

NEIMAN MARCUS GROUP INC  
Form 10-Q  
March 17, 2003

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the Quarterly Period Ended February 1, 2003**

**OR**

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

**Commission file no. 1-9659**

**The Neiman Marcus Group, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-4119509**

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

**One Marcus Square  
1618 Main Street  
Dallas, Texas 75201**

(Address of principal executive offices)

**(214) 741-6911**

(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.

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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

As of February 28, 2003, the number of outstanding shares of each of the issuer's classes of common stock was:

| <b>Class</b>                          | <b>Outstanding<br/>Shares</b> |
|---------------------------------------|-------------------------------|
| Class A Common Stock, \$.01 Par Value | 27,859,314                    |
| Class B Common Stock, \$.01 Par Value | 19,666,933                    |

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THE NEIMAN MARCUS GROUP, INC.

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Signatures

Certifications Required by Section 302(a) of the Sarbanes-Oxley Act of 2002

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**THE NEIMAN MARCUS GROUP, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

| (in thousands, except shares)                                 | February 1,<br>2003 | August 3,<br>2002 | January 26,<br>2002 |
|---------------------------------------------------------------|---------------------|-------------------|---------------------|
| <b>ASSETS</b>                                                 |                     |                   |                     |
| Current assets:                                               |                     |                   |                     |
| Cash and cash equivalents                                     | \$ 161,229          | \$ 178,638        | \$ 137,213          |
| Undivided interests in NMG Credit Card Master Trust           | 295,321             | 208,602           | 284,727             |
| Accounts receivable, net                                      | 22,271              | 19,778            | 21,493              |
| Merchandise inventories                                       | 654,309             | 656,844           | 584,132             |
| Other current assets                                          | 70,964              | 63,764            | 72,470              |
| Total current assets                                          | 1,204,094           | 1,127,626         | 1,100,035           |
| Property and equipment, net                                   | 678,131             | 653,166           | 633,635             |
| Other assets                                                  | 119,405             | 126,754           | 131,705             |
| Total assets                                                  | \$ 2,001,630        | \$ 1,907,546      | \$ 1,865,375        |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                   |                     |                   |                     |
| Current liabilities:                                          |                     |                   |                     |
| Notes payable and current maturities of long-term liabilities | \$ 2,246            | \$ 1,098          | \$ 4,098            |
| Accounts payable                                              | 258,360             | 257,560           | 232,694             |
| Accrued liabilities                                           | 282,259             | 259,800           | 281,272             |
| Total current liabilities                                     | 542,865             | 518,458           | 518,064             |
| Long-term liabilities:                                        |                     |                   |                     |
| Notes and debentures                                          | 249,722             | 249,710           | 249,698             |
| Other long-term liabilities                                   | 109,206             | 77,473            | 95,474              |
| Total long-term liabilities                                   | 358,928             | 327,183           | 345,172             |
| Minority interest                                             | 9,044               | 6,592             | 9,202               |
| Common stock                                                  | 482                 | 480               | 479                 |
| Additional paid-in capital                                    | 446,461             | 443,788           | 435,052             |
| Accumulated other comprehensive (loss) income                 | (12,270)            | 906               | (454)               |
| Retained earnings                                             | 671,140             | 610,139           | 557,860             |
| Treasury stock (524,177 shares, at cost)                      | (15,020)            |                   |                     |
| Total shareholders' equity                                    | 1,090,793           | 1,055,313         | 992,937             |
| Total liabilities and shareholders' equity                    | \$ 2,001,630        | \$ 1,907,546      | \$ 1,865,375        |

See Notes to Condensed Consolidated Financial Statements.



## THE NEIMAN MARCUS GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(UNAUDITED)

| (in thousands, except per share data)                                              | Thirteen Weeks Ended |                     | Twenty-Six Weeks Ended |                     |
|------------------------------------------------------------------------------------|----------------------|---------------------|------------------------|---------------------|
|                                                                                    | February 1,<br>2003  | January 26,<br>2002 | February 1,<br>2003    | January 26,<br>2002 |
| Revenues                                                                           | \$ 938,467           | \$ 908,086          | \$ 1,672,550           | \$ 1,589,235        |
| Cost of goods sold including buying and occupancy costs                            | 654,578              | 645,766             | 1,108,509              | 1,081,656           |
| Selling, general and administrative expenses                                       | 225,485              | 215,503             | 430,393                | 418,490             |
| Impairment and other charges                                                       |                      | 2,000               |                        | 2,000               |
| Operating earnings                                                                 | 58,404               | 44,817              | 133,648                | 87,089              |
| Interest expense, net                                                              | 4,345                | 4,260               | 7,939                  | 8,246               |
| Earnings before income taxes, minority interest and change in accounting principle | 54,059               | 40,557              | 125,709                | 78,843              |
| Income taxes                                                                       | 20,813               | 15,411              | 48,398                 | 29,960              |
| Earnings before minority interest and change in accounting principle               | 33,246               | 25,146              | 77,311                 | 48,883              |
| Minority interest in net earnings of subsidiaries                                  | (769)                | (844)               | (1,509)                | (1,588)             |
| Earnings before change in accounting principle                                     | 32,477               | 24,302              | 75,802                 | 47,295              |
| Change in accounting principle writedown of intangible assets, net of taxes        |                      |                     | (14,801)               |                     |
| Net earnings                                                                       | \$ 32,477            | \$ 24,302           | \$ 61,001              | \$ 47,295           |
| Weighted average number of common and common equivalent shares outstanding:        |                      |                     |                        |                     |
| Basic                                                                              | 47,558               | 47,431              | 47,627                 | 47,379              |
| Diluted                                                                            | 47,850               | 47,763              | 47,910                 | 47,698              |
| Basic earnings per share:                                                          |                      |                     |                        |                     |
| Earnings before change in accounting principle                                     | \$ 0.68              | \$ 0.51             | \$ 1.59                | \$ 1.00             |
| Change in accounting principle writedown of intangible assets, net of taxes        |                      |                     | (0.31)                 |                     |
| Basic earnings per share                                                           | \$ 0.68              | \$ 0.51             | \$ 1.28                | \$ 1.00             |
| Diluted earnings per share:                                                        |                      |                     |                        |                     |
| Earnings before change in accounting principle                                     | \$ 0.68              | \$ 0.51             | \$ 1.58                | \$ 0.99             |
| Change in accounting principle writedown of intangible assets, net of taxes        |                      |                     | (0.31)                 |                     |
| Diluted earnings per share                                                         | \$ 0.68              | \$ 0.51             | \$ 1.27                | \$ 0.99             |

*See Notes to Condensed Consolidated Financial Statements.*

## THE NEIMAN MARCUS GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

| (in thousands)                                                                      | Twenty-Six Weeks Ended |                     |
|-------------------------------------------------------------------------------------|------------------------|---------------------|
|                                                                                     | February 1,<br>2003    | January 26,<br>2002 |
| <b>CASH FLOWS OPERATING ACTIVITIES</b>                                              |                        |                     |
| Net earnings                                                                        | \$ 61,001              | \$ 47,295           |
| Change in accounting writedown of intangible assets, net of taxes                   | 14,801                 |                     |
| Earnings before change in accounting principle                                      | 75,802                 | 47,295              |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                        |                     |
| Depreciation and amortization                                                       | 39,749                 | 40,882              |
| Minority interest                                                                   | 1,509                  | 1,588               |
| Other                                                                               | 5,480                  | 10,914              |
| Changes in current assets and liabilities:                                          |                        |                     |
| Increase in accounts receivable                                                     | (2,493)                | (786)               |
| Decrease in merchandise inventories                                                 | 2,535                  | 64,735              |
| Increase in accounts payable and accrued liabilities                                | 27,910                 | 16,785              |
| Other                                                                               | (5,638)                | 3,277               |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                    | <b>144,854</b>         | <b>184,690</b>      |
| <b>CASH FLOWS INVESTING ACTIVITIES</b>                                              |                        |                     |
| Capital expenditures                                                                | (64,715)               | (85,003)            |
| Transactions related to undivided interests in NMG Credit Card Master Trust:        |                        |                     |
| Purchases of held-to-maturity securities                                            | (553,355)              | (555,937)           |
| Maturities of held-to-maturity securities                                           | 468,489                | 491,927             |
| <b>NET CASH USED FOR INVESTING ACTIVITIES</b>                                       | <b>(149,581)</b>       | <b>(149,013)</b>    |
| <b>CASH FLOWS FINANCING ACTIVITIES</b>                                              |                        |                     |
| Proceeds from borrowings                                                            | 81,051                 | 133,240             |
| Repayment of debt                                                                   | (80,000)               | (130,000)           |
| Acquisition of treasury stock                                                       | (15,020)               |                     |
| Proceeds from exercises of stock options and restricted stock grants                | 1,309                  | 1,005               |
| Other equity activities                                                             | (22)                   |                     |
| <b>NET CASH (USED FOR) PROVIDED BY FINANCING ACTIVITIES</b>                         | <b>(12,682)</b>        | <b>4,245</b>        |
| <b>CASH AND CASH EQUIVALENTS</b>                                                    |                        |                     |
| (Decrease) increase during the period                                               | (17,409)               | 39,922              |
| Beginning balance                                                                   | 178,638                | 97,291              |
| Ending balance                                                                      | \$ 161,229             | \$ 137,213          |

## SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION



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|                                  |    |        |           |
|----------------------------------|----|--------|-----------|
| Cash paid during the period for: |    |        |           |
| Interest                         | \$ | 9,197  | \$ 9,783  |
| Income taxes                     | \$ | 31,791 | \$ 11,113 |

*See Notes to Condensed Consolidated Financial Statements.*

**THE NEIMAN MARCUS GROUP, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

1. Basis of Presentation

The Condensed Consolidated Financial Statements of The Neiman Marcus Group, Inc. and subsidiaries (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted for complete financial statements. Therefore, the financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended August 3, 2002.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments (as well as a change in accounting principle as more fully described in Note 3), necessary to present fairly the financial position, results of operations and cash flows of the Company for the applicable interim periods. The results of operations for these periods are not necessarily comparable to, or indicative of, results of any other interim period or for the fiscal year as a whole.

Certain prior period balances have been reclassified to conform to the current period presentation.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of gain and loss contingencies at the date of the condensed consolidated financial statements.

Since future events and their effects cannot be determined with absolute certainty, actual results will differ from those estimates. The amounts currently estimated by the Company are subject to change if different assumptions as to the outcome of future events were made. The Company evaluates its estimates and judgments on an ongoing basis and predicates those estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Management makes adjustments to its assumptions and judgments when facts and circumstances dictate.

Management of the Company believes the following critical accounting policies, among others, encompass the more significant judgments and estimates used in preparation of its financial statements:

Revenue recognition;

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Valuation of merchandise inventories, including determination of original retail values, recognition of markdowns and vendor allowances, estimation of inventory shrinkage, and determination of cost of sales;

Recognition of income and expenses related to the Company's securitization program;

Determination of impairment of long-lived assets;

Recognition of advertising and catalogue costs;

Recognition of costs related to the Company's loyalty programs;

Recognition of income taxes; and

Measurement of accruals for general liability, workers' compensation and health insurance as well as short-term disability, pension and postretirement health care benefits.

A description of the Company's critical accounting policies is included in the Company's Annual Report on Form 10-K for the fiscal year ended August 3, 2002.

2. Operating Segments

The Company has identified two reportable segments: Specialty Retail Stores and Direct Marketing. The Specialty Retail Stores segment includes all Neiman Marcus and Bergdorf Goodman retail stores, including Neiman Marcus clearance stores. Direct Marketing includes the operations of Neiman Marcus Direct, which publishes NM by Mail, the Neiman Marcus Christmas catalogue, the Horchow catalogue and the Chef's Catalogue, and the Company's online operations. Other includes the operations of Kate Spade LLC and Gurwitch Bristow Products, LLC (the Brand Development Companies) and corporate expenses.

The following table sets forth the information for the Company's reportable segments:

| (in thousands)             | Thirteen Weeks Ended |                     | Twenty-Six Weeks Ended |                     |
|----------------------------|----------------------|---------------------|------------------------|---------------------|
|                            | February 1,<br>2003  | January 26,<br>2002 | February 1,<br>2003    | January 26,<br>2002 |
| <b>REVENUES:</b>           |                      |                     |                        |                     |
| Specialty Retail Stores    | \$ 756,097           | \$ 745,714          | \$ 1,357,218           | \$ 1,306,661        |
| Direct Marketing(1)        | 161,269              | 144,394             | 275,634                | 246,192             |
| Other                      | 21,101               | 17,978              | 39,698                 | 36,382              |
| <b>Total</b>               | <b>\$ 938,467</b>    | <b>\$ 908,086</b>   | <b>\$ 1,672,550</b>    | <b>\$ 1,589,235</b> |
| <b>OPERATING EARNINGS:</b> |                      |                     |                        |                     |
| Specialty Retail Stores(2) | \$ 43,826            | \$ 41,232           | \$ 115,539             | \$ 89,144           |
| Direct Marketing(1)        | 17,984               | 8,279               | 25,401                 | 5,954               |
| Other                      | (3,406)              | (2,694)             | (7,292)                | (6,009)             |
| <b>Total</b>               | <b>\$ 58,404</b>     | <b>\$ 46,817</b>    | <b>\$ 133,648</b>      | <b>\$ 89,089</b>    |

(1) Direct Marketing includes the operations of Neiman Marcus Direct and the Company's online operations. During fiscal year 2002, the Company reclassified its Neiman Marcus Online operations to the Direct Marketing segment from Other. Prior year amounts have been reclassified to conform to the current year presentation.

(2) Segment operating earnings for the thirteen weeks and twenty-six weeks ended January 26, 2002 exclude a \$2.0 million pretax charge in connection with certain cost reduction strategies consisting primarily of severance costs and lease termination expenses incurred in connection with the closing of the Galleries of Neiman Marcus store in Seattle, Washington.

3. Change in Accounting Principle Writedown of Intangible Assets

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The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets as of the beginning of the first quarter of fiscal year 2003. SFAS No. 142 established a new fair value-based accounting model for the valuation of goodwill and indefinite-lived intangible assets recorded in connection with business combinations. Pursuant to the provisions of SFAS No. 142, goodwill and indefinite-lived intangible assets are measured for impairment by applying a fair value-based test at least annually and are not amortized.

In connection with the adoption of the provisions of SFAS No. 142, the Company engaged third party appraisal experts to assist with the determination of the fair value of its goodwill and intangible assets. For each of the Company's operating segments, a summary of the intangible assets recorded by the Company as of the beginning of the first quarter of fiscal year 2003 in accordance with the cost-based accounting model established by previous accounting principles and the adjustment required to adopt the fair value model of SFAS No. 142 is as follows:

| (in thousands)              | Carrying<br>Value at<br>August 4, 2002 | SFAS<br>No. 142<br>Adjustment | Adjusted<br>Carrying<br>Value |
|-----------------------------|----------------------------------------|-------------------------------|-------------------------------|
| <b>Direct Marketing</b>     |                                        |                               |                               |
| Goodwill                    | \$ 23,747                              | \$                            | \$ 23,747                     |
| Indefinite-lived tradenames | 60,732                                 | (24,066)                      | 36,666                        |
| <b>Other</b>                |                                        |                               |                               |
| Indefinite-lived tradenames | 32,945                                 |                               | 32,945                        |
|                             | \$ 117,424                             | \$ (24,066)                   | \$ 93,358                     |

The \$24.1 million writedown in the carrying value of the indefinite-lived intangible assets of the Company's Direct Marketing segment is reflected as a change in accounting principle (\$14.8 million, net of taxes) in the accompanying Condensed Consolidated Statements of Earnings for the twenty-six weeks ended February 1, 2003.

The Company ceased amortization of its goodwill and indefinite-lived intangible assets as of the beginning of fiscal year 2003. Amortization expense for the second quarter of fiscal year 2002 was approximately \$1.4 million and reduced diluted earnings per share by \$0.02 for the period. Amortization expense for the twenty-six weeks ended January 26, 2002 was approximately \$2.9 million and reduced diluted earnings per share by \$0.04 for the period.

#### 4. Defined Benefit Pension Plan

The Company has a noncontributory defined benefit pension plan (Pension Plan) covering substantially all full-time employees. Benefits under the Pension Plan are based on the employees' years of service and compensation over defined periods of employment. Pension Plan assets consist primarily of equity and fixed income securities.

The Company received the final valuation of the Pension Plan for the 2002 plan year from its outside actuarial firm in March 2003. A summary of the assets held by the Pension Plan and the Company's obligations, as calculated by its actuaries, as of the beginning of fiscal year 2003 are as follows:

| (in thousands)                       |            |
|--------------------------------------|------------|
| Fair value of plan assets            | \$ 145,945 |
| Accumulated benefit obligation (ABO) | \$ 175,903 |

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|                                    |    |         |
|------------------------------------|----|---------|
| Projected benefit obligation (PBO) | \$ | 210,024 |
| Minimum liability                  | \$ | 29,958  |
| Less: accrued pension cost         |    | (6,108) |
| Additional minimum liability       | \$ | 23,850  |

Upon receipt of the actual calculation of the minimum liability by the Company's actuaries, the Company increased its pension liability by \$23.8 million to record the additional minimum liability in the second quarter of fiscal year 2003 which resulted in a decrease, net of tax, of \$14.1 million to accumulated other comprehensive loss.

Pension expense is based on information provided by the Company's actuaries that uses assumptions to estimate the total benefits ultimately payable to associates and allocates this cost to service periods. The actuarial assumptions used to calculate pension costs are reviewed annually. The Company recorded pension expense of \$2.6 million for the second quarter of fiscal year 2003 and \$1.5 million for the second quarter of fiscal year 2002. The Company recorded pension expense of \$5.2 million for the twenty-six weeks ended February 1, 2003 and \$3.0 million for the twenty-six weeks ended January 26, 2002.

When funding is required, the Company's policy is to contribute amounts that are deductible for federal income tax purposes. The Company anticipates making a contribution of \$11.5 million to the Pension Plan for the plan year ended July 2001 in the third quarter of fiscal year 2003. The Company's contribution for the plan year ended July 2002 is estimated to be \$17.3 million and will be funded in quarterly installments during fiscal year 2003 and fiscal year 2004.

### 5. Treasury Stock

In prior years, the Company's Board of Directors has authorized various stock repurchase programs and increases in the number of shares subject to repurchase. During the second quarter of fiscal year 2003, the Company repurchased 524,177 shares at an average purchase price of \$28.65. As of February 1, 2003, approximately 1.4 million shares remained available for repurchase under the Company's stock repurchase programs.

6. Earnings per Share

The weighted average shares used in computing basic and diluted earnings per share (EPS) are presented in the table below. No adjustments were made to net earnings for the computations of basic and diluted EPS during the periods presented.

| (in thousands of shares)                              | Thirteen Weeks Ended |                     | Twenty-Six Weeks Ended |                     |
|-------------------------------------------------------|----------------------|---------------------|------------------------|---------------------|
|                                                       | February 1,<br>2003  | January 26,<br>2002 | February 1,<br>2003    | January 26,<br>2002 |
| Weighted average shares outstanding                   | 47,855               | 47,716              | 47,918                 | 47,699              |
| Less: non-vested restricted stock                     | (297)                | (285)               | (291)                  | (320)               |
| Shares for computation of basic EPS                   | 47,558               | 47,431              | 47,627                 | 47,379              |
| Effect of dilutive stock options and restricted stock | 292                  | 332                 | 283                    | 319                 |
| Shares for computation of diluted EPS                 | 47,850               | 47,763              | 47,910                 | 47,698              |
| Shares represented by antidilutive stock options      | 1,955                | 1,260               | 1,956                  | 1,265               |

Antidilutive stock options were not included in the computation of diluted EPS because the exercise price of those options was greater than the average market price of the common shares.

7. Stock-Based Compensation

The Company accounts for stock-based compensation awards to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees and related interpretations.

8. Undivided Interests in NMG Credit Card Master Trust

Pursuant to a revolving credit card securitization program, the Company transfers substantially all of its credit card receivables to a wholly-owned subsidiary, Neiman Marcus Funding Corporation, which in turn sells such receivables to the Neiman Marcus Credit Card Master Trust (the Trust). The Trust issued certificates representing undivided interests in the credit card receivables to both third-party investors (Sold Interests) and to the Company (Retained Interests). The Retained Interests are shown as Undivided interests in NMG Credit Card Master Trust on the Company's Condensed Consolidated Balance Sheets.





9. Derivative Financial Instruments

As of February 1, 2003, the Company had foreign currency contracts in the form of forward exchange contracts in the amount of approximately \$39.4 million. The contracts have varying maturity dates through February 2004. The settlement terms of the forward contracts, including amount, currency and maturity, correspond with the payment terms for purchases of merchandise inventories. These contracts have been designated and accounted for as cash flow hedges.

At February 1, 2003, the fair value of the Company's outstanding foreign currency exchange contracts was an asset of approximately \$1.3 million. This amount, net of taxes, is reflected in accumulated other comprehensive loss.

10. Commitments and Contingencies

The Company is involved in various suits and claims in the ordinary course of business. Management does not believe that the disposition of any such suits or claims will have a material adverse effect upon the consolidated results of operations, cash flows or the financial position of the Company.

11. Recent Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies the guidance previously provided in Emerging Issues Task Force Issue (EITF) No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity is recognized at fair value when the liability is incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of SFAS No. 146 will be effective for disposal activities initiated after December 31, 2002.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for periods beginning after December 15, 2002. Accordingly, the Company will begin making the disclosures required by SFAS No. 148 beginning in the third quarter of fiscal year 2003.

In November 2002, the EITF reached a consensus on Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Cash Consideration Received from a Vendor. EITF Issue No. 02-16 provides guidance on how cash consideration received by the Company, as a reseller of others goods, should be classified in its statement of earnings. The Company does not expect EITF Issue No. 02-16 to have a material impact on its consolidated financial position or operating results.



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

**FACTORS THAT MAY AFFECT FUTURE RESULTS**

Matters discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations include forward-looking statements, including statements regarding the Company's objectives and expectations concerning, among other things, its:

productivity and profitability;

merchandising and marketing strategies;

inventory performance;

store renovation and expansion plans;

capital expenditures;

liquidity; and

development of management information systems.

These forward-looking statements are made based on management's expectations and beliefs concerning future events, as well as on assumptions made by and data currently available to management. These forward-looking statements involve a number of risks and uncertainties and, therefore, are not guarantees of future performance. A variety of factors could cause the Company's actual results to differ materially from the anticipated or expected results expressed in these forward-looking statements. Factors that could affect future performance include, but are not limited, to:

current political and economic conditions;

changes in political and economic conditions that may occur in the future;

continued terrorist activities in the United States, as well as the potential escalation in the international war on terrorism;

changes in consumer confidence resulting in a reduction of discretionary spending on goods that are, or are perceived to be, luxuries ;

changes in demographic or retail environments;

changes in consumer preferences or fashion trends;

competitive responses to the Company's marketing, merchandising and promotional efforts and/or inventory liquidations by vendors or other retailers;

delays in the receipt of merchandise ordered by the Company due to work stoppages and/or other causes of delay in connection with either the manufacture or shipment of such merchandise;

seasonality of the retail business;

adverse weather conditions, particularly during peak selling seasons;

delays in anticipated store openings;

political, social, economic or other events resulting in the short or long-term disruption in business at the Company's stores, distribution centers or offices;

natural disasters;

significant increases in paper, printing and postage costs;

litigation that may have an adverse effect on the financial results or reputation of the Company;

changes in the Company's relationships with designers, vendors and other sources of merchandise;

the financial viability of the Company's designers, vendors and other sources of merchandise;

changes in foreign currency exchange rates;

impact of funding requirements related to the Company's noncontributory defined benefit pension plan;

changes in the Company's relationships with certain of its key sales associates;

changes in key management personnel;

changes in the Company's proprietary credit card arrangement that adversely impact its ability to provide consumer credit; or

changes in government or regulatory requirements increasing the Company's costs of operations.

The Company undertakes no obligation to update or revise (publicly or otherwise) any forward-looking statements to reflect subsequent events, new information or future circumstances.

#### **CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events. Since future events and their effects cannot be determined with absolute certainty, actual results will differ from those estimates. The amounts currently estimated by the Company are subject to change if different assumptions as to the outcome of future events were made. The Company evaluates its estimates and judgments on an ongoing basis and predicates those estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Management makes adjustments to its assumptions and judgments when facts and circumstances dictate. See Note 1 of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 for a summary of the Company's critical accounting policies. A description of the Company's critical accounting policies is included in the Company's Annual Report to Shareholders on Form 10-K for the fiscal year ended August 3, 2002.

**OVERVIEW**

The Neiman Marcus Group, Inc., together with its operating divisions and subsidiaries, is a high-end specialty retailer. The Company's operations include the Specialty Retail Stores segment and the Direct Marketing segment. The Specialty Retail Stores segment consists primarily of Neiman Marcus and Bergdorf Goodman stores. The Direct Marketing segment conducts both print catalogue and online operations under the Neiman Marcus, Horchow and Chef's Catalogue brand names.

For purposes of the following discussion, all references to the second quarter of 2003 and second quarter of 2002 are to the Company's thirteen week fiscal periods ended February 1, 2003 and January 26, 2002, respectively. All references to 2003 and 2002 are to the Company's twenty-six week fiscal periods ended February 1, 2003 and January 26, 2002, respectively.

The following table sets forth certain items expressed as percentages of net sales for the periods indicated.

|                                                                                    | Thirteen Weeks Ended |                     | Twenty-Six Weeks Ended |                     |
|------------------------------------------------------------------------------------|----------------------|---------------------|------------------------|---------------------|
|                                                                                    | February 1,<br>2003  | January 26,<br>2003 | February 1,<br>2002    | January 26,<br>2002 |
| Revenues                                                                           | 100.0%               | 100.0%              | 100.0%                 | 100.0%              |
| Cost of goods sold including buying and occupancy costs                            | 69.7                 | 71.1                | 66.3                   | 68.1                |
| Selling, general and administrative expenses                                       | 24.0                 | 23.7                | 25.7                   | 26.3                |
| Impairment and other charges                                                       |                      | 0.2                 |                        | 0.1                 |
| Operating earnings                                                                 | 6.3                  | 5.0                 | 8.0                    | 5.5                 |
| Interest expense, net                                                              | 0.5                  | 0.5                 | 0.5                    | 0.5                 |
| Earnings before income taxes, minority interest and change in accounting principle | 5.8                  | 4.5                 | 7.5                    | 5.0                 |
| Income taxes                                                                       | 2.2                  | 1.7                 | 2.9                    | 1.9                 |
| Earnings before minority interest and change in accounting principle               | 3.6                  | 2.8                 | 4.6                    | 3.1                 |
| Minority interest in net earnings of subsidiaries                                  | (0.1)                | (0.1)               | (0.1)                  | (0.1)               |
| Earnings before change in accounting principle                                     | 3.5                  | 2.7                 | 4.5                    | 3.0                 |
| Change in accounting principle - writedown of intangible assets, net of taxes      |                      |                     | (0.9)                  |                     |
| Net earnings                                                                       | 3.5%                 | 2.7%                | 3.6%                   | 3.0%                |



Set forth in the following table is certain summary information with respect to the Company's operations for the periods indicated.

**OPERATING RESULTS**

| (dollars in millions)          | Thirteen Weeks Ended |                     | Twenty-Six Weeks Ended |                     |
|--------------------------------|----------------------|---------------------|------------------------|---------------------|
|                                | February 1,<br>2003  | January 26,<br>2002 | February 1,<br>2003    | January 26,<br>2002 |
| <b>REVENUES</b>                |                      |                     |                        |                     |
| Specialty Retail Stores        | \$ 756.1             | \$ 745.7            | \$ 1,357.2             | \$ 1,306.6          |
| Direct Marketing(1)            | 161.3                | 144.4               | 275.6                  | 246.2               |
| Other(2)                       | 21.1                 | 18.0                | 39.7                   | 36.4                |
| Total                          | \$ 938.5             | \$ 908.1            | \$ 1,672.5             | \$ 1,589.2          |
| <b>OPERATING EARNINGS</b>      |                      |                     |                        |                     |
| Specialty Retail Stores(3)     | \$ 43.8              | \$ 41.2             | \$ 115.5               | \$ 89.1             |
| Direct Marketing(1)            | 18.0                 | 8.3                 | 25.4                   | 6.0                 |
| Other(2)                       | (3.4)                | (2.7)               | (7.3)                  | (6.0)               |
| Total                          | \$ 58.4              | \$ 46.8             | \$ 133.6               | \$ 89.1             |
| <b>OPERATING PROFIT MARGIN</b> |                      |                     |                        |                     |
| Specialty Retail Stores(3)     | 5.8%                 | 5.6%                | 8.6%                   | 6.9%                |
| Direct Marketing(1)            | 11.2%                | 5.8%                | 9.3%                   | 2.5%                |
| Total                          | 6.3%                 | 5.2%                | 8.0%                   | 5.6%                |
| <b>COMPARABLE REVENUES(4)</b>  |                      |                     |                        |                     |
| Specialty Retail Stores        | (2.1)%               | (3.3)%              | 0.9%                   | (7.3)%              |
| Direct Marketing(1)            | 11.7%                | 1.2%                | 12.0%                  | (0.5)%              |
| Total                          | 0.5%                 | (3.0)%              | 2.8%                   | (6.5)%              |

(1) Direct Marketing includes the operations of Neiman Marcus Direct and the Company's online operations. During fiscal year 2002, the Company reclassified its Neiman Marcus Online operations to the Direct Marketing segment from Other. Prior year amounts have been reclassified to conform to the current year presentation.

(2) Other includes the operations of the Brand Development Companies and corporate expenses.

(3) Segment operating earnings for the second quarter of 2002 exclude a \$2.0 million pretax charge in connection with certain cost reduction strategies consisting primarily of severance costs and lease termination expenses incurred in connection with the closing of the Galleries of Neiman Marcus store in Seattle, Washington.

(4) Comparable revenues include 1) revenues derived from the Company's retail stores open for more than 52 weeks, including stores that have been relocated or expanded, 2) revenues from the Company's Direct Marketing operations and 3) revenues from the Company's Brand Development Companies.

**THIRTEEN WEEKS ENDED FEBRUARY 1, 2003 COMPARED TO THIRTEEN WEEKS ENDED JANUARY 26, 2002**

*Revenues.* Revenues for the second quarter of 2003 of \$938.5 million increased \$30.4 million, or 3.3 percent, from \$908.1 million in the prior year period. The increase in revenues was attributable to both an increase in comparable revenues and revenues generated by new stores.

Comparable revenues in the second quarter of 2003 increased 0.5 percent compared to the second quarter of 2002. Comparable revenues decreased 2.1 percent for Specialty Retail Stores and increased 11.7 percent for Direct Marketing. The increase in comparable revenues for Direct Marketing was attributable to increased sales in both the Company's catalogue and online businesses. Comparable revenues in the second quarter of 2002 declined by 3.0 percent.

Comparable revenues for the Brand Development Companies increased in the second quarter of 2003, with increases for both Kate Spade LLC and Gurwitch Bristow Products, LLC.

The Company opened a new clearance store in the Denver, Colorado area in November 2002 and completed a 60,000 square foot expansion and remodel of the Las Vegas Neiman Marcus store during the second quarter of 2003.

*Gross margin.* Gross margin was 30.3 percent of revenues for the second quarter of 2003 compared to 28.9 percent for the second quarter of 2002. The increase in gross margin was primarily due to a decrease in markdowns offset, in part, by an increase in buying and occupancy costs as a percentage of revenues.

Markdowns decreased as a percentage of revenues for the second quarter of 2003 compared to the prior year period. The Company incurred a higher level of markdowns in the second quarter of 2002 in connection with additional and more aggressive promotional events necessary to clear inventories in response to declines in retail sales.

Consistent with industry business practice, the Company receives reimbursement from certain vendors for markdowns related to the vendor's merchandise and/or to support the gross margins earned by the Company in connection with the sale of the vendor's merchandise. These reimbursements are included as a reduction to cost of goods sold, including buying and occupancy costs in the period in which the markdowns are incurred or when the Company otherwise earns such reimbursements. A substantial portion of these vendor reimbursements are received at the end of the Company's second and fourth fiscal quarters. The amounts of vendor reimbursements received by the Company did not have a significant impact on the year-over-year improvement in gross margin in the second quarter of 2003.

Buying and occupancy costs increased as a percentage of revenues during the second quarter of 2003 compared to the prior year period primarily due to a higher ratio of buying and occupancy expenses to revenues for the Company's less mature stores.

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*Selling, general and administrative expenses.* Selling, general and administrative expenses (SG&A) were 24.0 percent of revenues in the second quarter of 2003 compared to 23.7 percent of revenues in the second quarter of 2002.

The net increase in SG&A as a percentage of revenues in the second quarter of 2003 was primarily due to 1) a higher ratio of SG&A to revenues for the Company's less mature stores, 2) increased preopening costs incurred in connection with the opening of two Neiman Marcus stores in the first quarter of 2003, the opening of a new clearance store in the second quarter of 2003, and the completion of the remodel of the Las Vegas Neiman Marcus store in the second quarter of 2003, and 3) higher health care and other benefit expenses.

The increases in SG&A were partially offset by 1) lower catalogue production and circulation costs due primarily to a planned reduction in catalogue circulation and the leveraging of the fixed-cost component of Direct Marketing expenses, 2) lower SG&A as a percentage of revenues for the Company's more mature stores, and 3) the elimination of amortization of the Company's intangible assets upon implementation of a new accounting principle in the first quarter of 2003.

*Segment operating earnings.* Operating earnings for the Specialty Retail Stores segment were \$43.8 million in the second quarter of 2003 compared to \$41.2 million in the second quarter of 2002. This increase was primarily the result of increased sales and reduced markdowns offset, in part, by increased buying and occupancy expenses and increased SG&A expenses as percentages of revenues.

Operating earnings for Direct Marketing increased to \$18.0 million in the second quarter of 2003 from \$8.3 million in the second quarter of 2002, primarily as a result of an improvement in the operating performance of the Company's online operations and lower catalogue production and circulation costs due to planned reduction in catalogue circulation.

*Interest expense, net.* Net interest expense was \$4.3 million for both the second quarter of 2003 and the second quarter of 2002. Net interest expense for the second quarter of 2003 reflects a decrease in capitalized interest charges associated with store construction offset, in part, by reduced interest costs associated with lower borrowings on the Company's revolving credit facility compared to the prior year period. Seasonal borrowings under the Company's revolving credit facility reached \$80 million in the second quarter of 2003 compared to \$130 million in the prior year.

*Income taxes.* The Company's effective income tax rate was 38.5 percent for the second quarter of 2003 and 38.0 percent for the second quarter of 2002.

**TWENTY-SIX WEEKS ENDED FEBRUARY 1, 2003 COMPARED TO TWENTY-SIX WEEKS ENDED JANUARY 26, 2002**

*Revenues.* Revenues for 2003 of \$1,672.6 million increased \$83.3 million, or 5.2 percent, from \$1,589.2 million in the prior year period. The increase in revenues was attributable to both an increase in comparable revenues and revenues generated by new stores.

Comparable revenues in 2003 increased 2.8 percent compared to the prior year period. Comparable revenues increased 0.9 percent for Specialty Retail Stores and 12.0 percent for Direct Marketing. The increase in comparable revenues for Direct Marketing was attributable to increased sales in both the Company's catalogue and online businesses. Sales in September and October 2001 were significantly impacted by a decrease in consumer spending subsequent to the September 11, 2001 terrorist attacks in the United States. Comparable revenues in 2002 declined by 6.5 percent.

Comparable revenues for the Brand Development Companies increased in 2003, with the increase for Gurwitch Bristow Products, LLC being offset, in part, by a decrease for Kate Spade LLC.

The Company opened a new Neiman Marcus store in Coral Gables, Florida during September 2002 and a new Neiman Marcus store in Orlando, Florida during October 2002. During November 2002, the Company opened a new clearance store in the Denver, Colorado area and during the second quarter of 2003 completed a 60,000 square foot expansion and remodel of the Las Vegas Neiman Marcus store.

*Gross margin.* Gross margin was 33.7 percent of revenues in 2003 compared to 31.9 percent for the prior year period. The increase in gross margin was primarily due to a decrease in markdowns offset, in part, by an increase in buying and occupancy costs as percentages of revenues.

Markdowns decreased as a percentage of revenues compared to the prior year period. The Company incurred a higher level of markdowns in the first and second quarters of 2002 in connection with additional and more aggressive promotional events necessary to clear inventories in response to declines in retail sales.

Consistent with industry business practice, the Company receives reimbursement from certain vendors for markdowns related to the vendor's merchandise and/or to support the gross margins earned by the Company in connection with the sale of the vendor's merchandise. These reimbursements are included as a reduction to cost of goods sold, including buying and occupancy costs in the period in which the markdowns are incurred or when the Company otherwise earns such reimbursements. A substantial portion of these vendor reimbursements are received at the end of the Company's second and fourth fiscal quarters. The amounts of vendor reimbursements received by the Company did not have a significant impact on the year-over-year improvement in gross margin in 2003.

Buying and occupancy costs increased as a percentage of revenues in 2003 compared to the prior year period primarily due to a higher ratio of buying and occupancy expenses to revenues for the Company's less mature stores offset, in part, by reduced buying and occupancy costs as a percentage of revenues for mature stores.

*Selling, general and administrative expenses.* SG&A expenses were 25.7 percent of revenues in 2003 compared to 26.3 percent of revenues in the prior year period.

The net decrease in SG&A as a percentage of revenues in 2003 was primarily due to 1) a lower level of SG&A as a percentage of revenues for the Company's more mature stores, 2) lower catalogue production and circulation costs due primarily to a planned reduction in catalogue circulation and the leveraging of the fixed-cost component of Direct Marketing expenses, and 3) the elimination of amortization of the Company's intangible assets in the first quarter of fiscal year 2003 upon implementation of a new accounting principle.

The decreases in SG&A were partially offset by 1) a higher ratio of SG&A to revenues for the Company's less mature stores, 2) higher health care and other benefit expenses and higher professional fee expenses, 3) increased preopening costs incurred in connection with the opening of two Neiman Marcus stores in the first quarter of 2003, the opening of a new clearance store in the second quarter of 2003, and the completion of the remodel of the Las Vegas Neiman Marcus store in the second quarter of 2003, and 4) certain officer separation and retirement costs.

*Segment operating earnings.* Operating earnings for the Specialty Retail Stores segment were \$115.5 million in 2003 compared to \$89.1 million in the prior year period. This increase was primarily the result of increased sales and reduced markdowns offset, in part, by increased buying and occupancy expenses and increased SG&A expenses as percentages of revenues.

Operating earnings for Direct Marketing increased to \$25.4 million in 2003 from \$6.0 million in the prior year period, primarily as a result of an improvement in the operating performance of the Company's online operations and lower catalogue production and circulation costs due to planned reduction in catalogue circulation.

*Interest expense, net.* Net interest expense was \$7.9 million in 2003 compared to \$8.2 million for the prior year period. The decrease in net interest expense of \$0.3 million was primarily due to reduced interest costs associated with lower borrowings on the Company's revolving credit facility offset, in part, by a decrease in capitalized interest charges associated with store construction. Seasonal borrowings under the Company's revolving credit facility reached \$80 million in the second quarter of 2003 compared to \$130 million in the prior year.

*Income taxes.* The Company's effective income tax rate was 38.5 percent in 2003 and 38.0 percent in the prior year period.

*Change in accounting principle - writedown of intangible assets, net of taxes.* The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets as of the beginning of the first quarter of fiscal year 2003. SFAS No. 142 established a new fair value-based accounting model for the valuation of goodwill and indefinite-lived intangible assets recorded in connection with business combinations. Pursuant to the provisions of SFAS No. 142, goodwill and indefinite-lived intangible assets are measured for impairment by applying a fair value-based test at least annually and are not amortized. Based upon its review procedures and the valuation results of its independent third party appraisal experts, the Company recorded a \$24.1 million writedown in the carrying value of the indefinite-lived intangible assets of its Direct Marketing segment. The writedown (\$14.8 million, net of taxes) is reflected as a change in accounting principle in the accompanying Condensed Consolidated Statements of Earnings.



## QUARTERLY DATA AND SEASONALITY

The specialty retail industry is seasonal in nature and a disproportionately higher level of the Company's revenues and earnings are generated in the fall and holiday selling seasons. The Company's working capital requirements and inventories increase substantially in the first fiscal quarter in anticipation of the holiday selling season.

## LIQUIDITY AND CAPITAL RESOURCES

The Company's cash requirements consist principally of the funding of its merchandise purchases, capital expenditures for new store growth, store renovations, upgrades of its management information systems, debt service requirements and funding of the Company's obligations related to its defined benefit pension plan. The Company's working capital requirements fluctuate during the year, increasing substantially during the fall season as a result of higher planned seasonal inventory levels.

In 2003, cash provided by operating activities was \$144.9 million compared to cash provided by operating activities of \$184.7 million for the prior year period. Despite an increase in net earnings (before the non-cash impact of the accounting change in the first quarter of 2003), cash provided by operating activities decreased in 2003 by approximately \$39.8 million compared to the prior year period. This decrease was primarily the result of a higher net investment in inventory (inventory less accounts payables) compared to the prior year period. A significant portion of the higher net investment in inventories in the current year relates to the two new Neiman Marcus stores and two new clearance stores opened since the end of the first quarter of 2002.

As of February 1, 2003, the Company had cash and cash equivalents of \$161.2 million and no outstanding borrowings under the Company's \$300 million unsecured revolving credit facility. During the second quarter of fiscal year 2003, the Company repaid the \$80 million previously borrowed to fund seasonal working capital requirements. At January 26, 2002, the Company had cash and cash equivalents of \$137.2 million and no outstanding borrowings under the Company's \$450 million unsecured revolving credit facility. The \$450 million revolving credit facility was replaced by the \$300 million credit facility on August 26, 2002.

In prior years, the Company's Board of Directors has authorized various stock repurchase programs and increases in the number of shares subject to repurchase. During the second quarter of fiscal year 2003, the Company repurchased 524,177 shares at an average purchase price of \$28.65. As of February 1, 2003, approximately 1.4 million shares remained available for repurchase under the Company's stock repurchase programs.

The Company has a noncontributory defined benefit pension plan (Pension Plan) covering substantially all full-time employees. Benefits under the Pension Plan are based on the employees' years of service and compensation over defined periods of employment. Pension Plan assets consist primarily of equity and fixed income securities. When funding is required, the Company's policy is to contribute amounts that are deductible for federal income tax purposes. The Company anticipates making a contribution of \$11.5 million to the Pension Plan for the plan year ended July 2001 in the third quarter of 2003. The Company's contribution for the plan year ended July 2002 is estimated to be \$17.3 million and will be funded in quarterly installments during 2003 and 2004.

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Pension expense is based on information provided by the Company's actuaries that uses assumptions to estimate the total benefits ultimately payable to associates and allocates this cost to service periods. The actuarial assumptions used to calculate pension costs are reviewed annually. The Company recorded pension expense of \$2.6 million for the second quarter of 2003 and \$1.5 million for the second quarter of 2002. The Company recorded pension expense of \$5.2 million for 2003 and \$3.0 million for 2002.

The Company currently plans to open two new Neiman Marcus stores over the next three fiscal years and has consistently focused on renovating and modernizing its existing stores to improve productivity. The Company anticipates capital expenditures for fiscal year 2003 to be approximately \$120 million to \$130 million.

## OUTLOOK

Based on current assumptions, the Company anticipates comparable store revenues to be in the negative 1.0 percent to positive 1.0 percent range for the third quarter of 2003. The accuracy of these assumptions and of the resulting forecasts is subject to uncertainties and circumstances beyond the Company's control. Consequently, actual results could differ materially from the forecasted results. See "Factors That May Affect Future Results" for a discussion of items and events that could cause actual results to vary from the Company's expectations.

Management believes that operating cash flows, currently available vendor financing and amounts available pursuant to its \$300 million revolving credit facility and its credit card securitization program should be sufficient to fund the Company's operations, debt service, pension funding requirements and currently anticipated capital expenditure requirements through the end of 2003.

## IMPACT OF INFLATION

The Company believes changes in revenues and net earnings that have resulted from inflation and changing prices have not been material during the periods presented. The Company adjusts selling prices to maintain certain profit levels and will continue to do so in the future as economic conditions permit. There is no assurance, however, that inflation will not materially affect the Company in the future.

## RECENT ACCOUNTING PRONOUNCEMENTS

In June 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies the guidance previously provided in Emerging Issues Task Force Issue (EITF) No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity is recognized at fair value when the liability is incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of SFAS No. 146 will be effective for disposal activities initiated after December 31, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for periods beginning after December 15, 2002. Accordingly, the Company will begin making the disclosures required by SFAS No. 148 beginning in the third quarter of fiscal year 2003.

In November 2002, the EITF reached a consensus on Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Cash Consideration Received from a Vendor." EITF Issue No. 02-16 provides guidance on how cash consideration received by the Company, as a reseller of others goods, should be classified in its statement of earnings. The Company does not expect EITF Issue No. 02-16 to have a material impact on its consolidated financial position or operating results.



**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The market risk inherent in the Company's financial instruments represents the potential loss arising from adverse changes in interest rates and foreign currency exchange rates. The Company does not enter into derivative financial instruments for trading purposes. The Company seeks to manage exposure to adverse interest rate changes through its normal operating and financing activities.

Future borrowings under the Company's revolving credit facility, to the extent of outstanding borrowings, would be affected by interest rate changes. As of February 1, 2003, the Company had no borrowings outstanding under this facility.

The Company's outstanding long-term debt as of February 1, 2003 is at fixed interest rates and would not be affected by interest rate changes.

Pursuant to a revolving credit card securitization program that begins to expire in September 2005, the Company sold substantially all of its credit card receivables through a subsidiary in exchange for certificates representing undivided interests in such receivables. The Class A Certificates, which have an aggregate principal value of \$225 million, were sold to investors. The holders of the Class A Certificates are entitled to monthly interest distributions from the Trust at the contractually-defined rate of one month LIBOR plus 0.27 percent annually. The distributions to the Class A Certificate holders are payable from the finance charge income generated by the credit card receivables held by the Trust. At February 1, 2003, the Company estimates a 100 basis point increase in LIBOR would result in an approximate annual decrease of \$2.25 million in income to the Company from its Retained Interests in the credit card portfolio held by the Trust.

The Company uses derivative financial instruments to manage foreign currency risk related to the procurement of merchandise inventories from foreign sources. The Company enters into foreign currency contracts denominated in the euro and British pound. The Company had foreign currency contracts in the form of forward exchange contracts in the amount of approximately \$39.4 million as of February 1, 2003 and approximately \$35.0 million as of January 26, 2002. The market risk inherent in these instruments was not material to the Company's consolidated financial position, results of operations, or cash flows for the thirteen weeks and twenty-six weeks ended February 1, 2003 and January 26, 2002.

Based on a review of the Company's financial instruments outstanding at February 1, 2003 that are sensitive to market risks, the Company has determined that there was no material market risk exposure to the Company's consolidated financial position, results of operations, or cash flows as of such date.

**ITEM 4. CONTROLS AND PROCEDURES**

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports filed under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized and reported within required time periods. The Company's Chief Executive Officer and Chief Financial Officer, as well as other key members of the Company's management, evaluated the effectiveness of the disclosure controls and procedures (as such term is defined in Rules 13a-14(c) and 15d-14(c) of the Exchange Act) of the Company as of a date within 90 days before the filing of this quarterly report (the Evaluation Date). Based on that evaluation, such officers have concluded that, as of the Evaluation Date, such controls and procedures are effective to ensure that required information will be disclosed on a timely basis in the Company's reports filed under the Exchange Act.

(b) Changes in Internal Controls

There have been no significant changes to the Company's internal controls or in other factors that could significantly affect the disclosure controls and procedures since the Evaluation Date.

**THE NEIMAN MARCUS GROUP, INC.**

PART II

Item 1. Legal Proceedings

Note 10 of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 is incorporated herein by reference as if fully restated herein. Note 10 contains forward-looking statements that are subject to the risks and uncertainties discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations Factors That May Affect Future Results.

Item 4. Submission of Matters to a Vote of Security Holders

1. The Annual Meeting of Shareholders of the Company was held on January 21, 2003. One Class A director and two Class B directors were elected to serve for three-year terms expiring at the 2006 Annual Meeting of Shareholders as follows:

|                          | Votes<br>Cast For | Votes<br>Withheld | Broker<br>Non-Votes |
|--------------------------|-------------------|-------------------|---------------------|
| <u>CLASS A Director</u>  |                   |                   |                     |
| Vincent M. O Reilly      | 20,321,398        | 3,768,615         | 0                   |
| <u>CLASS B Directors</u> |                   |                   |                     |
| John R. Cook             | 16,052,152        | 1,168,897         | 0                   |
| Burton M. Tansky         | 16,051,485        | 1,169,564         | 0                   |

Only holders of Class A Common Stock are entitled to vote on the election of the Class A director and only holders of Class B Common Stock are entitled to vote on the election of the Class B directors. There were no abstentions with respect to the election of directors.

Richard A. Smith, Robert A. Smith, Brian J. Knez, Walter J. Salmon, Matina S. Horner, Paula Stern, Gary L. Countryman and Carl Sewell continued as directors of the Company.

2. Ratification of the appointment by the Board of Directors of Deloitte & Touche LLP as the Company's independent auditors for the 2003 fiscal year:

|         |            |
|---------|------------|
| For     | 35,682,556 |
| Against | 5,579,246  |
| Abstain | 49,260     |

3. Stockholder proposal concerning cumulative voting in the election of directors:

|                  |            |
|------------------|------------|
| For              | 9,132,809  |
| Against          | 29,304,201 |
| Abstain          | 91,526     |
| Broker Non-Votes | 2,782,526  |

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

**10.25 Separation Agreement and General Release by and between Gerald A. Sampson and The Neiman Marcus Group, Inc. dated January 1, 2003.**

(b) Reports on Form 8-K

None.



SIGNATURES

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

THE NEIMAN MARCUS GROUP, INC.

| <b>Signature</b>                           | <b>Title</b>                                                    | <b>Date</b>    |
|--------------------------------------------|-----------------------------------------------------------------|----------------|
| /s/ T. Dale Stapleton<br>T. Dale Stapleton | Vice President and Controller<br>(principal accounting officer) | March 17, 2003 |

CERTIFICATION REQUIRED BY SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002

I, Burton M. Tansky, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of The Neiman Marcus Group, Inc.;
2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Quarterly Report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Quarterly Report (the "Evaluation Date"); and
  - (c) presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and;
6. The registrant's other certifying officer and I have indicated in this Quarterly Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with

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regard to significant deficiencies and material weaknesses.

/s/ Burton M. Tansky  
Burton M. Tansky  
President and Chief Executive Officer

March 17, 2003

CERTIFICATION REQUIRED BY SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002

I, James E. Skinner, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of The Neiman Marcus Group, Inc.;
2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Quarterly Report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Quarterly Report (the "Evaluation Date"); and
  - (c) presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this Quarterly Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ James E. Skinner

March 17, 2003

James E. Skinner  
Senior Vice President and Chief Financial Officer