| Interest cost                  | 523                  | 557              | 1,568                   | 1,671            |
| Expected return on plan assets | (520)                | (550)            | (1,560)                 | (1,650)          |
| Net loss amortization          | 7                    | -                | 21                      | -                |
| Net periodic pension cost      | \$ 22                | \$ 21            | \$ 65                   | \$ 63            |

*Employer Contribution*

During the thirty-nine weeks ended October 29, 2005, the Company contributed \$1.4 million to the Retirement Plans.

**9. Cash Dividends**

On August 23, 2005, the Company declared a quarterly cash dividend of \$0.025 per share of common stock, which was paid on September 21, 2005 to shareholders of record on September 6, 2005. The total dividend payment was \$0.7 million.

On November 30, 2005, the Company declared a quarterly cash dividend of \$0.025 per share of common stock, which will be paid on December 28, 2005 to shareholders of record on December 13, 2005. The total dividend payment is expected to be approximately \$0.7 million.

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

**Forward Looking Statements**

Certain statements in this Form 10-Q contain or may contain forward-looking statements that are subject to known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These forward-looking statements were based on various factors and were derived utilizing numerous assumptions and other factors that could cause actual results to differ materially from those in the forward-looking statements. These factors include, but are not limited to, the ability of the Company and its subsidiaries to maintain normal trade terms with vendors, the ability of the Company and its subsidiaries to comply with the various covenant requirements contained in the Company's Revolving Credit Facility (as defined below), the demand for apparel and other factors. The demand for apparel and sales volume can be affected by significant changes in economic conditions, including an economic downturn, employment levels in our markets, consumer confidence, energy and gasoline prices and other factors influencing discretionary consumer spending. Other factors affecting the demand for apparel and sales volume include unusual weather patterns, an increase in the level of competition in the Company's market areas, competitors' marketing strategies, changes in fashion trends, changes in the average cost of merchandise purchased for resale, availability of product on normal payment terms and the failure to achieve the expected

results of the Company's merchandising and marketing plans as well as its store opening plans. The occurrence of any of the above could have a material and adverse impact on the Company's operating results. Most of these factors are difficult to predict accurately and are generally beyond the Company's control. Readers should consider the areas of risk described in the Company's Annual Report on Form 10-K for the year ended January 29, 2005 (the "Form 10-K"). Readers should carefully review the Form 10-K in its entirety including, but not limited to, the Company's financial statements and the notes thereto and the risks described under "Risk Factors" in Item 1 of the Form 10-K. Except for the Company's ongoing obligations to disclose material information under the federal securities laws, the Company undertakes no obligation to release publicly any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events. For any forward-looking statements contained in any document, the Company claims the protection of the safe harbor provisions for forward-looking statements as contained in the Private Securities Litigation Reform Act of 1995.

## General

Stage Stores is a Houston, Texas-based regional, specialty department store retailer offering moderately priced, nationally recognized brand name and private label apparel, accessories, cosmetics and footwear for the entire family. As of October 29, 2005, the Company operated 548 stores located in 31 states. The Company operates under the Stage, Bealls and Palais Royal names throughout the South Central states, and under the Peebles name throughout the Mid-Atlantic, Southeastern and Midwestern states. The Company's principal focus is on consumers in small and mid-size markets which the Company believes are under-served and less competitive. The Company believes that it is able to differentiate itself from the competition in the small and mid-size markets in which it operates by offering consumers access to basic as well as fashionable, brand name merchandise not typically carried by other retailers in the same market area. In the highly competitive metropolitan markets in which it operates, the Company competes against national department store chains, which similarly offer moderately priced, brand name and private label merchandise. As a way of differentiating itself from the competition in these larger markets, the Company endeavors to offer consumers a high level of customer service in convenient locations.

The financial information, discussion and analysis that follow should be read in conjunction with the Company's Consolidated Financial Statements as included in the 2004 Form 10-K for the year ended January 29, 2005.

## Results of Operations

The following table sets forth the results of operations as a percent of sales for the periods indicated:

|   | <u>Thirteen Weeks Ended</u> |                       | <u>Thirty-nine weeks ended</u> |                         |
|---|-----------------------------|-----------------------|--------------------------------|-------------------------|
|   | <u>10/29/2005 (1)</u>       | <u>10/30/2004 (1)</u> | <u>10/29/2005 (1)</u>          | <u>October 30, 2004</u> |
| Net sales   | 100.0 %                     | 100.0 %               | 100.0 %                        | 100.0 %                 |
| Cost of sales and related buying, occupancy and distribution expenses | <u>70.4</u>                 | <u>70.5</u>           | <u>70.0</u>                    | <u>70.4</u>             |
| Gross profit  | 29.6                        | 29.5                  | 30.0                           | 29.6                    |
| Selling, general and administrative expenses                          | 24.2                        | 23.9                  | 23.2                           | 23.1                    |
| Store pre-opening costs   | 0.4                         | 0.4                   | 0.3                            | 0.2                     |
| Interest, net   | <u>0.3</u>                  | <u>0.3</u>            | <u>0.2</u>                     | <u>0.2</u>              |
| Income before income tax  | 4.7                         | 5.0                   | 6.2                            | 6.1                     |
| Income tax expense  | <u>1.8</u>                  | <u>1.8</u>            | <u>2.3</u>                     | <u>2.3</u>              |
| Net income  | <u><u>3.0 %</u></u>         | <u><u>3.1 %</u></u>   | <u><u>3.9 %</u></u>            | <u><u>3.8 %</u></u>     |

(1) Percentages may not foot due to rounding.

**Thirteen Weeks Ended October 29, 2005 Compared to Thirteen Weeks Ended October 30, 2004**

Sales for the thirteen weeks ended October 29, 2005 (the “current year third quarter”) increased 7.3% to \$306.0 million from \$285.3 million for the thirteen weeks ended October 30, 2004 (the “prior year third quarter”). Comparable store sales, which are sales in stores open at least fourteen months prior to the reporting period, increased 3.9% as compared to a 4.3% increase in the prior year third quarter. The increase in total sales primarily reflects the beneficial impact of the comparable store sales increase as well as revenue generated by the 26 net new stores opened since the end of the prior year third quarter. In the current year third quarter, the Company’s sales in its Gulf Coast region stores were negatively impacted during the periods of time that hurricanes Katrina and Rita were making landfall, which was primarily in September. During October, the Company experienced a significant sales rebound in the market areas that were most impacted by the storms, as those affected by the storms began to replenish their wardrobes.

The Company achieved comparable store sales increases during the current year third quarter in almost all of its key merchandise categories (i.e., those categories comprising greater than 5% of sales). Special sizes, accessories and misses sportswear categories achieved the most significant increases in comparable store sales. On a market population basis, utilizing a ten mile radius from each store, the Company achieved overall comparable store sales increases during the current year third quarter of 4.6%, 4.5% and 1.7% in its small (less than 50,000 people), mid-size (50,000 to 150,000 people) and large markets (greater than 150,000 people) store groups, respectively.

Gross profit increased 7.8% to \$90.7 million for the current year third quarter from \$84.1 million for the prior year third quarter. Gross profit, as a percent of sales, was 29.6% in the current year third quarter as compared to 29.5% in the prior year third quarter. The increase in the gross profit rate in the current year third quarter was due to improved merchandise margins, as the buying, store occupancy and distribution expenses were flat with the prior year third quarter. Reductions in buying, store occupancy and distribution expenses, as a rate of sales, achieved during the current year third quarter from productivity improvements and improved leverage in distribution expenses from higher sales were offset by increased depreciation expense. The following is a summary of the changes between the current year third quarter and the prior year third quarter in the components of cost of sales, expressed as a percent of sales:

| <u>Cost Component</u>  | <u>Decrease<br/>Quarter 3, 2005</u> |
|--|-------------------------------------|
| Merchandise cost of sales  | (0.1) %                             |
| Buying, occupancy, and distribution expenses                                 | -                                   |
| Total cost of sales and related buying, occupancy, and distribution expenses | <u>(0.1) %</u>                      |

Selling, general and administrative (“SG&A”) expenses for the current year third quarter increased \$5.7 million or 8.4% to \$73.9 million from \$68.2 million in the prior year third quarter. As a percent of sales, SG&A expenses increased to 24.2% from 23.9% in the comparable period last year. The overall increase in SG&A expenses from the prior year third quarter included the impact of higher sales and increased store count on store operating expenses. However, as a rate of sales, store expenses decreased 20 basis points as a result of efficiencies in store payroll expenses during the current year third quarter which were partially offset by increases in other store expenses including higher utility costs. The increase in SG&A expenses for the current year third quarter also included charges of \$2.3 million due under employment agreements for payments associated with the continuing consolidation of the Peebles management and operational functions, an increase of \$1.6 million in incentive compensation which reflects current year third quarter operating results as compared to the Company’s targeted operating results and a \$0.8 million increase in required reserves for workers compensation and general liability claims due to unfavorable claims development, principally related to Peebles’ trucking operations which were outsourced in the second quarter of the current fiscal year. These increases in expenses were somewhat offset by a \$2.3 million reduction in the previously recorded liability associated with the sale of the Peebles portfolio in March 2004 (see Liquidity and Capital Resources) as well as \$0.8 million in reductions to expense associated with the program agreement with World Financial Network National Bank (the “Bank”) related to the premiums received on private label credit card sales in the current year third quarter. Beginning in October 1, 2004, under terms of the program agreement with the Bank, the Company receives a premium or pays a discount on sales generated using the private label credit card, based on the portfolio performance.

Store pre-opening costs include costs related to stores opened during the quarter as well as costs associated with stores that are scheduled to be opened or relocated in subsequent months. Store pre-opening costs in the current year third quarter of \$1.3 million included costs related to eleven new stores opened and six stores relocated. During the prior year third quarter, the Company incurred \$1.1 million in store pre-opening costs. There were seven store openings and four relocations in the prior year third quarter.

Net interest expense was \$1.0 million in the third quarter of 2005 compared to \$0.8 million during the same period in 2004. Interest expense is principally comprised of interest on borrowings under the Company’s senior secured revolving credit facility (the “Revolving Credit Facility”), related letters of credit and commitment fees and amortization of debt issue costs.

The Company’s effective tax rate in 2005 is estimated to be 37%, resulting in income tax expense of \$5.4 million in the current year third quarter. This compares to income tax expense of \$5.2 million in the prior year third quarter during which its effective tax rate was 37%.

As a result of the foregoing, the Company had net income of \$9.1 million for the current year third quarter as compared to net income of \$8.9 million for the prior year third quarter, which represents an increase of 2.2%.

***Thirty-nine Weeks Ended October 29, 2005 Compared to Thirty-nine Weeks Ended October 30, 2004***

Sales for the thirty-nine weeks ended October 29, 2005 (the “current year”) increased 8.3% to \$925.5 million from \$854.8 million for the thirty-nine weeks ended October 30, 2004 (the “prior year”). Comparable store sales increased 5.3% in the current year as compared to a 1.8% increase in the prior year. The increase in total sales primarily reflects the beneficial impact of the comparable store sales increase as well as the sales generated by the 26 net new stores opened since the end of the prior year third quarter.

For the current year, the Company achieved the largest comparable store sales increases in its special sizes, accessories, misses sportswear, men’s, young men’s and shoes departments. On a market population basis, the Company achieved overall comparable store sales increases during the current year of 5.9%, 5.1% and 3.9% in its small, mid-size and large markets store groups, respectively.

Gross profit increased 9.6% to \$277.6 million for the current year from \$253.3 million for the prior year. Gross profit, as a percent of sales, was 30.0% in the current year as compared to 29.6% in the prior year. The increase in the gross profit rate was due to (i) improved merchandise margins and (ii) improvement in the buying, store occupancy and distribution expenses. The decrease in buying, store occupancy and distribution expenses, as a rate of sales, was principally due to productivity improvements in distribution expenses as well as improved leverage in distribution and store occupancy expenses from higher sales. These improvements were somewhat offset by higher depreciation expense. The following is a summary of the changes between the current year and the prior year in the components of cost of sales, expressed as a percent of sales:

| <u>Cost Component</u>  | <u>Decrease YTD<br/>2005</u> |
|--|------------------------------|
| Merchandise cost of sales  | (0.2) %                      |
| Buying, occupancy and distribution expenses                                  | <u>(0.2)</u>                 |
| Total cost of sales and related buying, occupancy, and distribution expenses | <u><u>(0.4) %</u></u>        |

Selling, general and administrative (“SG&A”) expenses for the current year increased \$17.3 million, or 8.8%, to \$215.1 million from \$197.8 in the prior year and, as a percent of sales, increased to 23.2% from 23.1% in the comparable period last year. SG&A expenses for the current year increased from the prior year primarily as a result of the higher sales, increases in the number of stores in operation in the current year, and increased advertising costs. However, as a rate of sales, store expenses decreased 40 basis points as a result of efficiencies in store payroll expenses during the current year. The increase in SG&A expenses for the current year included charges of \$2.3 million due under employment agreements for payments associated with the continuing consolidation of the Peebles management and operational functions. SG&A also included an increase of \$4.1 million in incentive compensation over the prior year. The increase in incentive compensation is reflective of the operating results in each year as compared to the Company’s targeted operating results for each of the respective years. These increases in expenses were somewhat offset by a \$3.0 million reduction in the previously recorded liability associated with the sale of the

Peebles portfolio in March 2004 (see Liquidity and Capital Resources) as well as \$3.2 million in reductions to expense associated with the program agreement with the Bank related to the premiums received on private label credit card sales in the current year third quarter. Beginning in October 1, 2004, under terms of the program agreement with the Bank, the Company receives a premium or pays a discount on sales generated by customers using the private label credit card, based on the portfolio performance.

Store pre-opening costs include costs associated with stores opened during the period as well as with stores that are scheduled to be opened or relocated in subsequent months. Store pre-opening costs in the current year of \$3.0 million included costs related to the 28 new stores opened and thirteen stores relocated during the current year as compared to \$1.6 million incurred in the prior year related to the thirteen new stores opened and four stores relocated.

Net interest expense was \$2.1 million for the current year compared to \$1.8 million in the prior year.

The Company's effective tax rate in 2005 is estimated to be 37%, resulting in income tax expense of \$21.2 million in the current year, as compared to income tax expense of \$19.3 million in the prior year, during which its effective tax rate was 37.0%.

As a result of the foregoing, the Company had net income of \$36.2 million for the current year as compared to net income of \$32.8 million for the prior year, which represents an increase of 10.4%.

### **Seasonality and Inflation**

Historically, the Company's business is seasonal and quarterly sales are traditionally lower during the first three quarters of the year (February through October) and higher during the last quarter of the year (November through January). The fourth quarter typically accounts for slightly more than 30% of the Company's annual sales, with the other quarters accounting for approximately 22% to 24% each. Working capital requirements fluctuate during the year and generally reach their highest levels during the third and fourth quarters. The Company does not believe that inflation had a material effect on its results of operations during the thirteen and thirty-nine weeks ended October 29, 2005 and October 30, 2004. However, there can be no assurance that the Company's business will not be affected by inflation in the future.

### **Liquidity and Capital Resources**

The Company's liquidity is currently provided by (i) existing cash balances, (ii) operating cash flows, (iii) normal trade credit terms from the vendor and factor community, and (iv) its Revolving Credit Facility.

On November 4, 2003, the Company acquired Peebles Inc. ("Peebles"), a privately held, similarly focused retail company headquartered in South Hill, Virginia, which then operated 136 stores in 17 Mid-Atlantic, Southeastern and Midwestern states under the Peebles name. With this acquisition, the Company also acquired Peebles' private label credit card portfolio. On March 5, 2004, the Company sold this private label credit card portfolio to World Financial Network National Bank (the "Bank"). At closing, the Company received consideration of approximately \$34.8 million, which approximated the amount of account balances outstanding at the time of closing. Under the terms of the Amended and Restated Program Agreement dated March 5, 2004, the Company is obligated to reimburse the Bank up to a total of \$3.5 million, based on the non-attainment of a defined net yield for the Peebles portfolio during the first three years after the sale (the "measurement period"), with a calculation of the cumulative amount due related to this obligation on each of the first three anniversary dates of the agreement. At the time of the sale, a liability of \$3.5 million was recorded for this estimated obligation. The Company paid the Bank approximately \$0.5 million on the initial anniversary date after the sale, which reduced the recorded liability to \$3.0 million, as a result of the actual net portfolio yield falling below the defined net portfolio yield during the initial year of the measurement period. Based on the improving trend in the actual net portfolio yield in the first and second quarters of 2005, the Company estimated that the total amount to be paid under the obligation could range from a refund of the approximately \$0.5 million paid to the Bank on the initial anniversary date to a \$2.3 million payment. To reduce the recorded liability to the \$2.3 million estimate at July 30, 2005, the Company recorded a benefit of \$0.7 million in the twenty-six weeks ended July 30, 2005. However, based on the further improvement in the current trend of the defined portfolio yield in the third quarter of 2005, the Company now anticipates that no additional amounts will be due and the approximately \$0.5 million already paid to the Bank may be recovered after the second anniversary date reconciliation. Accordingly, the Company recorded a benefit of \$2.3 million in the thirteen weeks ended October 29, 2005 to reverse the remaining recorded liability. The total benefit recognized in the thirty-nine weeks ended October 29, 2005 was \$3.0 million.

The Company's Revolving Credit Facility matures on August 21, 2008 and provides for borrowings up to a maximum of \$250.0 million. Borrowings under the Revolving Credit Facility are limited to the availability under a borrowing base that is

determined principally on eligible inventory as defined by the Revolving Credit Facility agreement. The daily interest rates under the Revolving Credit Facility are equal to the applicable prime rate or Eurodollar rate plus an applicable margin as set forth in the Revolving Credit Facility agreement. Inventory and cash and cash equivalents are pledged as collateral under the Revolving Credit Facility. The Revolving Credit Facility is used by the Company to provide financing for working capital, capital expenditures, interest payments and other general corporate purposes, as well as to support its outstanding letters of credit requirements. The outstanding borrowings at October 29, 2005 were \$73.5 million. Excess borrowing availability under the Revolving Credit Facility, net of letters of credit outstanding of \$23.1 million, was \$153.4 million at October 29, 2005. During the third quarter of 2005, the weighted average interest rate on outstanding borrowings and the average daily borrowings under the Revolving Credit Facility were 5.4% and \$11.3 million, respectively.

The Revolving Credit Facility contains covenants which, among other things, restrict (i) the amount of additional debt or capital lease obligations, (ii) the amount of capital expenditures, payment of dividends and repurchase of common stock under certain circumstances, and (iii) related party transactions. The Company continually monitors its liquidity position and compliance with those covenants. At October 29, 2005, the Company was in compliance with all of the debt covenants of the Revolving Credit Facility.

The Company generated \$0.2 million in cash from operating activities in the current year. Net income, adjusted for non-cash expenses such as depreciation and amortization, deferred income taxes, amortization of debt issue costs and deferred stock compensation, provided cash of approximately \$66.0 million. Changes in operating assets and liabilities used net cash of approximately \$75.4 million, which included a \$105.4 million increase in merchandise inventories related to the increased investment to support new store growth and merchandising initiatives, as well as the seasonal build of inventories. Additionally, cash flows from operating activities included the receipt of \$9.6 million of construction allowances from landlords, which funded a portion of the capital expenditures related to store leasehold improvements in new and relocated stores.

Management currently estimates the capital expenditures, net of construction allowances to be received from landlords, in 2005 will be approximately \$65 million. The expenditures will be for the estimated opening of 36 new stores and the remodels and relocations of existing stores. In addition, the Company will be closing and consolidating the operations of the Knoxville, Tennessee distribution center into the South Hill, Virginia distribution center in early 2006. Related to this consolidation, during 2005 the Company is investing in new sortation equipment and adding a new warehouse management system in the South Hill, Virginia, facility to improve its efficiency and productivity. The sortation systems and software being installed are the same as those currently used in the Jacksonville, Texas distribution center. In connection with this consolidation, the Company is in the process of converting the Peebles merchandise management systems from the current "legacy" system to the Retek merchandise management system used in Houston. This project will also be completed in early 2006. Having the same supply chain support systems and merchandising system in place will position the Jacksonville distribution center to eventually service the western Peebles stores, thus providing further capacity for the South Hill distribution center to support new store growth in eastern markets. The Company is also investing in the development and installation of a new merchandise planning system in 2005 which is expected to be completed in the second quarter of 2006. The new system is expected to improve the ability to optimize product assortments on a store-by-store basis. Capital expenditures are also being incurred for general maintenance of the Company's infrastructure.

Year-to-date capital expenditures were \$58.5 million in the current year related to the above projects as compared to \$32.3 million in the prior year. The Company opened 28 new stores and relocated thirteen stores in the current year, as compared to thirteen stores opened and four relocated stores in the same period during the prior year. As noted above, through the third quarter the Company received construction allowances from landlords of \$9.6 million in the current year to fund a portion of the capital expenditures related to store leasehold improvements in new and relocated stores, while \$2.1 million was received from landlords in the prior year. These funds have been recorded as a deferred rent credit in the balance sheet and will be recorded as an offset to rent expense over the lease terms, commencing on the dates the allowances were earned.

On October 1, 2003, the Company's Board of Directors approved a stock repurchase program (the "2003 Stock Repurchase Program") authorizing the Company to repurchase up to \$50.0 million of its outstanding common stock. On July 5, 2005, the Company's Board of Directors approved an additional stock repurchase program (the "2005 Stock Repurchase Program") authorizing the Company to repurchase up to \$30.0 million of its outstanding common stock, specifically intended to help mitigate the dilutive impact on earnings per share that is expected to occur from the future exercise of the Company's Series A and B warrants prior to their expiration on August 23, 2006. Under these programs additional amounts of outstanding common stock could be repurchased using proceeds of the exercise of employee stock options.

During 2004, the Company completed the \$50.0 million portion of the 2003 Stock Repurchase Program. During the thirty-nine weeks ended October 29, 2005, the Company repurchased approximately 1,823,000 shares of its common stock at a



cost of approximately \$48.7 million, which included the completion of the \$30.0 million portion of the 2005 Stock Repurchase Program and \$18.7 million funded using the proceeds from the exercise of employee stock options. At October 29, 2005, approximately \$2.9 million was available to the Company for stock repurchases with proceeds from the exercise of employee stock options.

On August 23, 2005, the Company declared a quarterly cash dividend of \$0.025 per share of common stock, which was paid on September 21, 2005 to shareholders of record on September 6, 2005. The total dividend payment was \$0.7 million.

On November 30, 2005, the Company declared a quarterly cash dividend of \$0.025 per share of common stock, which will be paid on December 28, 2005 to shareholders of record on December 13, 2005. The total dividend payment is expected to be approximately \$0.7 million.

While there can be no assurances, management believes that there should be sufficient liquidity to cover both the Company's short-term and long-term funding needs.

### **Recent Accounting Standards**

Disclosure concerning recent accounting standards is incorporated by reference to Note 1 of the Company's Unaudited Condensed Consolidated Financial Statements contained in this Form 10-Q.

### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Borrowings under the Company's Revolving Credit Facility bear a floating rate of interest. As of October 29, 2005, there were \$73.5 million outstanding borrowings under the Company's Revolving Credit Facility. A hypothetical 10% change in interest rates from the October 29, 2005 levels would have an approximate \$0.4 million effect on the Company's results of operations and cash flows.

### **Item 4. CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures**

As defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act"), the term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

The Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, they concluded that the Company's disclosure controls and procedures were effective as of October 29, 2005.

#### **Internal Control Over Financial Reporting**

As defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act, the term "internal control over financial reporting" means a process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material adverse effect on the financial statements.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. There were no changes in the Company's internal control over financial reporting during the quarter ended October 29, 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS

During the fiscal quarter ended October 29, 2005, the Company did not have any material legal proceedings brought against it, its subsidiaries or their properties.

### Item 1A. RISK FACTORS

There have not been any material changes from the risk factors as previously disclosed in the Form 10-K.

### Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

#### ISSUER PURCHASES OF EQUITY SECURITIES

| Period                                 | Total Number of<br>Shares Purchased | Average Price Paid<br>Per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs (1) | Approximate Dollar<br>Value of Shares that May<br>Yet Be Purchased Under<br>the Plans or Programs (1) |
|--|-------------------------------------|---------------------------------|--|---|
| July 31, 2005 to<br>August 27, 2005    | -                                   | \$ -                            | -  | \$ 35,258,103   |
| August 28, 2005 to<br>October 1, 2005  | 497,740                             | \$ 27.28                        | 497,740  | \$ 22,877,580   |
| October 2, 2005 to<br>October 29, 2005 | 762,809                             | \$ 26.24                        | 762,809  | \$ 2,944,775  |
| Total                                  | <u>1,260,549</u>                    | <u>\$ 26.65</u>                 | <u>1,260,549</u>   |   |

- (1) On July 5, 2005, the Company's Board of Directors approved a stock repurchase program (the "2005 Stock Repurchase Program") authorizing the Company to repurchase up to \$30.0 million of its outstanding common stock, specifically intended to help mitigate the dilutive impact on earnings per share that is expected to occur from the future exercise of

the Company's Series A and B warrants prior to their expiration on August 23, 2006. Under this program additional amounts of outstanding common stock could be repurchased using proceeds of the exercise of employee stock options. During the third quarter 2005, as reflected above, the Company repurchased approximately 1,261,000 shares of its common stock at a cost of approximately \$33.6 million, which included the completion of the \$30.0 million portion of the 2005 Stock Repurchase Program and \$3.6 million funded using the proceeds from the exercise of employee stock options. At October 29, 2005, approximately \$2.9 million was available to the Company for stock repurchases with proceeds from the exercise of employee stock options.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**Item 5. OTHER INFORMATION**

None.

**Item 6. EXHIBITS**

The following documents are the exhibits to this Form 10-Q. For convenient reference, each exhibit is listed according to the Exhibit Table of Item 601 of Regulation S-K.

| <b><u>Exhibit<br/>Number</u></b> | <b><u>Description</u></b>   |
|----------------------------------|---|
| 31.1*                            | Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended. |
| 31.2*                            | Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended. |
| 32*                              | Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.                                 |

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\* Filed electronically herewith

## SIGNATURES

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

### STAGE STORES, INC.

December 8, 2005  
(Date)

/s/ James R. Scarborough  
James R. Scarborough  
Chief Executive Officer and President  
(Principal Executive Officer)

December 8, 2005  
(Date)

/s/ Michael E. McCreery  
Michael E. McCreery  
Executive Vice President, Chief Financial  
Officer and Corporate Secretary  
(Principal Financial and Accounting Officer)