

REEDS JEWELERS INC
Form 10-Q
July 15, 2002

Table of Contents

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON DC 20549**

FORM 10-Q

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

**FOR THE QUARTER ENDED MAY 31, 2002
COMMISSION FILE NUMBER 0-15247**

REEDS JEWELERS, INC.

(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

56-1441702

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

2525 South Seventeenth Street

Wilmington, North Carolina

(Address of principal executive offices)

28401

(Zip code)

Registrant's telephone number, including area code:

(910) 350-3100

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 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 the number of shares outstanding of each of the issuer's class of common stock, as of the latest practicable date.

The number of outstanding shares of Common Stock, par value \$0.10 per share, as of July 15, 2002 was 8,476,372.

TABLE OF CONTENTS

PART I

Item 1. Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Item 2. Changes in Securities.

Item 3. Defaults Upon Senior Securities.

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

Item 5. Other Information.

Item 6. Exhibits and Reports on Form 8-K.

SIGNATURES

Table of Contents

PART I

Item 1. *Financial Statements*

The consolidated financial statements included herein have been prepared by Reeds Jewelers, Inc. (the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations; however, the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest annual report on Form 10-K for the fiscal year ended February 28, 2002.

Table of Contents**REEDS JEWELERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

	February 28 2002	May 31 2002	May 31 2001
ASSETS		(unaudited)	(unaudited)
Current assets:			
Cash and cash equivalents	\$ 809,000	\$ 533,000	\$ 832,000
Accounts receivable:			
Customers, less allowance for doubtful accounts of \$1,043,000, \$834,000 and \$3,903,000	133,000	159,000	44,883,000
Other	488,000	1,095,000	1,361,000
Merchandise inventories	44,337,000	49,650,000	53,401,000
Income taxes receivable	6,776,000	7,300,000	1,258,000
Deferred income taxes, net of valuation allowance of \$138,000 in 2001 (Note C)			2,065,000
Other	654,000	954,000	769,000
	<u>53,197,000</u>	<u>59,691,000</u>	<u>104,569,000</u>
Property, furniture and equipment:			
Land and building	83,000	83,000	83,000
Furniture and equipment	20,650,000	20,155,000	26,585,000
Leasehold improvements	9,186,000	9,135,000	12,524,000
	<u>29,919,000</u>	<u>29,373,000</u>	<u>39,192,000</u>
Less accumulated depreciation and amortization	17,765,000	17,848,000	20,361,000
	<u>12,154,000</u>	<u>11,525,000</u>	<u>18,831,000</u>
Other assets:			
Goodwill, net of accumulated amortization of \$3,104,000 in 2001			5,291,000
Deferred income taxes, net of valuation allowance of \$18,000 in 2001 (Note C)			275,000
Restricted investments (Note D)			2,514,000
Other receivable, less allowance of \$906,000, \$906,000 and \$0	5,474,000	5,474,000	
Miscellaneous	1,123,000	1,081,000	893,000
	<u>6,597,000</u>	<u>6,555,000</u>	<u>8,973,000</u>
TOTAL ASSETS	<u>\$71,948,000</u>	<u>\$77,771,000</u>	<u>\$132,373,000</u>
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Accounts payable	\$17,233,000	\$16,999,000	\$ 18,441,000
Accrued compensation	2,011,000	1,783,000	1,827,000
Accrued expenses	3,805,000	2,924,000	2,331,000
	<u>23,049,000</u>	<u>21,706,000</u>	<u>22,599,000</u>
Revolving credit note	15,809,000	23,874,000	63,224,000
Subordinated notes payable to shareholders	2,579,000	2,579,000	845,000
Deferred income taxes (Note C)			2,212,000
Other long-term liabilities	855,000	856,000	212,000
	<u>855,000</u>	<u>856,000</u>	<u>212,000</u>

Edgar Filing: REEDS JEWELERS INC - Form 10-Q

Total liabilities	42,292,000	49,015,000	89,092,000
Shareholders' equity:			
Common stock, par value \$0.10 per share; 25,000,000 shares authorized; 8,476,372 shares issued and outstanding in 2002 and 2001			
	847,000	847,000	847,000
Additional paid-in capital	10,560,000	10,560,000	10,560,000
Retained earnings	18,249,000	17,349,000	31,874,000
	<u> </u>	<u> </u>	<u> </u>
Total shareholders' equity	29,656,000	28,756,000	43,281,000
	<u> </u>	<u> </u>	<u> </u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$71,948,000	\$77,771,000	\$132,373,000
	<u> </u>	<u> </u>	<u> </u>

Table of Contents

REEDS JEWELERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three months ended May 31	
	2002	2001
Net sales	\$ 21,107,000	\$ 21,293,000
Cost of sales	10,570,000	10,883,000
Gross profit	10,537,000	10,410,000
Selling, general and administrative expenses	10,974,000	12,341,000
Depreciation and amortization	608,000	980,000
Operating loss	(1,045,000)	(2,911,000)
Interest expense	383,000	488,000
Loss from continuing operations before income taxes	(1,428,000)	(3,399,000)
Income tax benefit	(528,000)	(1,073,000)
Loss from continuing operations	(900,000)	(2,326,000)
Income from discontinued credit operations, net of income tax expense of \$249,000 in 2001		575,000
Net loss	\$ (900,000)	\$ (1,751,000)
Basic and diluted net loss from continuing operations per share	\$ (0.11)	\$ (0.27)
Basic and diluted net income from discontinued credit operations per share		0.06
Basic and diluted net loss per share	\$ (0.11)	\$ (0.21)
Weighted average shares outstanding diluted	8,476,372	8,476,372

Table of Contents

REEDS JEWELERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Three months ended May 31	
	2002	2001
	<u> </u>	<u> </u>
Operating activities		
Net loss	\$ (900,000)	\$(1,751,000)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities of continuing operations:		
Income from discontinued credit operations		(824,000)
Depreciation	579,000	848,000
Amortization	29,000	132,000
(Gain) loss on sale of property, furniture and equipment	(88,000)	12,000
Changes in operating assets and liabilities:		
Accounts receivable	(633,000)	4,813,000
Merchandise inventories	(5,313,000)	(4,849,000)
Other current assets and other assets	(287,000)	231,000
Accounts payable	(234,000)	5,023,000
Accrued compensation and expenses	(1,109,000)	(495,000)
Income taxes	(524,000)	(910,000)
Other long-term liabilities	1,000	1,000
	<u> </u>	<u> </u>
Net cash (used in) provided by operating activities of continuing operations	(8,479,000)	2,231,000
Investing activities		
Proceeds from sale of property, furniture and equipment	285,000	
Purchases of property, furniture and equipment	(147,000)	(1,547,000)
	<u> </u>	<u> </u>
Net cash provided by (used in) investing activities	138,000	(1,547,000)
Financing activities		
Net proceeds from (payments on) revolving credit note	8,065,000	(537,000)
	<u> </u>	<u> </u>
Net cash provided by (used in) financing activities	8,065,000	(537,000)
	<u> </u>	<u> </u>
Net (decrease) increase in cash and cash equivalents	(276,000)	147,000
Cash and cash equivalents at beginning of period	809,000	685,000
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	\$ 533,000	\$ 832,000
	<u> </u>	<u> </u>
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest	\$ 613,000	\$ 1,134,000
	<u> </u>	<u> </u>
Income taxes	\$ (3,800)	\$ 10,000
	<u> </u>	<u> </u>

Table of Contents**REEDS JEWELERS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****A. MANAGEMENT S OPINION**

These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Form 10-K for the fiscal year ended February 28, 2002.

Management of Reeds Jewelers, Inc. believes that the consolidated financial statements contained herein contain all adjustments necessary to present fairly the financial position, consolidated results of operations, and cash flows for the interim period. Management also believes that all adjustments so made are of a normal and recurring nature.

B. RECLASSIFICATIONS

Certain reclassifications were made to the 2001 financial statements to conform to the classifications used in 2002. The reclassifications had no material effect on net loss or shareholders equity as previously reported.

C. INCOME TAXES

Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws anticipated to be in effect when those differences are expected to reverse. For the quarters ended May 31, 2002 and 2001 the Company generated net losses. The Company has established a valuation allowance for these net operating losses and certain other deferred tax assets. The Company will reduce the valuation allowance when, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will be realized.

D. RESTRICTED INVESTMENTS

	<u>05/31/02</u>	<u>05/31/01</u>
Cash	\$	\$ 17,000
Held-to-maturity investments		2,437,000
Equity investment		60,000
	—	—
Total restricted investments	\$	\$2,514,000

Restricted investments in the accompanying balance sheet represent cash, bonds and stock held by the Company s subsidiary, First Retail Bank N.A., to comply with the Federal Banking Regulations.

The held-to-maturity investments consist of Federal Home Loan Bank bonds. These bonds are stated at cost at May 31, 2001, as the company held these securities until maturity in June 2001. The Company s equity investment, carried at cost, consists of 1,200 shares of Federal Reserve Bank stock with a \$50 par value at May 31, 2001.

In October 2001, the company dissolved the First Retail Bank, N.A., and as a result, the restricted investments became available for general use.

Table of Contents**E. OPERATING SEGMENT INFORMATION**

On February 28, 2002, Reeds Jewelers discontinued its credit segment. The Company sold substantially all of the outstanding accounts receivable owned by its subsidiary Reeds Financial Services, Inc. (RFSI). In connection with the sale of the accounts receivable portfolio the Company signed a seven-year agreement with the purchaser whereby the purchaser will provide a full-service private label credit card program to Reeds Jewelers, Inc. Upon outsourcing its credit operations, the Company closed its credit facilities in Wilmington, NC and Flowery Branch, GA. In accordance with SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, the Company reported two segments, retail operations and credit operations. Separate financial information was produced internally and was regularly reviewed by the chief operating decision-maker (CODM). The retail operations segment consists of all store locations and corporate headquarters. The stores have all been combined into one segment because they have similar basic characteristics, such as the nature of products, and the class of customers for their products. Corporate headquarters is included in this same segment due to the fact that its revenues earned are incidental to the Company s activities and it serves as a support system to the stores. The credit operations segment was primarily engaged in providing and maintaining financing for the Company s customers. This operation was segregated since the CODM evaluated it separately. It also met one of the three quantitative thresholds, the asset test, since it represented 10.0% or more of the combined assets of all operating segments.

The following table summarizes the net sales, revenues, operating earnings, interest expense, assets, depreciation, and capital expenditures for each reportable segment for the quarters ended May 31, 2002 and 2001. In the financial statements, other revenues are reflected as a reduction of selling, general, and administrative expenses and inter-segment revenue eliminates in consolidation.

	Retail Operations	Credit Operations	Total
<i>For the quarter ended May 31, 2002</i>			
Net Sales	\$ 21,107,000	\$	\$ 21,107,000
Other revenues	351,000		351,000
Inter-segment revenue			
Operating loss excluding inter-segment revenue	(1,045,000)		(1,045,000)
Interest expense	383,000		383,000
Identifiable assets	77,771,000		77,771,000
Depreciation and amortization	608,000		608,000
Capital expenditures	147,000		147,000

	Retail Operations	Credit Operations	Total
<i>For the quarter ended May 31, 2001</i>			
Net Sales	\$ 21,293,000	\$	\$ 21,293,000
Other revenues	394,000	3,429,000	3,823,000
Inter-segment revenue		169,000	169,000
Operating (loss) earnings excluding inter-segment revenue	(2,911,000)	1,444,000	(1,467,000)
Interest expense	488,000	620,000	1,108,000
Identifiable assets	84,375,000	47,998,000	132,373,000
Depreciation and amortization	980,000	34,000	1,014,000
Capital expenditures	1,547,000		1,547,000

Table of Contents**F. RESTRUCTURING CHARGE**

In the fiscal year ended February 28, 2002, \$6,020,000 was recorded for restructuring and related costs associated with the Company's exit from under-performing markets. These costs, in accordance with EITF 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring), represent the costs of closing 23 stores out of a total 31 identified under-performing stores and costs of not opening 3 new stores in new or under-performing markets. The amounts recorded consist of the costs associated with buying out store leases, store closing costs, and the loss on the sale or abandonment of leasehold improvements and furniture and fixtures. The restructuring charge also includes the severance costs associated with reducing its corporate office personnel by approximately 20% and its store personnel by approximately 17%. The Company expects the execution of its restructuring plan to be completed during fiscal year ended February 2003. The remaining liability as of May 31, 2002 was \$277,000, which is included in accrued expenses on the balance sheet. As of May 31, 2002, the following amounts were recorded:

Activity For the Period Ended May 31, 2002

	Balance at February 28, 2002	Accruals	Write-offs/ Payments	Balance at May 31, 2002
Lease exit costs	\$307,000	\$	\$ 49,000	\$258,000
Sale/disposal of fixed assets	33,000		18,000	15,000
Store closing costs				
Severance costs	38,000		38,000	
Professional fees	15,000		11,000	4,000
	<u> </u>	<u>—</u>	<u> </u>	<u> </u>
Totals	\$393,000	\$	\$ 116,000	\$277,000

G. ACCOUNTING CHANGES

As of March 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 144, Accounting for the Impairment of Disposal of Long-Lived Assets, which addresses financial accounting and reporting for the impairment of disposal of long-lived assets. This standard harmonizes the accounting for impaired assets and resolves some of the implementation issues as originally described in SFAS No. 121. The adoption of SFAS 144 did not affect the Company's operations or financial position.

H. DERIVATIVE FINANCIAL INSTRUMENTS

Financial Accounting Standards Board Statement (SFAS) No. 133/138, Accounting for Derivative Instruments and Hedging Activities, as amended, requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings, or recognized in comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is recognized in earnings.

Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cashflows and to lower overall borrowing costs. To achieve these objectives, from time to time the Company enters into interest rate hedge contracts such as swaps and caps in order to mitigate our interest rate risk with respect to various debt instruments. We do not hold these derivatives for trading or speculative purposes.

Table of Contents

Throughout the year ended February 28, 2002, the Company did not hold any derivative instruments. During the first quarter of fiscal 2003, the Company purchased an interest rate cap for \$152,000 with a notional amount of \$20 million. The fair value of our interest rate cap agreement was \$152,000 at May 31, 2002 and is recorded in other assets in the Consolidated Balance Sheet at May 31, 2002. To determine the fair values of derivative and financial instruments, we use a variety of methods and assumptions that are based on market conditions and risks existing at the balance sheet date. For the majority of financial instruments including derivatives and long-term debt, standard market conventions and techniques such as discounted cash flow analysis, option pricing models, replacement cost and termination cost are used to determine fair value. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**Results of Operations***Net Sales*

The Company's total net sales for the first quarter decreased to \$21,107,000 from \$21,293,000, a 0.9% decrease, while operating an average of 16 fewer stores in the first quarter of the current fiscal year. Same store sales, or stores open in comparable periods, increased 8.2% for the quarter ended May 31, 2002 compared to the same quarter of the prior year. During the first quarter of fiscal 2003, the Company opened a new store in Durham NC and closed one under-performing store in Parkersburg WV. Reeds closed two additional under-performing stores in Wichita KS and one under-performing store in Macon GA in June of 2002. Reeds Jewelers presently operates 96 stores in 20 states compared to 118 stores in 20 states at May 31, 2001.

The sales of a retail jeweler depend upon having the right mixture of merchandise available in its stores. Inventory items that have the most favorable turnover and are the most profitable have been identified as core inventory items. The Company averaged 96.0% in-stock on its core items during first quarter fiscal 2003, compared to 92.0% last year; it averaged 89.8% in-stock on its entire basic merchandise mix compared to 88.7% during the same quarter a year ago. During the quarter ended May 31, 2002, core merchandise accounted for 47.6% of net sales, 52.4% of the items offered in the Company's basic merchandise mix, and 31.3% of its inventory investment. In the same quarter last year, core merchandise accounted for 55.0% of net sales, 71.4% of the items offered in the Company's basic merchandise mix, and 35.8% of its inventory investment. In the first quarter of fiscal 2003 and 2002, the average price of each piece of merchandise sold was \$241 and \$246, respectively.

Gross Profit

Gross margins were 49.9% of net sales for the first quarter this year, up from 48.9% for the first quarter last year. The increase results from a higher recovery value on discontinued merchandise during this quarter compared to the same quarter of last year.

Selling, General, and Administrative Expenses (SG&A)

Selling, general, and administrative expenses as a percentage of net sales were 52.0% and 58.0% for the quarters ended May 31, 2002 and 2001, respectively. Significant expense categories are reflected on a normalized basis for the first quarters of the last two fiscal years in the following table:

	2003	2002
Compensation salaries & hourly wages	20.8%	25.3%
Compensation bonuses & commissions	4.2%	2.9%
Compensation benefits & other personnel costs	4.4%	5.6%
Rents for space	12.8%	13.9%
Advertising	2.8%	3.9%

Table of Contents

Selling, general, and administrative expenses decreased as a percentage of net sales primarily due to the combination of the 8.2% increase in comparable store sales and the closing of 23 under-performing stores in the second half of the prior fiscal year. Fixed costs, on a per store basis, including occupancy, base compensation and benefits also decreased 2.3% from the first quarter of the prior year.

In the second half of the prior fiscal year management reduced the basic staffing in the stores by 17% and implemented corporate office personnel reductions (of approximately 20%). These two factors account for the decrease in salaries & hourly wages and benefits & other personnel costs. Bonuses & commissions are higher in the quarter ended May 31, 2002 versus the same quarter in the prior year as a result of the improved sales and operating performance at the store level and an incentive plan introduced to increase sales of discontinued merchandise. Management negotiated additional cooperative advertising agreements from its vendors resulting in lower net advertising expenses.

Interest Expense

Interest expense from continuing operations decreased \$105,000 or 21.5% over the prior year to \$383,000 for the quarter. The Company's effective pre-tax interest rate during the quarter dropped to 5.8% from 6.8% for the same period in the previous year. The decrease in interest expense from continuing operations results predominately from the reduced interest rate. Interest expense related to the financing of the accounts receivable portfolio is included in the income from discontinued credit operations, net of taxes.

Income Taxes

The benefit for income taxes was \$528,000 during the first quarter ended May 31, 2002, compared to a benefit of \$1,073,000 for the same period a year earlier. The Company's anticipated net effective tax rate was 37.0% and 32.0% in the first quarters of fiscal 2003 and 2002, respectively.

Liquidity and Capital Resources

Reeds Jewelers requires cash for purchasing inventory, updating technology and equipment, opening new stores, and remodeling existing locations. The Company's primary sources of liquidity are cash flows generated from operations and its revolving credit facility with the Bank of America, N.A. Cash used in operations for the three months ending May 31, 2002 was \$8,479,000 compared to cash provided by operations of \$2,231,000 for the three months ending May 31, 2001. The main factor that contributed to the change in cash flows from operations was the sale of the accounts receivable portfolio in February 2002. During the quarter ended May 31, 2001 the Company's accounts receivable balance decreased as customers paid for their Christmas and Valentine's Day purchases thereby increasing cash flows provided by operations. Since the accounts receivable portfolio was sold in February 2002, the Company realized the cash benefit in the fourth quarter of fiscal 2002 instead of the first quarter of fiscal 2003. The sale of the accounts receivable in February 2002 also increased the availability on the Company's revolving credit agreement. The Company was therefore able to take advantage of cash payment discounts with its vendors. Working capital needs normally peak in the third quarter as the Company increases inventories to meet anticipated demand during the Christmas selling season. The fourth quarter has historically produced the majority of the Company's cash flows from operations. In June of 2002 the Company received a \$6.3 million tax refund related to net operating losses incurred in fiscal 2001.

The asset-based revolving credit agreement with Bank of America, N.A. is collateralized by substantially all of the Company's assets and permits borrowings of up to \$30 million, subject to advance rates applied to levels of eligible inventory. The Company could have borrowed \$27.1 million at May 31, 2002 based on its eligible inventory and a 55% advance rate. At that time, \$23.9 million was outstanding. The loan agreement requires Reeds Jewelers to satisfy certain financial and other covenants including maintaining a minimum amount of earnings before interest, taxes, depreciation and amortization (EBITDA) and limiting capital expenditures to \$1,000,000 per fiscal year.

Table of Contents

The Company borrowed \$1,734,000 from three related parties in conjunction with the pay-off of its previous revolving credit facility. Interest is payable monthly at the prime rate (4.75% at May 31, 2002) plus 6.0%. The note is secured and is subordinate to the Bank of America, N.A. revolving credit facility. The loan matures on February 28, 2005, but principal payments may be made earlier based on the Company achieving certain financial targets in its audited financial results for the fiscal year ending February 28, 2003.

The Company also has subordinated notes totaling \$845,000 with three related parties, with interest payable monthly at the prime rate (4.75% at May 31, 2002) quoted in *The Wall Street Journal*. The notes are unsecured and are subordinate to the revolving credit facility.

Reeds Jewelers expects to incur capital expenditures of almost \$1,000,000 for the fiscal year ending February 28, 2003 for equipment upgrades and store remodels. The Company does not plan to open additional locations in the current fiscal year.

Disclosure Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements to encourage companies to provide prospective information about their companies without fear of litigation so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the statement. Various forward-looking statements have been made throughout this discussion, including comments about:

- (i) planned store openings and store closings;
- (ii) anticipated capital expenditures

Accordingly, Reeds Jewelers, Inc. hereby identifies the following important factors that could cause its actual financial results to differ materially from those projected by the Company in forward-looking statements:

- (i) availability of favorable locations on terms acceptable to the Company;
- (ii) unexpected changes in the marketing and pricing strategies of competitors;
- (iii) adverse changes in the political environments of countries providing raw materials for the jewelry industry;
- (iv) potential future terrorist attacks and a decline in the domestic economy;
- (v) adverse changes in consumer spending;
- (vi) significant changes in interest rates; or
- (vii) the loss of key executives.

Impact of Inflation

In management's opinion, changes in net sales and net earnings that have resulted from inflation and changing prices have not been material during the periods presented. There is no assurance, however, that inflation will not materially affect Reeds Jewelers, Inc. in the future.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is from time to time involved in routine litigation incidental to the conduct of its business. The Company believes that no currently pending litigation to which it is a party will have a material adverse effect on its consolidated financial condition or results of operations.

Item 2. Changes in Securities.

Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

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

Not applicable.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

Not applicable.

(b) Reports on Form 8-K.

Not applicable.

Table of Contents

SIGNATURES

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

REEDS JEWELERS, INC.

July 15, 2002

/s/ James R. Rouse

James R. Rouse
Treasurer and
Chief Financial Officer