

FOOTSTAR INC
Form 10-Q
November 21, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 1, 2011

or

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

For the transition period from _____ to _____

Commission File Number: 1-11681

FOOTSTAR, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

22-3439443
(I.R.S. Employer Identification No.)

933 MacArthur Blvd., Mahwah, New Jersey
(Address of principal executive offices)

07430
(Zip Code)

(201) 934-2000
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Number of shares outstanding of common stock, par value \$.01 per share, as of November 15, 2011: 24,231,737

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PART 1. FINANCIAL INFORMATION

ITEM 1. Financial Statements.

Consolidated Condensed Statements of Net Assets in Liquidation

October 1, 2011 and January 1, 2011

(Liquidation Basis)

(\$ in millions)

	October 1, 2011 (Unaudited)	January 1, 2011*
Assets:		
Cash and cash equivalents	\$ 4.2	\$ 8.7
Other Receivables	0.3	-
Prepaid expenses	1.2	1.6
Real Estate	6.2	6.2
Investment in FCB I Holdings Inc.	3.2	-
Receivable from FCB I Holdings Inc.	0.8	-
Total assets	15.9	16.5
Liabilities:		
Accounts Payable and Accrued Expenses	3.3	4.2
Other liabilities	1.0	2.5
Total liabilities	4.3	6.7
Net Assets in Liquidation	\$ 11.6	\$ 9.8

* Derived from audited financial information

See accompanying notes to unaudited condensed financial statements.

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Consolidated Condensed Statement of Changes in Net Assets in Liquidation
 For the Nine Months Ended October 1, 2011
 (Liquidation Basis – Unaudited)
 (\$ in millions)

	Nine Months Ended October 1, 2011
Net Assets in liquidation January 1, 2011	\$9.8
Other cash proceeds received	0.2
Net Assets in Liquidation – April 2, 2011	10.0
Decrease in estimated value of FCB I Holdings Inc.	(0.3)
Increase in receivable from FCB I Holdings Inc.	0.6
Bridge loan to FCB I Holdings Inc.	(3.0)
Repayment of bridge loan from FCB I Holdings Inc.	3.0
Other cash proceeds received	0.3
Changes in liquidation accruals	0.7
Net Assets in Liquidation – July 2, 2011	11.3
Increase in receivable from FCB I Holdings Inc.	0.2
Increase in estimated value of FCB I Holdings Inc.	0.3
Increase in other receivables	0.3
Other cash proceeds received	0.1
Changes in liquidation accruals	(0.6)
Net Assets in Liquidation – October 1, 2011	\$ 11.6

See accompanying notes to unaudited condensed financial statements.

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1. Nature of Company

Footstar, Inc. (“Footstar”, the “Company”, “we”, “us” or “our”), a Delaware corporation, is a holding company that is currently winding down pursuant to the Amended Plan of Complete Dissolution and Liquidation of Footstar, Inc. (the “Plan of Dissolution”), which was adopted by Footstar’s stockholders on May 5, 2009.

Until the time it discontinued regular business operations in December 2008, Footstar had operated its business since 1961 through its subsidiaries primarily as a retailer selling family footwear through licensed footwear departments in discount chains and wholesale arrangements. Commencing March 2, 2004, Footstar and most of its subsidiaries filed voluntary petitions for reorganization under Chapter 11 of Title 11 of the United States Code in the United States Bankruptcy Court. On February 7, 2006, Footstar successfully emerged from bankruptcy. As part of its emergence from bankruptcy, substantially all of Footstar’s business operations were related to the agreement pursuant to which it operated the licensed footwear departments in Kmart stores (the “Kmart Agreement”).

Following its emergence from bankruptcy, Footstar’s Board of Directors, with the assistance of investment bankers, evaluated a number of possible alternatives to enhance shareholder value, including acquisition opportunities, changes in the terms of Footstar’s principal contracts, including the early termination of or extension of the Kmart Agreement, the payment of one or more dividends, and the sale of our assets or stock. The Board of Directors determined the best course of action was to operate under the Kmart Agreement through its scheduled expiration at the end of December 2008.

In May 2008, the Board of Directors determined that it was in the best interests of Footstar and its stockholders to liquidate and ultimately dissolve after the expiration of the Kmart Agreement in December 2008 (and other miscellaneous contracts through the end of such term) and to sell and/or dispose of any of Footstar’s other remaining assets, including its owned property in Mahwah, New Jersey, which contains its corporate headquarters building, improvements and 21 acres of underlying land (collectively, the “Mahwah Real Estate”). Under the terms of the Kmart Agreement, Kmart was required to purchase from Footstar all of the remaining inventory in the Kmart footwear departments at values set forth in the Kmart Agreement. The process of selling the inventory to Kmart commenced immediately after the expiration of the Kmart Agreement on December 31, 2008. During 2009, Footstar received approximately \$55.3 million related to the liquidation sale of the inventory from Kmart in full satisfaction of all of Kmart’s obligations. Following the sale of the inventory to Kmart during early 2009, Footstar’s principal remaining non-cash asset consisted of the Mahwah Real Estate.

Also in May 2008, the Board of Directors approved the Plan of Complete Liquidation of Footstar, Inc. (the “Original Plan”), which provided for the complete liquidation and ultimate dissolution of Footstar after expiration of the Kmart Agreement in December 2008.

On March 5, 2009, the Board of Directors adopted and approved the Plan of Dissolution. The Plan of Dissolution reflects technical and legal changes to the Original Plan consistent with the Delaware General Corporate Law and was intended to modify, supersede and replace the Original Plan in order to more efficiently facilitate the liquidation and dissolution of Footstar in the best interests of its stockholders. The Plan of Dissolution provides for the complete, voluntary liquidation of the Company providing for the sale of its remaining assets and the wind down of the Company’s business as described in the Plan of Dissolution and of the distributions of available cash to stockholders as determined by the Board of Directors. On May 5, 2009, at a special meeting of stockholders of Footstar, the stockholders adopted and approved the Plan of Dissolution and Footstar’s dissolution. Subsequent to such time, the Board of Directors moved forward with the liquidation, adopted the liquidation basis of accounting (see Note 2), and worked toward selling all of Footstar’s remaining assets and settling all claims.

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CPEX Pharmaceuticals, Inc. Acquisition

In August 2010, the Board of Directors was made aware of an opportunity regarding a potential strategic transaction with CPEX Pharmaceuticals, Inc. (“CPEX”), an emerging specialty pharmaceutical company whose shares were traded on the Nasdaq Capital Market under the symbol “CPEX”. Substantially all of CPEX’s revenue is a royalty stream under a licensing agreement with Auxilium Pharmaceuticals, Inc. (“Auxilium”) pursuant to which CPEX licenses its CPE-215 technology with a testosterone formulation to Auxilium and receives royalties of 12% from Auxilium based upon Auxilium’s sales of Testim. Testim is a gel for testosterone replacement therapy, which is a formulation of CPEX’s technology with testosterone. Auxilium is currently marketing Testim in the United States, Europe and other countries. From August 2010 through January 3, 2011, Footstar negotiated the terms of a strategic merger transaction with CPEX pursuant to which CPEX would become a majority-owned indirect subsidiary of Footstar (the “CPEX Transaction”).

On January 3, 2011, CPEX, FCB I Holdings Inc., a Delaware corporation (“FCB Holdings”), and FCB I Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of FCB Holdings (“FCB Acquisition”), entered into an Agreement and Plan of Merger (the “CPEX Transaction Agreement”).

On April 5, 2011, the parties completed the CPEX Transaction pursuant to the CPEX Transaction Agreement. As a result of the CPEX Transaction, FCB Acquisition merged with and into CPEX, with CPEX surviving as a wholly owned subsidiary of FCB Holdings.

As of October 1, 2011, FCB Holdings is owned 80.5% by Footstar Corp and 19.5% by an unaffiliated investment holding company (the “Investment Holding Company”). The Investment Holding Company is affiliated with a minority Lender under the Term Loan Agreement (as defined below). Footstar Corp is a wholly-owned subsidiary of Footstar.

Pursuant to the CPEX Transaction, CPEX common stock that was outstanding immediately prior to the effective time of the CPEX Transaction, other than shares held by stockholders who properly exercised their appraisal rights and shares owned by CPEX as treasury stock, was automatically cancelled and converted into the right to receive \$27.25 in cash, without interest and less any applicable withholding taxes.

The acquisition of CPEX was accounted for as a purchase under FASB ASC Topic 805. The purchase price of \$76.1 million (which includes cash paid and liabilities assumed) has been allocated to the estimated fair value of tangible and identifiable intangible assets acquired and liabilities assumed. The excess of the purchase price over the estimated fair value of tangible and identifiable assets acquired and liabilities assumed has been allocated to Intangible Assets based on management’s estimate and pending a final valuation.

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On April 5, 2011, in connection with the CPEX Transaction, FCB I LLC (“Borrower”), a wholly owned subsidiary of FCB Acquisition which became a wholly owned subsidiary of CPEX upon FCB Acquisition’s merger with and into CPEX, borrowed approximately \$64 million under that certain Loan Agreement dated as of January 3, 2011 (the “Term Loan Agreement”), by and among Borrower, The Bank of New York Mellon, as Agent, and certain Lenders from time to time party thereto, in the form of a secured term loan to Borrower. The term loan under the Term Loan Agreement bears interest at “LIBOR” plus 16% per annum and matures on the earlier of January 3, 2026 or the date any of CPEX’s patents that are associated with Testim®, a topical testosterone gel, expire, and contains customary events of default for loans of such nature. As part of the Term Loan Agreement, CPEX contributed to Borrower all of its intellectual property rights in Testim® and rights to the royalty stream pursuant to the license agreement with Auxilium, and the loan is secured by Borrower’s interest in all such rights. Repayment of the loan is made through a waterfall arrangement whereby, if certain conditions are met, the Testim royalty stream is distributed on a quarterly basis as follows: first to pay certain fees and expenses of Agent and Borrower, second to pay fees of the banks maintaining the accounts associated with the loan, third to pay any expenses of Agent used to protect the loan collateral and any other unreimbursed fees or expenses of Agent or any Lender, fourth to replenish any shortfall in the interest reserve (which is \$2.5 million), fifth to pay interest due, sixth to pay 65% of the remaining royalty funds to Agent for the benefit of the Lenders as payment toward loan principal, and finally to Borrower for its benefit.

On April 5, 2011, in connection with the CPEX Transaction, Footstar Corp made a \$3 million bridge loan to FCB Holdings under that certain Loan Agreement dated as of April 5, 2011 (the “Footstar Loan Agreement”), by and between FCB Holdings and Footstar Corp. The loan bore interest at 20% per annum and provided for a fee of 3% of the principal amount (less accrued interest) payable to Footstar, which was due upon repayment of the loan. The bridge loan was repaid on April 5, 2011, prior to maturity.

On April 5, 2011, in connection with the CPEX Transaction, Black Horse Capital LP and Black Horse Capital Master Fund Ltd. (together, “Black Horse”) made a \$10 million bridge loan to FCB Holdings under that certain Loan Agreement dated as of April 5, 2011 (the “Black Horse Loan Agreement”), by and between Black Horse and FCB Holdings. The bridge loan under the Black Horse Loan Agreement had substantially the same terms as the bridge loan under the Footstar Loan Agreement, and was repaid on April 5, 2011, prior to maturity. Footstar Corp is party to a consulting and advisory agreement with the Investment Holding Company for such entity to provide certain consulting and advisory services to Footstar Corp relating to intellectual property and other matters. The agreement provides for payment solely to the extent Footstar Corp has received dividends from FCB Holdings, of which there have been none to date. The annual amounts to be paid, following receipt of such dividends pursuant to the terms of the agreement, would be \$1,000,000 for 2011, \$750,000 for 2012, \$750,000 for 2013, \$500,000 for 2014 and \$250,000 for 2015 and annually thereafter through the agreement termination. The agreement terminates upon the conclusion of the monetization of CPEX’s intellectual property, subject to the terms of the agreement. It is not anticipated that any payment will be made in 2011.

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Furthermore, in the opinion of management, such amounts would not be payable upon liquidation and as such have not been reflected as a liability in the accompanying consolidated statements of net assets in liquidation.

In light of the CPEX Transaction, Footstar has determined that it would be in the best interest of stockholders to suspend liquidating Footstar pursuant to the Plan of Dissolution.

On July 21, 2011, the Company held a special meeting of its stockholders to vote on a proposal to revoke the Plan of Dissolution (“Dissolution Proposal”) and a proposal (the “Merger Proposal”) to adopt the Agreement and Plan of Merger, dated as of February 14, 2011, and as amended on May 16, 2011, by and among the Company, and Footstar Acquisition, Inc., a wholly owned subsidiary of the Company, to become a non-public company. The shares represented at the meeting did not constitute a quorum of stockholders with respect to the Dissolution Proposal, and accordingly, no action was taken with respect to this matter. The approval of the Merger Proposal was subject to the approval of the Dissolution Proposal. Therefore, although a vote was held on the Merger Proposal, the approval and implementation of the Merger Proposal did not proceed. In light of the failure to revoke the Plan of Dissolution, and the resulting inability to proceed with the Merger Proposal, the Company is considering other alternatives. Furthermore, as the Plan of Dissolution was not approved, the liquidation basis of accounting is still being followed (see Note 2).

The Company is considering various options to permit stockholders to continue to participate in earnings resulting from the CPEX Transaction, if any, after Footstar is completely dissolved.

As discussed further in Note 2, the consolidated financial statements of the Company are presented on the liquidation basis of accounting. The 80.5% ownership of FCB Holdings (the “Controlling Interest”) has been reflected in the accompanying condensed consolidated financial statements at its estimated net realizable value.

Presented below is a summarized statement of operations from the date of the acquisition of CPEX through the end of the third quarter and for the third quarter and a summarized balance sheet at October 1, 2011 of FCB Holdings (in millions on a going concern basis in accordance with accounting principles generally accepted in the United States of America (“GAAP”)):

	July 3, 2011 to October 1, 2011	April 5, 2011 to October 1, 2011
Royalty revenue	\$6.6	\$12.4
G&A expenses	0.4	2.6
Amortization expense	1.4	2.7
Interest expense	3.0	6.1
Income before income taxes	1.8	1.0
Net income attributable to Non-controlling Interest	0.3	0.2
Net income attributable to Controlling Interest	\$1.5	\$0.8

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Summarized balance sheet related to FCB Holdings consisted of the following (in millions):

	October 1, 2011
Assets:	
Current assets	\$17.5
Assets held for resale (primarily Real Estate)	2.5
Intangible assets, net	74.2
Deferred charges and other assets	