

CHILDRENS PLACE RETAIL STORES INC

Form 10-Q

December 05, 2007

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 July 29, 2006

**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 0-23071

THE CHILDREN S PLACE RETAIL STORES, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: CHILDRENS PLACE RETAIL STORES INC - Form 10-Q

Delaware

(State or other jurisdiction of
Incorporation or organization)

31-1241495

(I.R.S. employer
identification number)

915 Secaucus Road

Secaucus, New Jersey
(Address of Principal Executive Offices)

07094

(Zip Code)

(201) 558-2400

(Registrant's Telephone Number, Including Area Code)

Edgar Filing: CHILDRENS PLACE RETAIL STORES INC - Form 10-Q

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 an accelerated filer and large accelerated filer 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 Exchange Act).

Yes No

The number of shares outstanding of the registrant's common stock with a par value of \$0.10 per share, as of October 6, 2007 was 29,083,916 shares.

THE CHILDREN S PLACE RETAIL STORES, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE PERIOD ENDED JULY 29, 2006

TABLE OF CONTENTS

EXPLANATORY NOTE

PART I FINANCIAL INFORMATION

<u>Item 1.</u>	<u>Condensed Consolidated Financial Statements (Unaudited):</u> <u>Condensed Consolidated Balance Sheets</u> <u>Condensed Consolidated Statements of Income</u> <u>Condensed Consolidated Statements of Cash Flows</u> <u>Notes to Condensed Consolidated Financial Statements</u>
<u>Item 2.</u>	<u>Management s Discussion and Analysis of Financial Condition and Results of Operations</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>

PART II OTHER INFORMATION

<u>Item 1.</u>	<u>Legal Proceedings</u>
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>
<u>Item 6.</u>	<u>Exhibits</u>
<u>Signatures</u>	

EXPLANATORY NOTE

Edgar Filing: CHILDRENS PLACE RETAIL STORES INC - Form 10-Q

The Children's Place Retail Stores, Inc. (the Company) is restating its condensed consolidated financial statements to reflect additional stock-based compensation expense relating to stock option grants made in each year from the fiscal year ended January 31, 1998 (fiscal 1997) through the first quarter of fiscal year ended February 3, 2007 (fiscal 2006). The Company also is restating its financial statements for all periods beginning with the fiscal year ended February 2, 2002 (fiscal 2001) through the first quarter of fiscal 2006 to reflect the correction of other errors related to personal property taxes and certain accrual accounts and reserves, including those related to occupancy costs for the Company's 52- and 53-week fiscal years. This Quarterly Report on Form 10-Q for the thirteen and twenty-six weeks ended July 29, 2006 reflects the restatement of the Company's consolidated balance sheets as of January 28, 2006 (fiscal 2005) and July 30, 2005, the related consolidated statements of income for the thirteen and twenty-six weeks ended July 30, 2005 and the related consolidated statement of cash flows for the twenty-six weeks ended July 30, 2005. Restated financial information for these periods is set forth in Note 2 Restatement of Consolidated Financial Statements in the unaudited condensed consolidated financial statements included in Item 1 of this report.

The Company has not amended and does not intend to amend its previously filed Annual Report on Form 10-K for fiscal 2005 or any other fiscal year or its previously filed Quarterly Reports on Form 10-Q for the first quarter of fiscal 2006 or the first two quarters of fiscal 2005 or any other fiscal quarter. The financial information that has been previously filed or otherwise reported for these periods is superseded by the information in this Quarterly Report on Form 10-Q and the quarterly and annual reports on Form 10-Q and 10-K, respectively, being filed concurrently with this Quarterly Report on Form 10-Q. Accordingly, as previously stated by the Company, the financial statements and related financial information contained in such previously filed reports should no longer be relied upon.

The aggregate impact of the stock-based compensation adjustments on the Company's consolidated statements of income, net of forfeitures of unvested awards and taxes, between the fiscal year ended January 30, 1999 (fiscal 1998) and the first quarter of fiscal 2006 was a decrease in net income of approximately \$11.2 million. The aggregate impact of the other adjustments unrelated to stock options on the Company's consolidated statements of income, net of taxes, between fiscal 2001 and the first quarter of fiscal 2006 was an increase to net income of approximately \$1.7 million. Additionally, variable rate demand note balances as of April 29, 2006 have been reclassified from cash to short-term investments, and certain other balance sheet amounts have been reclassified. These reclassifications do not result in any additional charges in any period and do not affect working capital for the affected periods.

On September 8, 2006, December 8, 2006, April 5, 2007 and June 15, 2007, the Company filed notifications of late filings with the Securities and Exchange Commission (SEC) on Form 12b-25, disclosing that, due to an ongoing investigation of its stock option granting practices, it was delaying the filing of its Quarterly Reports on Form 10-Q for the second and third quarters of fiscal 2006, its Annual Report on Form 10-K for fiscal 2006, and its Quarterly Report on Form 10-Q for the first quarter of the fiscal year ending February 2, 2008 (fiscal 2007), respectively. In addition, on September 14, 2007, the Company filed another notification of late filing with the SEC on Form 12b-25, disclosing that the Company's Board of Directors (Board) was reviewing circumstances surrounding certain violations of the Company's policies and procedures by two executives of the Company and was considering the appropriate actions to take regarding these matters and, therefore, the Company would be delaying the filing of its Quarterly Report on Form 10-Q for the second quarter of fiscal 2007. The Company is filing its Quarterly Report on Form 10-Q for the third quarter of fiscal 2006 and its Annual Report on Form 10-K for fiscal 2006 with the SEC concurrently with this Quarterly Report on Form 10-Q. The Company intends, in the near future, to file its Quarterly Reports on Form 10-Q for the first and second quarters of fiscal 2007.

Mr. Ezra Dabah resigned from his position as the Company's Chief Executive Officer (CEO), for various reasons, on September 24, 2007. Mr. Dabah remains a member of the Board of Directors (the Board). The Board has named Mr. Charles Crovitz, a current Board member, as interim CEO.

STOCK OPTION INVESTIGATION

Overview of the Investigation

Edgar Filing: CHILDRENS PLACE RETAIL STORES INC - Form 10-Q

In light of various media reports on stock option backdating at public companies and as recommended by the Audit Committee of the Company's Board, the Company undertook a preliminary review of its stock option granting practices starting in June 2006. After considering the results of this preliminary review, on August 24, 2006, the Audit Committee retained the Company's outside counsel (Outside Counsel) to assist it

with a formal review of the Company's stock option grants. On September 6, 2006, Outside Counsel issued to the Audit Committee a preliminary report concluding that there had been errors in the grant dates of options. The report also concluded that, aside from one grant as to which the report was inconclusive, the errors in stock option dating were unintentional. The Company announced the preliminary report and that, pending completion of its analysis of its accounting for stock option grants, the Company was delaying the filing of its Quarterly Report on Form 10-Q for the second quarter of fiscal 2006. The review of the Company's stock option grants continued and expanded into a full investigation. On or about September 14, 2006, the Company suspended all stock-based compensation activity, including granting stock options and other stock-based compensation and issuing shares pursuant to stock option exercises, pending completion of the review and the Company becoming current on its delinquent filings with the SEC.

In October 2006, the Audit Committee retained separate independent counsel that had not previously represented the Company (Independent Counsel) to advise the Audit Committee regarding the matters under investigation and a forensic accounting consulting firm was retained to assist in the investigation. On October 5, 2006, the Company announced that it expected to restate its financial statements and on October 11, 2006, the Company filed with the SEC a Current Report on Form 8-K disclosing that, because of issues with regard to its accounting for stock option grants, the Company's previously issued financial statements and other historical financial information and related disclosures for periods through the first quarter of fiscal 2006 should no longer be relied upon. On November 24, 2006, a two-member special committee of independent members of the Company's Board (Special Committee) was appointed by the Company's Board to supervise and complete the investigation commenced by the Audit Committee. On December 8, 2006 the Company filed a Form 12b-25 with the SEC disclosing that due to the ongoing investigation it was delaying the filing of its Quarterly Report on Form 10-Q for the third quarter of fiscal 2006.

During the period from September 17, 1997 (the day before the Company first became publicly held) through the most recent grant in February 2006 (Review Period), separate option grant authorizing actions were undertaken by the Company on 122 occasions. For convenience of reference, each of these occasions is referred to herein as a Recorded Grant (regardless of the number of people who received an option award on such occasion or any variations in terms of the awards so granted). At the request of Independent Counsel, the forensic accounting firm conducted an empirical assessment of all stock option grants during the Review Period to identify grants that might warrant further investigation. Using various statistical tests, twenty Recorded Grants were selected for detailed investigation, plus one additional Recorded Grant to a family member of the Company's former CEO. Overall, the investigation involved interviews of fourteen people, representing all the individuals involved in any material respect in the option granting process, and the review of tens of thousands of paper and electronic documents from the files (including office and personal computers) of such individuals and others and from other Company files (including e-mails and other documents recovered from the Company's electronic information system). A grant made to the Company's former CEO, Mr. Ezra Dabah, in connection with the Company's initial public offering of its shares (1997 CEO IPO Grant) also was subsequently investigated by Independent Counsel. As noted below, on September 24, 2007, Mr. Dabah resigned from his position as the Company's CEO, and Mr. Charles Crovitz, an independent Board member, was appointed interim CEO.

Findings of the Stock Option Investigation

On January 30, 2007, the Special Committee delivered its written report of investigation including recommendations (Report of Investigation) to the Board. The Board accepted the report and resolved to adopt the Special Committee's recommendations and to take the actions necessary to implement them. Key findings of the Report of Investigation, as disclosed in a Current Report on Form 8-K filed with the SEC on February 1, 2007, included:

There was no conclusive evidence of intentional backdating of options or other misconduct in connection with the option granting process. There was no evidence of intent to mislead about option grant dates or exercise prices.

No member of management and no director engaged in improper self-dealing in connection with the option grants made by the Company.

All Company personnel cooperated fully with the investigation.

The Company did not maintain appropriate governance and other internal controls, which resulted in errors in the dating of options and other irregularities in option grants. In many instances options were dated before all grant-making processes were finalized. Consequently, in such instances the option exercise price was lower than it should have been based on the trading price on the date the grant process was completed and incorrect charges were taken for the options for financial reporting purposes. Also, in a few instances, the Company may have selected grant dates with a view toward upcoming disclosures.

The Report of Investigation further concluded that, apart from some immaterial discrepancies in grants to non-executives representing less than 1.5% of the number of shares subject to options issued over the Review Period, there were no unauthorized grants. This conclusion was based on a comparison by the Company of its grant authorizing documentation to the Company's records of options issued, which correctly reflected the documented and authorized grants in terms of who received option grants and the number of options granted. However, subsequent to the Report of Investigation being issued, it was determined that certain unauthorized actions were taken in May 2004 relating to the 1997 CEO IPO Grant. These actions were ratified by the Board in 2007.

During the Review Period, the Company used the effective date reflected in its grant approval documentation as the grant date and in its accounting for option grants used such date as the measurement date under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). In many instances that date was an as of date on a unanimous written consent (UWC) of the Board or the Compensation Committee. Since the Company believed options were granted with exercise prices that equaled or exceeded their quoted market price at the date of grant, no compensation expense was recorded in the Company's financial statements for options granted prior to its adoption of Statement of Financial Accounting Standards No. 123 (Revised 2004), Accounting for Share-Based Payments (SFAS 123(R)) as of January 29, 2006, other than in connection with the acceleration of the vesting of options in fiscal 2005 and the acceleration of the vesting of options related to a terminated employee. However, the Report of Investigation concluded that, as a result of the inadequacy of the Company's governance, internal financial reporting and other controls over the option grant process, the measurement dates used by the Company for a significant portion of the stock options granted during the Review Period were incorrect, as the recipients of the grants, number of shares subject to the options granted and exercise prices were not approved and established with finality by the date the Company had recorded as the grant date.

The Company used available documentation and guidance set forth by the Office of the Chief Accountant of the SEC on September 19, 2006 (September 2006 OCA Guidance) to determine the revised measurement dates for option grants made during the Review Period. For a discussion of the Company's historical stock option granting process and use of available information to determine the revised measurement dates, refer to Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Restatement of Financial Statements and Note 2 Restatement of Consolidated Financial Statements in the accompanying unaudited condensed consolidated financial statements.

After completion of the Report of Investigation, the Company in reviewing its accounting for options became aware of certain inconsistencies in its records concerning the terms of the options included in the 1997 CEO IPO Grant. Under the direction of the Special Committee, Independent Counsel investigated the Company's treatment of these options and reported thereon to the Special Committee. On April 11, 2007, the Special Committee reported to the Board on the 1997 CEO IPO Grant. Based on the evidence assembled in Independent Counsel's investigation, the Special Committee found that there had been confusion, resulting in inconsistencies in the Company records, in connection with the implementation of the 1997 CEO IPO Grant and over the years with regard to the terms of this grant. In considering the results of the investigation into the 1997 CEO IPO Grant, the Special Committee reconsidered the key findings it had reached in the Report of Investigation, as described above, and concluded that the evidence from the additional investigation did not lead it to different findings. The Board concurred in this conclusion.

Inadequate Internal Controls

The Company is undertaking to remediate the material weakness in internal control over financial reporting related to stock option grants found by the Special Committee, as further discussed in Item 4. Controls and Procedures of this Quarterly Report on Form 10-Q. The Company has continued its suspension of the granting of all stock-based compensation, including the granting of stock options, as well as the exercise of any options, until these improved procedures have been instituted. Furthermore, the suspension of granting and exercise of stock options will continue until the Company becomes current with its SEC filings.

Resolution of Tax Consequences and Corrective Action Related to Discounted Options

Revision to the measurement dates of stock options often resulted in options with exercise prices below the fair market value of the related shares on the revised measurement date (discounted options). Individuals currently holding discounted options may incur an excise tax liability under Section 409A of the Internal Revenue Code of 1986, as amended (the Internal Revenue Code). As recommended by the Special Committee, in order to avoid any benefit from the errors made in dating of options to any person involved in the option granting process and, also, as part of the Company's efforts to address certain tax considerations associated with outstanding options granted with an exercise price below fair market value, the Company has taken the following actions:

The Company and its directors (including Mr. Dabah, its former CEO), its President and its former Chief Administrative Officer have agreed to amend all discounted options held by them (other than those described in the next paragraph) to increase the exercise price to the average of the high and low trading price on the date determined by the Company to be the revised measurement date applicable to the option grant to be used for financial reporting purposes. In the few instances where these individuals have exercised options as to which a revised measurement date has been determined by the Company, the individuals have agreed to return to the Company the difference between the exercise price and the trading price on the revised measurement date.

In the three instances where the Report of Investigation found that non-executive directors received options shortly before the public disclosure of positive information, the Company and these directors have further agreed to amend such options to increase the exercise price to the average of the high and low trading price over the balance of the calendar year following the recorded date of the grant.

With respect to all other option grants, the Company has decided to honor the options as issued, consistent with the Special Committee's finding of no intentional misconduct on the part of management in the option granting process. Nevertheless, the Company and all members of senior management holding outstanding options have agreed to amend their outstanding discounted options that vested after 2004 either to increase the exercise price to the average of the high and low trading price on the date determined by the Company to be the revised measurement date or to limit the exercise period of their options.

In addition, with respect to holders of discounted options that vested after 2004 who are employees at the time, other than members of senior management who have already agreed to amend their outstanding discounted options, the Company plans to offer as soon as practicable the opportunity to exchange their discounted options for options with the same terms except that the exercise price will be changed to the average of the high and low trading price on the revised measurement date. Option holders who agree to such amendment will receive a cash bonus in the amount of the increase in the exercise price.

The foregoing actions are expected to bring all outstanding options held by employees and non-employee directors into compliance with pertinent requirements relating to discounted options so that the 20% excise tax under Section 409A of the Internal Revenue Code does not apply to the options. To the extent such discounted options were exercised during fiscal 2006, the Company expects to bear the liability for, and has accrued during fiscal 2006, an amount estimated to equal the potential 20% excise tax under Section 409A that would be incurred by the recipient in connection with such option if such tax is applicable, and any related income tax liability that would be incurred by the recipient in respect of receiving from the Company such amount, if any.

OTHER ADJUSTMENTS

Edgar Filing: CHILDRENS PLACE RETAIL STORES INC - Form 10-Q

As previously mentioned in the Explanatory Note in this Quarterly Report on Form 10-Q, in addition to the adjustments related to the stock option investigation, the restated condensed consolidated financial statements presented herein include other adjustments related to personal property taxes and certain accrual accounts and reserves, including those related to occupancy costs for the Company's 52- and 53-week fiscal years. The aggregate impact of these adjustments on the Company's consolidated statements of income, net of taxes, between fiscal 2001 and the first quarter of fiscal 2006 was an increase to net income of approximately \$1.7 million. Additionally, variable rate demand note balances as of the quarter ended April 29, 2006 have been reclassified from cash to short-term investments, and certain other balance sheet amounts have been reclassified. These reclassifications do not result in any additional charges in any period and do not affect working capital for the affected periods. For further discussion of these adjustments, refer to Note 2 Restatement of Consolidated Financial Statements in the unaudited condensed consolidated financial statements included in Item 1 of this report and Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

CUMULATIVE ADJUSTMENTS

The following table summarizes the cumulative increase or decrease to net income from fiscal 1998 through the first quarter of fiscal 2006. These adjustments relate to the Company recognizing stock-based compensation expense as a result of determining revised measurement dates for past stock option grants as well as the other adjustments noted above (in thousands):

Period Ended	Stock Option Related Adjustments			Other Adjustments(1)			Total After Tax Adjustment
	Expense (Increase)	Tax Benefit	Net Stock Option Related Adjustments	Expense (Increase) Decrease	Tax Benefit (Provision)	Net Other Adjustments	
January 30, 1999 (fiscal 1998)	\$ (59)	\$ 19	\$ (40)	\$	\$	\$	\$ (40)
January 29, 2000 (fiscal 1999)	(211)	81	(130)				(130)
February 3, 2001 (fiscal 2000)	(386)	131	(255)				(255)
February 2, 2002 (fiscal 2001)	(915)	295	(620)	240	(98)	142	(478)
February 1, 2003 (fiscal 2002)	(972)	375	(597)	772	(311)	461	(136)
January 31, 2004 (fiscal 2003)	(1,632)	486	(1,146)	1,722	(695)	1,027	(119)
January 29, 2005 (fiscal 2004)	(3,386)	772	(2,614)	589	(82)	507	(2,107)
January 28, 2006 (fiscal 2005)(2)	(8,927)	3,956	(4,971)	(853)	218	(635)	(5,606)
Cumulative effect at January 28, 2006	\$ (16,488)	\$ 6,115	\$ (10,373)	\$ 2,470	\$ (968)	\$ 1,502	\$ (8,871)
April 29, 2006 (Q1 fiscal 2006)	\$ (1,331)	\$ 544	\$ (787)	\$ 327	\$ (161)	\$ 166	\$ (621)

(1) Other adjustments relate to personal property taxes and certain accrual accounts and reserves, including those related to occupancy costs for the Company's 52- and 53-week fiscal years.

(2) The Company has not previously recorded stock-based compensation expense in any fiscal year other than fiscal 2005. During fiscal 2005, the Company recorded approximately \$0.3 million related to the modification of stock options for a terminated employee, before taxes of approximately \$0.1 million. The Company also recorded approximately \$2.1 million, before taxes of approximately \$0.1 million, of stock-based compensation expense related to the acceleration of the vesting of certain options. As part of the restatement process, the stock option acceleration amounts were adjusted to approximately \$1.7 million of stock-based compensation expense, before taxes of approximately \$0.5 million. Therefore, the restated total stock-based compensation expense for fiscal 2005 is approximately \$11.3 million, before taxes of approximately \$4.1 million.

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	July 29, 2006 (Unaudited)	January 28, 2006(1) (As restated)	July 30, 2005(1) (As restated) (Unaudited)
ASSETS:			
Current assets:			
Cash and cash equivalents	\$ 97,419	\$ 173,323	\$ 121,958
Short-term investments	12,665		
Accounts receivable	34,853	29,121	22,237
Inventories	254,626	213,665	180,012
Prepaid expenses and other current assets	65,245	38,550	57,902
Deferred income taxes	7,400	5,387	3,328
Total current assets	472,208	460,046	385,437
Long-term assets:			
Property and equipment, net	282,998	248,628	208,507
Deferred income taxes	55,546	50,168	17,368
Other assets	5,258	5,206	3,346
Total assets	\$ 816,010	\$ 764,048	\$ 614,658
LIABILITIES AND STOCKHOLDERS EQUITY			
LIABILITIES:			
Current liabilities:			
Revolving loan	\$	\$	\$ 23,090
Accounts payable	101,580	81,620	81,177
Income taxes payable	11,711	52,707	604
Accrued expenses, interest and other current liabilities	108,768	95,681	88,492
Total current liabilities	222,059	230,008	193,363
Long-term liabilities:			
Deferred rent liabilities	115,072	105,560	95,127
Deferred royalty	36,398	27,152	14,627
Other long-term liabilities	7,011	5,678	2,957
Total liabilities	380,540	368,398	306,074
COMMITMENTS AND CONTINGENCIES			
STOCKHOLDERS EQUITY:			
Common stock, \$0.10 par value; 100,000,000 shares authorized; 29,029,607 shares, 27,954,386 shares and 27,721,914 shares issued and outstanding, at July 29, 2006, January 28, 2006 and July 30, 2005, respectively	2,903	2,796	2,772
Additional paid-in capital	185,082	147,065	132,619
Accumulated other comprehensive income	7,706	7,211	4,661
Retained earnings	239,779	238,578	168,532
Total stockholders equity	435,470	395,650	308,584
Total liabilities and stockholders equity	\$ 816,010	\$ 764,048	\$ 614,658

(1) See Note 2 Restatement of Consolidated Financial Statements in the accompanying Notes to Condensed Consolidated Financial Statements

See accompanying notes to these condensed consolidated financial statements

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 29, 2006	July 30, 2005(1) (As restated)	July 29, 2006	July 30 2005(1) (As restated)
Net sales	\$ 395,614	\$ 318,750	\$ 822,123	\$ 687,967
Cost of sales (exclusive of depreciation shown separately below)	258,300	219,996	517,846	447,232
Gross profit	137,314	98,754	304,277	240,735
Selling, general and administrative expenses	143,247	119,251	273,061	232,576
Asset impairment charges		229		229
Depreciation and amortization	15,858	12,496	30,065	24,620
Operating (loss) income	(21,791)	(33,222)	1,151	(16,690)
Interest income, net	796	335	1,673	430
(Loss) income before income taxes	(20,995)	(32,887)	2,824	(16,260)
Provision for (benefit from) income taxes	(7,476)	(12,768)	1,623	(6,183)
Net (loss) income	\$ (13,519)	\$ (20,119)	\$ 1,201	\$ (10,077)
Basic net (loss) income per common share	\$ (0.47)	\$ (0.73)	\$ 0.04	\$ (0.37)
Basic weighted average common shares outstanding	28,899	27,683	28,571	27,533
Diluted net (loss) income per common share	\$ (0.47)	\$ (0.73)	\$ 0.04	\$ (0.37)
Diluted weighted average common shares and common share equivalents outstanding	28,899	27,683	29,729	27,533

(1) See Note 2 Restatement of Consolidated Financial Statements in the accompanying Notes to Condensed Consolidated Financial Statements

See accompanying notes to these condensed consolidated financial statements

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Twenty-Six Weeks Ended	
	July 29, 2006	July 30, 2005(1)
		(As restated)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,201	\$ (10,077)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	30,065	24,620
Deferred financing fee amortization	175	180
Amortization of lease buyouts	81	86
Loss on disposals of property and equipment	711	78
Asset impairment charges		229
Equity compensation expense	1,229	1,384
Deferred royalty, net	9,236	7,528
Deferred taxes	(7,389)	(1,073)
Deferred rent and lease incentives	(6,059)	(3,998)
Changes in operating assets and liabilities:		
Accounts receivable	(5,699)	1,858
Inventories	(40,691)	(17,958)
Prepaid income taxes	(25,601)	(11,083)
Prepaid expenses and other current assets	(580)	(3,441)
Other assets	(299)	(738)
Accounts payable	17,625	2,485
Accrued expenses, interest and other current liabilities	12,587	6,643
Income taxes payable	(40,998)	(16,087)
Deferred rent liabilities	15,129	7,551
Other liabilities	1,342	748
Total adjustments	(39,136)	(988)
Net cash used by operating activities	(37,935)	(11,065)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property and equipment purchases	(62,398)	(28,820)
Purchase of investments	(725,576)	(52,515)
Sale of investments	712,911	52,515
Other investing activities	(24)	(1,004)
Net cash used in investing activities	(75,087)	(29,824)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Exercise of stock options and employee stock purchases	25,971	11,283
Excess tax benefit for stock option exercises	10,924	
Borrowings under revolving credit facility	109,103	267,391
Repayments under revolving credit facility	(109,103)	(281,569)
Net cash provided by (used in) financing activities	36,895	(2,895)
Effect of exchange rate changes on cash	223	546
Net decrease in cash and cash equivalents	(75,904)	(43,238)
Cash and cash equivalents, beginning of period	173,323	165,196
Cash and cash equivalents, end of period	\$ 97,419	\$ 121,958

See accompanying notes to these condensed consolidated financial statements

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Unaudited)

(In thousands)

	Twenty-Six Weeks Ended	
	July 29, 2006	July 30, 2005(1) (As restated)
OTHER CASH FLOW INFORMATION:		
Cash paid during the period for interest	\$ 397	\$ 298
Cash paid during the period for income taxes	64,664	22,857
Accrued purchases of property and equipment, lease acquisition and software costs	2,299	733

(1) See Note 2 Restatement of Consolidated Financial Statements in the accompanying Notes to Condensed Consolidated Financial Statements

See accompanying notes to these condensed consolidated financial statements

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) and restatements (as described in Note 2 Restatement of Consolidated Financial Statements) necessary to present fairly the Company s consolidated financial position as of July 29, 2006, the results of its consolidated operations for the thirteen and twenty-six weeks ended July 29, 2006 and July 30, 2005, respectively, and its consolidated cash flows for the thirteen and twenty-six weeks ended July 29, 2006 and July 30, 2005, respectively. Due to the seasonal nature of the Company s business, the results of operations for the thirteen and twenty-six weeks ended July 29, 2006 are not necessarily indicative of the results to be expected for the full year. The consolidated balance sheets at January 28, 2006 (fiscal 2005) and July 30, 2005 have been taken from the consolidated financial statements as of that date, as restated (as described in Note 2 Restatement of Consolidated Financial Statements). These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended February 3, 2007 (fiscal 2006), which are contained in the Company s fiscal 2006 Annual Report on Form 10-K which is being filed with the SEC concurrently with this Quarterly Report on Form 10-Q.

2. RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

Edgar Filing: CHILDRENS PLACE RETAIL STORES INC - Form 10-Q

As a result of an investigation into its stock option granting process, the Company is restating its prior financial statements to reflect additional stock-based compensation expense relating to stock option grants made in each year during the period from the fiscal year ended January 31, 1998 (fiscal 1997) through the first quarter of fiscal 2006. The Company also is restating its financial statements for all periods beginning with the fiscal year ended February 2, 2002 (fiscal 2001) through the first quarter of fiscal 2006 to reflect the correction of other errors. This Quarterly Report on Form 10-Q reflects the restatement of the Company's consolidated balance sheet as of January 28, 2006 and July 30, 2005 and its consolidated statements of income and cash flows for the thirteen and twenty-six weeks ended July 30, 2005 to reflect additional stock-based compensation expense relating to stock option grants and to correct other errors unrelated to stock option grants.

The Company discovered errors in the dating of its stock options. In many instances, options were dated before all grant-making processes were finalized. Consequently, in some instances the option exercise price was lower than it should have been based on the trading price on the date the grant process was completed. In those instances, compensation expense related to those options was not recognized for financial reporting purposes when it should have been.

Basis for Use of the Company's Documentation Hierarchy

APB 25 provides that the accounting measurement date is the first date on which both of the following are known: (1) the number of shares that an individual employee is entitled to receive and (2) the option or purchase price, if any. In light of the Company's option granting practices, the Company has concluded that there was a mutual understanding that the terms of an award were approved by the authorized body or person and final prior to completion of all formal granting actions. The Company therefore has used the date when, most likely, the terms of the awards can be identified as approved and final, as established by the best available evidence, as the revised measurement date for accounting under APB 25. (Each of these grant authorizing occasions is referred to herein as a Recorded Grant, regardless of the number of people who received an option award on such occasion or any variations in terms of the awards so granted.)

The Company's Documentation Hierarchy

The Company has developed a hierarchy of documentation as its basis for determining the revised measurement date for stock option grants. In each case, the document used to establish the revised measurement date is dated and evidences the point in time when the Company can substantiate with finality approval of the award, the recipients of

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

the option award, and the number of shares purchasable pursuant to the option awarded to that recipient. This award-by-award review resulted in different measurement dates in some instances for grants made within the same Recorded Grant. Metadata was accumulated where available to corroborate the revised measurement date for an option award. Metadata, obtained as part of the electronic data collection process, provides information about electronic data, such as how, when and by whom a set of data was collected, recorded or changed. When the metadata did not corroborate the revised measurement date (i.e., indicated that a document was created or revised later than it was dated), the metadata date was used as the date of the supporting document. If another source of support was available with an earlier date, that support was used to define the revised measurement date.

Grant dates based on Board minutes were deemed appropriate in determining the revised measurement dates if the minutes specified: (i) a list of stock option recipients, (ii) the number of options granted to each recipient, and (iii) the grant date and price. If the minutes were not determinative, the Company applied the following document hierarchy to determine the revised measurement dates:

1. *Offer Letters to New Employees/Promotion Letters* The Company has concluded that information set forth in accepted offer letters and promotion letters, which specified the number of options to be granted at a stated date, constituted a mutual understanding between the employee and the Company. Once the employee began to render service under the terms of the employment or promotion letter, the Company believes it had a legal liability to grant the option as promised in the letter. As such, the Company has concluded that these letters established with finality the number of options granted to a recipient and the date to be used as a grant date, as long as the employee had commenced employment.

2. *Documentation Sent to Third Parties and the Compensation Committee Members* If acceptable evidence was not identified in the Board minutes or offer and promotion letters, the Company determined that the earliest date on which a list of option recipients and number of options to each recipient was disseminated outside the Company established the finality of the grant. The Company has identified the following sources of documentation sent outside the Company as establishing the date on which the terms of an option became final: (i) Forms 3 and 4 filed with the SEC, (ii) archive data obtained from the Company's outside stock option plan administrator (Stock Option Administrator) with the list of option recipients and number of options evidencing the terms of option grants that was provided by the Company and the date when the Stock Option Administrator was so advised of the grant, and (iii) Legal Department Memoranda requesting unanimous written consent (UWC) approval with an attached UWC documenting with finality (either in the body of the UWC or as a referenced attachment) the option recipients, number of shares subject to each grant and the exercise price (as well as the as of grant date) which, in accordance with the Company's option granting process, would not have been prepared if the related list of option recipients was not final and approved by its former CEO.

3. *Internal Documentation* The next level of documentation used included the last modified date metadata of a Microsoft Excel file specifying the recipient and the number of shares subject to an option grant, or email dates on comparable data prepared by the Legal or Human Resources Departments, where in each case the grant was recorded in the Stock Option Administrator's records.

4. *Unanimous Written Consents* If no other support was available, the Company used the last modified date metadata associated with the UWC reflecting formal approval of a grant as the revised measurement date.

The Company has revised the measurement dates used to account for certain stock option grants since fiscal 1997 based on the hierarchy above.

Variable Accounting

During the course of the investigation and the review of the documentation for each grant, the Company identified instances where changes were made in its records respecting certain Recorded Grants. In these instances, the Company reviewed all documents related to the grant to determine if the change was an isolated change to an individual award or if the change indicated that the granting process was not complete for the entire Recorded Grant. If the change was an isolated change, the Company determined whether the change represented an administrative error or a modification of a term of the award. The investigation did not reveal a practice by the Company of retracting awards or modifying the terms of awards across a group of recipients after the date determined to be the

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

revised measurement date. Instead, changes were rare and occurred only at the individual level. The Company found no evidence regarding any of the changes that indicated that at the time of the change the granting process remained open for an entire Recorded Grant.

Since none of the changes indicated an incomplete granting process, the Company used available documentation to determine whether the changes represented administrative errors or a modification to an individual award. For changes deemed to be administrative errors (e.g., adding an individual to a list of recipients for service awards where the number of options involved in the award and the criteria required to earn the award were set prior to the issuance of the award), the Company did not change the revised measurement date applicable to the individual award from that determined from the Recorded Grant as determined based on the documentation hierarchy.

If the Company determined based on a review of supporting documentation that the change was a modification to the original award (e.g., a change in the number of shares for which the option was granted or the exercise price of the option), the Company considered the appropriate accounting for the individual award in accordance with FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation (FIN 44). For any changes involving either the number of shares for which the options were granted or the exercise price of the option, the Company determined that variable accounting should be applied in accordance with FIN 44. With respect to options for 328,775 shares, the Company has applied variable accounting because of a modification to the terms of the award, resulting in additional stock-based compensation expense.

The 1997 CEO IPO Grant

The Company granted to Ezra Dabah, its former CEO, who owned more than 10% of the Company's outstanding shares, options under its 1996 Stock Option Plan (1996 Plan) for 99,660 shares in connection with its initial public offering in September 1997 (the 1997 CEO IPO Grant). Under the plan, options could be granted as either incentive stock options under the tax code (ISOs) or as options not qualified as ISOs (NQOs). The plan required grants to more than 10% shareholders treated as ISOs to have an exercise price of 110% of the fair market value of the stock on the grant date and to have a five year duration. The plan required NQOs to have a ten year duration and an exercise price determined by the Compensation Committee. At the time of the grant, the Company issued two certificates in Mr. Dabah's name reflecting the 1997 CEO IPO Grant as bifurcated partly into ISOs and partly into NQOs, both parts having a five year duration and an exercise price of 110% of the initial public offering price. However, other Company records reflected the options as having different terms. In 2004, the Company realized there were inconsistencies in the Company's records regarding the duration, exercise price and ISO/NQO status related to the 1997 CEO IPO Grant. On May 6, 2004, management, without review or approval of the Compensation Committee, interpreted the grant to have a ten year duration in its entirety and changed the Company's records of outstanding options to reflect the entire grant as NQOs with a duration of ten years. In April 2007, after an investigation of the circumstances, the Company's Board ratified the change to the records made in May 2004. The Company considers the accounting consequence of the now ratified 2004 action to be the equivalent of a grant to Mr. Dabah for a below market, fully vested option, since, based on the certificates, the options would have expired on September 17, 2002. Accordingly, the Company has recognized in its restatement of its financial statements a charge to compensation expense of approximately \$0.9 million in fiscal 2004.

Other Adjustments

In addition to the adjustments related to the stock option investigation, the restated condensed consolidated financial statements presented herein include other adjustments to correct errors related to personal property taxes and certain accrual accounts and reserves, including those related to occupancy costs for the Company's 52- and 53-week fiscal years. The aggregate impact of these adjustments on the Company's consolidated statements of income, net of taxes, between fiscal 2001 and fiscal 2005 was an increase to net income of approximately \$1.7 million. Additionally, variable rate demand note balances as of the quarter ended April 29, 2006 have been reclassified from cash to short-term investments, and certain other balance sheet amounts have been reclassified. These reclassifications do not result in any additional charges in any period and do not affect working capital for the affected periods.

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

The following table reconciles as reported net income to as restated net income and retained earnings (in thousands):

	Net Income		Retained Earnings as of January 29, 2005
	Thirteen weeks ended July 30, 2005	Twenty-six weeks ended July 30, 2005	
As previously reported	\$ (18,911)	\$ (9,113)	\$ 181,874
Increase (decrease) to net income and retained earnings			
Stock based compensation expense(1)	(935)	(1,384)	(6,754)
Payroll withholding expense and penalties related to stock options	(502)	(942)	(807)
Other stock option related expenses	(24)	624	
Total additional stock option related expense	(1,461)	(1,702)	(7,561)
Other adjustments(2)	(448)	343	3,323
Income tax benefit related to stock option related expenses	520	673	2,159
Income tax benefit (provision) related to other adjustments	181	(278)	(1,186)
Total	(1,208)	(964)	(3,265)
As restated	\$ (20,119)	\$ (10,077)	\$ 178,609

- (1) Prior to the adoption of SFAS 123(R), the only stock-based compensation expense previously recorded by the Company was approximately \$1.7 million (as restated) in the fourth quarter of fiscal 2005 related to the acceleration of the vesting of certain options in the fourth quarter of fiscal 2005 and approximately \$0.3 million in the first quarter of fiscal 2005 for the acceleration of the vesting of options related to a terminated employee.
- (2) Other adjustments relate to personal property taxes and certain accrual accounts and reserves, including those related to occupancy costs for the Company's 52- and 53-week fiscal years.

The following table details the components of the beginning retained earnings adjustment as of January 29, 2005 (in thousands):

Period Ended	Stock Option Related Adjustments(1)			Expense (Increase) Decrease	Other Adjustments(2)		Total After Tax Adjustment
	Expense (Increase)	Tax Benefit	Net Stock Option Related Adjustments		Tax Benefit (Provision)	Net Other Adjustments	
January 30, 1999 (fiscal 1998)	\$ (59)	\$ 19	\$ (40)	\$	\$	\$	\$ (40)
January 29, 2000 (fiscal 1999)	(211)	81	(130)				(130)
February 3, 2001 (fiscal 2000)	(386)	131	(255)				(255)
February 2, 2002 (fiscal 2001)	(915)	295	(620)	240	(98)	142	(478)
February 1, 2003 (fiscal 2002)	(972)	375	(597)	772	(311)	461	(136)

Edgar Filing: CHILDRENS PLACE RETAIL STORES INC - Form 10-Q

January 31, 2004 (fiscal 2003)	(1,632)	486	(1,146)	1,722	(695)	1,027	(119)
January 29, 2005 (fiscal 2004)	(3,386)	772	(2,614)	589	(82)	507	(2,107)
Cumulative effect at January 29, 2005	(7,561)	2,159	(5,402)	3,323	(1,186)	2,137	(3,265)
Fiscal year 2005:							
April 30, 2005 (Q1)	(241)	153	(88)	791	(459)	332	244
July 30, 2005 (Q2)	(1,461)	520	(941)	(448)	181	(267)	(1,208)
Cumulative effect at July 30, 2005	(9,263)	2,832	(6,431)	3,666	(1,464)	2,202	(4,229)
October 29, 2005 (Q3)	(685)	274	(411)	267	(111)	156	(255)
January 28, 2006 (Q4)	(6,540)	3,009	(3,531)	(1,463)	607	(856)	(4,387)
Cumulative effect at January 28, 2006	\$ (16,488)	\$ 6,115	\$ (10,373)	\$ 2,470	\$ (968)	\$ 1,502	\$ (8,871)
April 29, 2006 (Q1 fiscal 2006)	\$ (1,331)	\$ 544	\$ (787)	\$ 327	\$ (161)	\$ 166	\$ (621)

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

- (1) There was no stock-based compensation expense previously recorded by the Company during the period from fiscal 1998 through fiscal 2004.
- (2) Other adjustments relate to personal property taxes and certain accrual accounts and reserves, including those related to occupancy costs for the Company's 52- and 53-week fiscal years.

The following tables reconcile the Company's consolidated results of operations and financial position from the previously reported consolidated financial statements to the restated consolidated financial statements.

Consolidated Balance Sheet Impact

The following table reconciles the consolidated balance sheet previously reported to the restated amounts as of January 28, 2006 (in thousands):

	As Reported	January 28, 2006		As Restated
		Stock Option Related Adjustments	Other Adjustments(1)	
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 173,323	\$	\$	\$ 173,323
Accounts receivable	28,971		150	29,121
Inventories	214,702		(1,037)	213,665
Prepaid expenses and other current assets	36,955		1,595	38,550
Deferred income taxes	6,043		(656)	5,387
Total current assets	459,994		52	460,046
Property and equipment, net	248,628			248,628
Deferred income taxes	43,492	4,397	2,279	50,168
Other assets	5,206			5,206
Total assets	\$ 757,320	\$ 4,397	\$ 2,331	\$ 764,048
LIABILITIES AND STOCKHOLDERS				
EQUITY				
Current liabilities:				
Accounts payable	\$ 82,826	\$	\$ (1,206)	\$ 81,620
Taxes payable	49,078		3,629	52,707
Accrued expenses and other current liabilities	94,160	2,077	(556)	95,681
Total current liabilities	226,064	2,077	1,867	230,008
Deferred rent liabilities	105,560			105,560
Deferred royalty	27,152			27,152
Other long-term liabilities	5,678			5,678

Edgar Filing: CHILDRENS PLACE RETAIL STORES INC - Form 10-Q

Total liabilities	364,454	2,077	1,867	368,398
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS EQUITY:				
Common stock, \$0.10 par value	2,796			2,796
Preferred stock, \$1.00 par value				
Additional paid-in capital	134,372	12,693		147,065
Accumulated other comprehensive income	8,249		(1,038)	7,211
Retained earnings	247,449	(10,373)	1,502	238,578
Total stockholders equity	392,866	2,320	464	395,650
Total liabilities and stockholders equity	\$ 757,320	\$ 4,397	\$ 2,331	\$ 764,048

-
- (1) Other adjustments relate to personal property taxes and certain accrual accounts and reserves, including those related to occupancy costs for the Company's 52- and 53-week fiscal years and inventory adjustments.

THE CHILDREN S PLACE RETAIL STORES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

The following table reconciles the consolidated balance sheet previously reported to the restated amounts as of July 30, 2005 (in thousands):

		July 30, 2005		
	As Reported	Stock Option Related Adjustments	Other Adjustments(1)	As Restated
ASSETS				