

Edgar Filing: A.C. Moore Arts & Crafts, Inc. - Form 10-Q

A.C. Moore Arts & Crafts, Inc.  
Form 10-Q  
October 28, 2005

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 September 30, 2005

OR

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

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

Commission File Number: 000-23157

A.C. MOORE ARTS & CRAFTS, INC.

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

Pennsylvania

22-3527763

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

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

130 A.C. Moore Drive, Berlin, NJ

08009

-----  
(Address of principal executive offices) (Zip Code)

(856) 768-4930

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

N/A

-----  
(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 is an accelerated filer

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(as defined in Rule 12b-2 of the Exchange Act). [ X ] Yes [ ] No

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

CLASS	OUTSTANDING AT OCTOBER 27, 2005
----- Common Stock, no par value	----- 19,816,374

A.C. MOORE ARTS & CRAFTS, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

A.C. MOORE ARTS & CRAFTS, INC.  
 CONSOLIDATED BALANCE SHEETS  
 (dollars in thousands)  
 (unaudited)

	September 30, 2005	December 31, 2004
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents .....	\$ 15,701	\$ 48,428
Marketable securities .....	12,554	17,558
Inventories .....	166,997	142,832
Prepaid expenses and other current assets .....	6,415	7,655
Prepaid income taxes .....	5,473	--
Deferred tax asset .....	47	2,673
	-----	-----
	207,187	219,146
Non-current assets:		
Property and equipment, net .....	87,089	83,219
Other assets .....	1,432	1,747
	-----	-----
	\$295,708	\$304,112
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt .....	\$ 2,571	\$ 2,571
Trade accounts payable .....	45,225	50,256
Accrued payroll and payroll taxes .....	2,878	3,706
Accrued expenses .....	7,496	8,573
Income taxes payable .....	--	3,626
	-----	-----
	58,170	68,732
Long-term liabilities:		
Long-term debt .....	24,857	26,786
Deferred tax liability .....	7,841	8,584
Accrued lease liability .....	16,939	13,795
	-----	-----
	49,637	49,165
	-----	-----
	107,807	117,897
	-----	-----
Shareholders' Equity:		
Preferred stock, no par value, 10,000,000 shares authorized; none issued .....	--	--

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Common stock, no par value, 40,000,000 shares authorized; issued and outstanding 19,814,374 shares at September 30, 2005 and 19,655,100 at December 31, 2004	111,515	109,131
Retained earnings .....	76,386	77,084
	187,901	186,215
	\$295,708	\$304,112

See accompanying notes to financial statements.

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A.C. MOORE ARTS & CRAFTS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(dollars in thousands, except per share data)  
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Net sales .....	\$ 115,094	\$ 107,713	\$ 351,462	\$ 320,376
Cost of sales (including buying and distribution costs) .....	68,402	64,010	210,953	195,401
Gross margin .....	46,692	43,703	140,509	124,975
Selling, general and administrative expenses	48,426	40,795	139,036	118,800
Store pre-opening expenses .....	1,194	1,488	2,300	2,456
Income (loss) from operations .....	(2,928)	1,420	(827)	3,719
Interest expense .....	331	133	881	148
Interest (income) .....	(129)	(119)	(557)	(377)
Income (loss) before income taxes .....	(3,130)	1,406	(1,151)	3,948
Provision for income taxes .....	(1,230)	541	(453)	1,520
Net income (loss) .....	\$ (1,900)	\$ 865	\$ (698)	\$ 2,428
Basic net income (loss) per share .....	\$ (0.10)	\$ 0.04	\$ (0.04)	\$ 0.12
Diluted net income (loss) per share .....	\$ (0.10)	\$ 0.04	\$ (0.04)	\$ 0.12

See accompanying notes to financial statements.

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A.C. MOORE ARTS & CRAFTS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(dollars in thousands)  
(unaudited)

	Nine months ended September 30,	
	2005	2004
	-----	-----
Cash flows from operating activities:		
Net (loss) income .....	\$ (698)	2,428
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization .....	7,837	6,290
Disposal of assets .....	438	--
Changes in assets and liabilities:		
Inventories .....	(24,165)	(16,483)
Prepaid expenses and other current assets .....	1,240	(2,598)
Accounts payable, accrued payroll, payroll taxes and accrued expenses .....	(6,936)	4,853
Income taxes .....	(5,840)	(7,316)
Deferred lease liability .....	3,144	1,915
Other .....	315	59
	-----	-----
Net cash used in operating activities .....	(24,665)	(10,852)
	-----	-----
Cash flows from investing activities:		
Capital expenditures .....	(12,145)	(36,094)
Net proceeds from marketable securities .....	5,004	764
	-----	-----
Cash flows used in investing activities .....	(7,141)	(35,330)
	-----	-----
Cash flows from financing activities:		
Exercise of stock options .....	1,008	716
Increase in long-term debt .....	--	30,000
Repayment of long-term debt .....	(1,929)	(504)
	-----	-----
Net cash provided by (used in) financing activities .....	(921)	30,212
	-----	-----
Net decrease in cash and cash equivalents .....	(32,727)	(15,970)
Cash and cash equivalents at beginning of period .....	48,428	43,700
	-----	-----
Cash and cash equivalents at end of period .....	\$ 15,701	\$ 27,730
	=====	=====

See accompanying notes to financial statements.

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(UNAUDITED)

(1) BASIS OF PRESENTATION

The consolidated financial statements included herein include the accounts of A.C. Moore Arts & Crafts, Inc. and its wholly owned subsidiaries (collectively the "Company"). The Company is a chain of 105 retail stores selling arts and crafts merchandise. The stores are located throughout the eastern United States.

These financial statements have been prepared by management without audit and should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004. Due to the seasonality of the Company's business, the results for the interim periods are not necessarily indicative of the results for the year. The accompanying consolidated financial statements reflect, in the opinion of management, all adjustments necessary for a fair statement of the interim financial statements. In the opinion of management, all such adjustments are of a normal and recurring nature.

(2) STOCK-BASED COMPENSATION

The Company accounts for its employee stock options using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). Compensation cost for stock options is measured as the excess of the quoted market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. No stock-based compensation has been included in the determination of net income.

Had compensation cost for the Company's stock-based compensation plan been determined based on the fair value at the grant date for awards under those plans, consistent with the requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," net income and earnings per share would have been reduced to the following pro forma amounts:

		THREE MONTHS ENDED SEPTEMBER 30,		NINE SE
		2005	2004	2005
(in thousands, except per share data)				
Net income (loss).....	As reported	\$ (1,900)	\$ 865	\$ (69
	Compensation cost, net	454	403	1,40
	Pro forma	(2,354)	462	(2,09
Basic earnings (loss) per share.....	As reported	\$ (.10)	\$ .04	\$ (.0
	Pro forma	(.12)	.02	(.1
Diluted earnings (loss) per share.....	As reported	\$ (.10)	\$ .04	\$ (.0
	Pro forma	(.12)	.02	(.1

The pro forma results may not be representative of the effects on reported operations for future years. The fair value of the options was calculated using a Black-Scholes options pricing model with the following weighted-average assumptions:

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	2005 -----	2004 -----	2003 -----
Average fair value of options granted.....	\$9.79	\$11.15	\$12.9
Risk free interest rate.....	4.4%	3.8%	3.
Dividend yield.....	--	--	--
Average expected life.....	5.0 yrs	4.9 yrs	4.
Expected stock price volatility.....	38.9%	54.9%	56.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123(R), Share-Based Payment (FAS 123(R)). FAS 123(R) revised FASB Statement No. 123, Accounting for Stock-Based Compensation (FAS 123) and requires companies to expense the fair value of employee stock options and other forms of stock-based compensation. Companies must adopt FAS 123(R) no later than the beginning of their next fiscal year that begins after June 15, 2005. Accordingly, the Company will be required to adopt FAS 123(R) in its first quarter of 2006.

Previously, in complying with FAS 123, the Company disclosed the value of stock options granted and its pro forma impact on its net income in a footnote to its financial statements. The Company is currently considering which transition method it expects to select in adopting FAS 123(R), and whether this new accounting requirement will result in any changes in compensation strategies. Information contained in the Company's footnotes provides the impact on pro forma net income for past financial statements. The impact of the adoption of FAS 123(R) on future financial statements is expected to be material.

(3) MANAGEMENT ESTIMATES

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reported period and related disclosures. Significant estimates made as of and for the three and nine month periods ended September 30, 2005 and 2004 include provisions for shrinkage, capitalized buying, warehousing and distribution costs related to inventory, and markdowns of merchandise inventories. Actual results could differ materially from those estimates.

(4) MARKETABLE SECURITIES

Marketable securities represent investments in fixed financial instruments, are classified as held-to-maturity and recorded at amortized cost. Securities with maturities in excess of 12 months are classified as long-term.

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### (5) INVENTORIES

Inventories, which consist of general consumer merchandise held for sale, are stated at the lower of cost or market. The cost of store inventories is determined by the retail inventory method. Warehouse inventories are stated at cost determined on a first-in, first-out basis. The Company includes as inventoriable costs certain indirect costs, such as purchasing and receiving costs, inbound freight, duties related to import purchases, internal transfer costs and warehousing costs. The Company records vendor monies which support its advertising programs as a reduction in the cost of inventory, and are recognized as a reduction of cost of goods sold when the inventory is sold. The Company adopted this accounting effective January 1, 2004.

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### (6) PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets. Buildings and building improvements are depreciated over periods of twenty to forty years, furniture, fixtures and equipment are depreciated over periods of five to ten years and leasehold improvements are depreciated over the shorter of their estimated useful lives or the term of the related lease.

### (7) LONG-TERM DEBT

The Company maintains two mortgage agreements with Wachovia Bank on its new corporate offices and distribution center of which \$27.4 million and \$29.4 million was outstanding at September 30, 2005 and December 31, 2004, respectively. The mortgages are secured by land, building, and equipment. Of the original \$30.0 million in mortgages, \$22.5 million (\$21.0 million at September 30, 2005) is repayable over 15 years and \$7.5 million (\$6.4 million at September 30, 2005) is repayable over 7 years. Monthly payments totaling \$214,000 started in October 2004. The mortgages bear interest at rates that will vary between LIBOR plus 85 basis points and LIBOR plus 135 basis points, depending on the debt service coverage ratio and the length of the mortgage payment. The Company has the option of fixing the interest rate at any time. The mortgages contain covenants that, among other things, restrict the Company's ability to incur additional indebtedness or guarantee obligations in excess of \$8.0 million, engage in mergers or consolidations, dispose of assets, make acquisitions requiring a cash outlay in excess of \$10.0 million, make loans or advances in excess of \$1.0 million, or change the nature of its business. The Company is restricted in capital expenditures, paying dividends and making other distributions unless certain financial covenants are maintained including those relating to tangible net worth, funded debt and a current ratio. The mortgages also define various events of default, including cross default provisions, defaults for any material judgments or a change in control. At September 30, 2005 the Company was in compliance with these agreements.

### (8) REVENUE RECOGNITION

The Company recognizes revenue at the time of sale of merchandise to its customers. The value of point of sale coupons, which have a very limited life, and other discounts that result in a reduction of the price paid by the customer are recorded as a reduction of sales. Sales returns, which are reserved for based on historical experience, are provided for in the period that the related sales are recorded. Proceeds from the sale of gift cards are recorded as gift card liability and recognized as revenue when redeemed by the holder.

### (9) INSURANCE CLAIMS

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The Company records any insurance claim receivable based upon their net realizable value when the amounts are estimable and the recovery is probable. Gains on recovery of inventory in excess of cost are recognized in gross margin.

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(10) EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2005	2004	2005	
	(in thousands, except per share data)			
Net income (loss).....	\$ (1,900)	\$ 865	\$ (698)	\$
Weighted average shares:				
Basic.....	19,808	19,491	19,740	
Incremental shares from assumed exercise of stock options.....	--	623	--	
Diluted.....	19,808	20,114	19,740	
Basic net income (loss) per share.....	\$ (0.10)	\$ 0.04	\$ (.04)	\$
Diluted net income (loss) per share.....	\$ (0.10)	\$ 0.04	\$ (.04)	\$
Stock options excluded from calculation because exercise price was greater than average market price.....	0	314	0	

The diluted weighted average shares outstanding for both the three and nine month periods ended September 30, 2005 excludes 1,170,990 potentially dilutive shares as the result would be anti-dilutive.

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

OVERVIEW

The following discussion and analysis contains certain forward-looking statements. These forward-looking statements do not constitute historical facts

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and involve risks and uncertainties. Actual results could differ materially from those referred to in the forward-looking statements due to a number of factors, including, but not limited to, the following: the impact of EITF Issue 02-16, the impact of the adoption of FAS 123(R) (as defined below), customer demand and trends in the arts and crafts industry, the effect of economic conditions and rising gasoline prices, the impact of unfavorable weather conditions, the impact of competitors' locations or pricing, the availability of acceptable real estate locations for new stores, difficulties with respect to new information system technologies, achieving the expected efficiencies in our new distribution center, supply constraints or difficulties, the effectiveness of advertising strategies, the impact of the threat of terrorist attacks and war, the uncertainty of the final resolution of the insurance claim relating to the roof collapse and our ability to maintain an effective system of internal control over financial reporting. For additional information concerning factors that could cause actual results to differ materially from the information contained herein, reference is made to the information under the heading "Cautionary Statement Relating to Forward-Looking Statements" in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission.

Due to the importance of our peak selling season, which includes Fall/Halloween, Thanksgiving and Christmas, the fourth quarter has historically contributed, and we expect it will continue to contribute, disproportionately to our profitability for the entire year. As a result, our quarterly results of operations may fluctuate. In addition, results of a period shorter than a full year may not be indicative of results expected for the entire year.

Our quarterly results of operations also may fluctuate based upon such factors as the length of holiday seasons, the date on which holidays fall, the number and timing of new store openings, the amount of store pre-opening expenses, the amount of net sales contributed by new and existing stores, the mix of products sold, the amount of sales returns, the timing and level of markdowns and other competitive factors.

On July 27, 2004, a section of the roof on our Blackwood, New Jersey warehouse and corporate headquarters facility collapsed. At the time of the incident, we had been in the process of moving into a new distribution center in Winslow Township, New Jersey. The effort of recovering from the roof collapse delayed our ability to achieve the productivity we anticipated in the new facility in 2004. During the first half of 2005, we significantly increased the productivity of the distribution center and we are now operating this new facility at the level of productivity we had expected.

We insure our warehouse inventory at selling value. Included in our 2004 results is an estimate of the insurance claim recovery for lost merchandise and other expenses related to the roof collapse of \$2.2 million, which includes estimated gross margin of \$1.3 million. This claim was originally estimated at \$4.2 million, of which \$3.4 million has been received. The estimated gross margin of \$1.3 million was recorded as a reduction in the cost of goods sold during the third quarter of 2004.

On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 123(R), Share-Based Payment ("FAS 123(R)"). FAS 123(R) revised FASB Statement No. 123, Accounting for Stock-Based Compensation ("FAS 123") and requires companies to expense the fair value of employee stock options and other forms of stock-based compensation. Companies must adopt FAS 123(R) no later than the beginning of their next fiscal year that begins after June 15, 2005. Accordingly, we will be required to adopt FAS 123(R) in our first quarter of 2006. Previously, in complying with FAS 123, we disclosed the value of stock options granted and its pro forma impact on our net income in a footnote to our

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financial statements. We are currently considering which transition method we expect to select in adopting FAS 123(R) and whether this new accounting requirement will result in any changes in compensation strategies. Information contained in our footnotes provides the impact on pro forma net income for past financial statements. The impact of the adoption of FAS 123(R) on future financial statements is expected to be material.

### RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, selected statement of operations data expressed as a percentage of net sales and the number of stores open at the end of each such period:

	THREE MONTHS ENDED SEPTEMBER 30,		NI
	2005	2004	
Net sales.....	100.0%	100.0%	100
Cost of sales.....	59.4%	59.4%	60
Gross margin.....	40.6%	40.6%	40
Selling, general and administrative expenses.....	42.1%	37.9%	39
Store pre-opening expenses.....	1.0%	1.4%	0
Income (loss) from operations.....	(2.5)%	1.3%	(0)
Net interest (income) expense.....	0.2 %	0.0%	0
Income (loss) before income taxes.....	(2.7)%	1.3%	(0)
Provision for income taxes.....	(1.1)%	0.5%	(0)
Net income (loss).....	(1.6)%	0.8%	(0)
Number of stores open at end of period.....	105	91	

Three Months Ended September 30, 2005 Compared to Three Months Ended September 30, 2004

**NET SALES.** Net sales increased \$7.4 million or 6.9% to \$115.1 million in the three months ended September 30, 2005 from \$107.7 million in the comparable 2004 period. This increase is comprised of (i) net sales of \$3.8 million from nine stores opened in 2005, (ii) net sales of \$8.1 million from stores opened in 2004 not included in the comparable store base, and (iii) a comparable store sales decrease of \$4.5 million or 4.3%. For the three months ended September 30, 2005, customer transactions in comparable stores were down 6.2% and the average sale increased by 1.9% compared with the same period in 2004. We believe that sales in the quarter were negatively impacted by rising gasoline prices and unusually hot and dry weather. We experienced a decline in our yarn sales as last year we were achieving major sales increases that we could not repeat given the large supply of yarn in the marketplace. Sales were strongest in our jewelry and wearables categories.

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**GROSS MARGIN.** Gross margin is net sales minus the cost of merchandise which includes purchasing and receiving costs, inbound freight, duties related to import purchases, internal transfer costs and warehousing costs. Gross margin as a percent of net sales was 40.6% in both the three month periods ended September 30, 2005, and September 30, 2004. The mix of merchandise sold increased margins by 0.5% and the improved productivity in our warehouse increased margins by 0.3% as a result of a reduction in distribution costs. In the third quarter of 2004 the Company recorded \$1.3 million of insurance proceeds in excess of cost from an insurance claim which added 1.2% to the gross margin. The application of Emerging Issues Task Force ("EITF") Issue 02-16, Accounting by a Customer (including a Reseller) for Cash Consideration Received from a Vendor ("EITF 02-16"), relating to our accounting for vendor monies which support our advertising programs on our gross margin resulted in an increase of 0.4% in margin rate in the three months ended September 30, 2005 compared with the three months ended September 30, 2004.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES.** Selling, general and administrative expenses include (a) direct store level expenses, including rent and related operating costs, payroll, advertising, depreciation and other direct costs, and (b) corporate level costs not directly associated with or allocable to cost of sales including executive salaries, accounting and finance, corporate information systems, office facilities and other corporate expenses.

Selling, general and administrative expenses, as a percent of sales, increased 4.2% in the three months ended September 30, 2005, to 42.1% from 37.9% in the three months ended September 30, 2004. Selling, general and administrative costs increased by 2.4% in the comparable store base as a result of the decline in comparable store sales. On a per store basis, selling, general and administrative expenses increased by 2.6% in the third quarter of 2005 as compared with the same period in 2004. There was a 1.5% increase attributable to new stores opened in 2004 and 2005 which have higher selling, general and administrative expenses as a percentage of sales than existing stores. There was a 0.3% increase in corporate office costs.

**STORE PRE-OPENING EXPENSES.** We expense store pre-opening expenses as they are incurred which would include rent holidays prior to store opening. Pre-opening expenses for the seven stores we opened in the third quarter of 2005, and lease costs related to the new stores which will open in the fourth quarter amounted to \$1.2 million. In the third quarter of 2004, we incurred store pre-opening expenses of \$1.5 million related to the seven stores we opened in that quarter and lease costs related to stores opened in the fourth quarter of 2004.

**NET INTEREST (INCOME) EXPENSE.** In the third quarter of 2005, we had net interest expense of \$202,000 compared with net interest expense of \$14,000 for the same period in 2004. The third quarter of 2005 includes \$331,000 in interest expense related to our mortgages on which interest expense commenced in August 2004.

**INCOME TAXES.** Our effective income tax rate was 39.3% for the three months ended September 30, 2005 and 38.5% for the three months ended September 30, 2004. The increase is due to tax changes in several of the states in which we operate.

Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004

**NET SALES.** Net sales increased \$31.1 million or 9.7% to \$351.5 million in the nine months ended September 30, 2005 from \$320.4 million in the comparable 2004 period. This increase is comprised of (i) net sales of \$4.4 million from nine stores opened in 2005, (ii) net sales of \$32.4 million from stores opened in 2004 not included in the comparable store base, and (iii) a comparable store sales decrease of \$5.7 million or 1.8%. Sales during the nine months ended September 30, 2005 were significantly impacted by severe winter weather conditions in the first quarter throughout our northern store base and by

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unusually hot and dry weather and rising gasoline prices in the third quarter. For the nine months ended September 30, 2005, customer transactions in comparable stores were down 2.4% compared with 2004 and the average sale increased by 0.6%. Sales were strongest in our jewelry and wearables categories.

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**GROSS MARGIN.** Gross margin as a percent of net sales increased 1.0% in the nine months ended September 30, 2005, to 40.0% from 39.0% in the nine months ended September 30, 2004. The mix of merchandise sold increased margins by 0.7%. The application of EITF 02-16 relating to our accounting for vendor monies which support our advertising programs on our gross margin resulted in an increase of 0.7% in margin rate in the nine months ended September 30, 2005 compared with the nine months ended September 30, 2004. The insurance claim proceeds added 0.4% to the margins in 2004.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES.** Selling, general and administrative expenses, as a percent of sales, increased 2.5% in the nine months ended September 30, 2005, to 39.6% from 37.1% in the nine months ended September 30, 2004. Selling, general and administrative costs increased by 1.4% in the comparable store base as a result of the decrease in comparable store sales. On a per store basis, selling, general and administrative expenses increased by 2.3% in the first nine months of 2005 compared with the same period in 2004. There was a 1.1% increase attributable to new stores opened in 2004 and 2005 which have higher selling, general and administrative expenses as a percentage of sales than existing stores.

**STORE PRE-OPENING EXPENSES.** Pre-opening expenses for the nine stores we opened and the store we relocated in the first nine months of 2005, and lease costs related to the new stores which will open in the fourth quarter amounted to \$2.3 million. In the first nine months of 2004, we incurred store pre-opening expenses of \$2.5 million related to the 10 stores opened in that period and lease costs related to stores opened in the fourth quarter of 2004.

**NET INTEREST (INCOME) EXPENSE.** In the first nine months of 2005, we had net interest expense of \$324,000 compared with net interest income of \$229,000 for the same period in 2004. The first nine months of 2005 includes \$881,000 in interest expense related to our mortgages on which interest expense commenced in August 2004.

**INCOME TAXES.** Our effective income tax rate was 39.3% for the nine months ended September 30, 2005 and 38.5% for the nine months ended September 30, 2004. The increase is due to tax changes in several of the states in which we operate.

### LIQUIDITY AND CAPITAL RESOURCES

Our cash is used primarily for working capital to support inventory requirements and capital expenditures, pre-opening expenses and beginning inventory for new stores. In recent years, we have financed our operations and new store openings primarily with cash from operations, the net proceeds we received from our initial public offering in 1997 and from a secondary offering in 2002. In the first half of 2004 we borrowed \$30.0 million under two mortgage agreements we have with Wachovia Bank to finance the construction of our new corporate offices and distribution center.

At September 30, 2005 and December 31, 2004, our working capital was \$149.0 million and \$150.4 million, respectively. Cash used in operations was \$24.7 million for the nine months ended September 30, 2005 principally as a result of a seasonal increase in inventories of \$24.2 million, the seasonal decrease in accounts payable and other accrued expenses of \$6.9 million and income tax payments of \$5.8 million.

Net cash used in investing activities during the nine months ended September 30, 2005 was \$7.1 million, including \$12.1 million for capital expenditures. In 2005, we expect to spend approximately \$15.0 million on capital expenditures, which includes \$10.0 million for new store openings, and the remainder for remodeling existing stores, upgrading systems in existing stores, warehouse equipment and corporate systems development. Of the \$10.0 million in new store capital expenditures, we expect to receive \$2.5 million back from landlords.

We maintain two mortgage agreements with Wachovia Bank on our new corporate offices and distribution center of which \$27.4 million was outstanding at September 30, 2005. The mortgages are secured by land, building and equipment. Of the original \$30.0 million in mortgages, \$22.5 million (\$21.0 million as of September 30, 2005) is repayable over 15 years and \$7.5 million (\$6.4 million as of September 30, 2005) is repayable over 7 years. Monthly payments totaling \$214,000 started in October 2004. The mortgages bear interest at rates that will vary between LIBOR plus 85 basis points and LIBOR plus 135 basis points, depending on the debt service coverage ratio and the length of the mortgage payment. We have the option of fixing the interest rate at any time. The mortgages contain covenants that, among other things, restrict our ability to incur additional indebtedness or guarantee obligations in excess of \$8.0 million, engage in mergers or consolidations, dispose of assets, make acquisitions requiring a cash outlay in excess of \$10.0 million, make loans or advances in excess of \$1.0 million, or change the nature of our business. We are restricted in capital expenditures, paying dividends and making other distributions unless certain financial covenants are maintained including those relating to tangible net worth, funded debt and a current ratio. The mortgages also define various events of default, including cross default provisions, defaults for any material judgments or a change in control. At September 30, 2005, we were in compliance with these agreements.

We currently have a \$25.0 million line of credit agreement with Wachovia Bank, which expires on May 1, 2006. Borrowing under this line will bear interest at LIBOR plus 95 basis points and is subject to the same covenants as the mortgages described above. At September 30, 2005, there were no borrowings outstanding under this agreement.

We believe the cash generated from operations during the year, funds received through the financing of the new distribution center and available borrowings under the line of credit agreement will be sufficient to finance our working capital and capital expenditure requirements for at least the next 12 months.

#### CRITICAL ACCOUNTING ESTIMATES

Our accounting policies are fully described in Note 1 of our notes to consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2004. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events that affect the amounts reported in our consolidated financial statements and accompanying notes. Since future events and their effects cannot be determined with absolute certainty, actual results may differ from those estimates. Management makes adjustments to its assumptions and judgments when facts and circumstances dictate. The amounts currently estimated by us are subject to change if different assumptions as to the outcome of future events were made. We evaluate our estimates and judgments on an ongoing basis and predicate those estimates and judgments on historical experience and on various other factors that management believes to be reasonable under the circumstances. Management believes the following critical

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accounting estimates encompass the more significant judgments and estimates used in preparation of our consolidated financial statements:

- o merchandise inventories;
- o impairment of long-lived assets;

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- o income taxes; and
- o other estimates.

The foregoing critical accounting estimates are more fully described in our annual report on Form 10-K for the year ended December 31, 2004. During the three months ended September 30, 2005, we did not make any material changes to our estimates or methods by which estimates are derived with regard to our critical accounting estimates.

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

We invest cash balances in excess of operating requirements primarily in money market mutual funds and to a lesser extent in interest-bearing securities with maturities of less than two years. The fair value of our cash and equivalents at September 30, 2005 approximated carrying value. We had no borrowings outstanding under the line of credit at September 30, 2005. The interest rates on our mortgages fluctuate with market rates and therefore the value of these financial instruments will not be impacted by a change in interest rates. Based on the amounts outstanding at September 30, 2005, the impact of a hypothetical increase or decrease in interest rates of 10% compared with the rates in effect at September 30, 2005 would result in an increase or decrease in our interest expense of \$131,000 annually, and an increase or decrease in our interest income of \$53,000 annually.

### ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 ("Exchange Act"), as of the end of the period covered by this report. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

During the three months ended September 30, 2005, there has not occurred any change in our internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

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Not Applicable.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

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

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended ("Exchange Act").

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) promulgated under the Exchange Act.

32 Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

A.C. MOORE ARTS & CRAFTS, INC.

Date: October 28, 2005

By: /s/ John E. Parker

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John E. Parker  
Chief Executive Officer (duly authorized  
officer and principal executive officer)

Date: October 28, 2005

By: /s/ Leslie H. Gordon

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Leslie H. Gordon  
Executive Vice President and  
Chief Financial Officer  
(duly authorized officer and principal  
financial officer)

Exhibit Index

Exhibit No. -----	Description -----
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) promulgated under the Exchange Act.
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32	Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.