# Stein Mart Annual Report 2002

# Message from the Chairman

I would like to personally address you, my fellow shareholders, about the governance of our Company. As chairman of the board, the largest shareholder and the person whose name is above the door, I have a unique vantage point – a bird's eye view, if you will – of our business.

I, along with the individual board members, represent you in the governance of this Company. Your board is – and has been – operating according to many of the "best practices" guidelines that have emerged in the aftermath of negative corporate headlines. Some of our actions include:

- Separate chairman of the board and chief executive officer positions.
- An independent, outside director, Michael Rose, as our lead director.
- Audit and compensation committees comprised of independent, outside directors, with specific duties and responsibilities detailed in separate charters.
- The establishment of a Disclosure Committee, and
- We are offering, for your approval, new outside and inside directors whom we believe can increase the business acumen of our board.

In short, we are and have been attentive to the quality, integrity and transparency of our board leadership.

As you know, our esteemed CEO, Jack Williams, retired earlier this year (see note below.) Our new leadership – Mike Fisher, chief executive officer, and Gwen Manto, vice chair and chief merchandising officer – reflects our belief that the future will continue to be forged by those who successfully blend intelligence, experience and leadership. Both are seasoned executives with extensive background at some of the nation's premier retailers, and both have served this Company well over the past several years. I am personally delighted by the opportunities that we have given them, and that they, in turn, can create for all of us.

We each have a stake in this company, and I take the performance of this company personally. Although we live in uncertain times, I believe that Stein Mart's proven concept, seasoned management and loyal customers will ultimately prevail. As we continue to pursue greater profitability, I look forward to bottom line progress that reflects our commitment to you, the stockholders.

Thank you for your interest in our Company.

*Jay Stein*
*Chairman of the Board*

*I must take a moment in this public message to thank and to show my appreciation to my friend, my partner and my co-worker, Jack Williams. Jack began with us almost at the beginning, when we had just three stores. I want to thank him for his sincere love, wise counsel, and tireless devotion to this company and me. We are, in great part, the Company we are today because Jack Williams answered my call 23 years ago.*

*How do you thank someone for a lifetime of commitment? The way you start is to tell the world what he has meant to us.*

*Jay*

# Stein Mart, Inc. Corporate Profile

Stein Mart's 265 stores offer the merchandise, service and presentation of a traditional, better department/specialty store, at prices competitive with off-price retail chains.

Located in 29 states from California to Florida to New York, Stein Mart stores feature fashion merchandise including moderate to designer brand-name apparel for women, men and children, as well as accessories, gifts, linens and shoes.

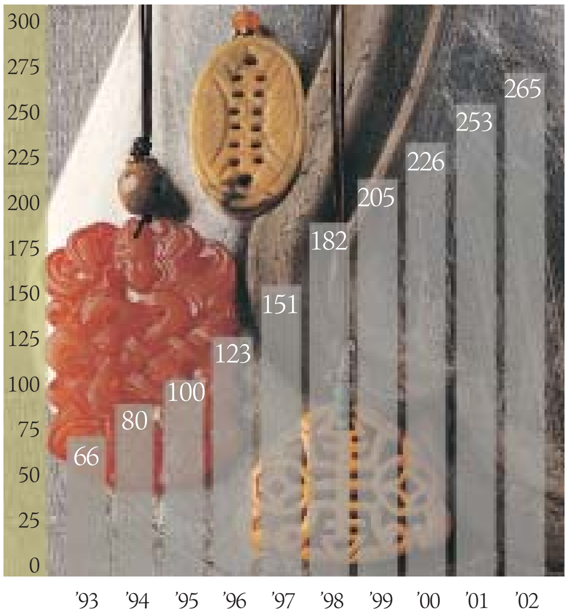
For a complete list of Stein Mart store locations, please visit www.steinmart.com

## Selected Financial Highlights (Dollars in thousands except per share amounts)

| | 2002 | 2001[1] | % change |
|---|---|---|---|
| Income Statement Data: | | | |
| Net Sales | $1,408,648 | $1,320,190 | 6.7 |
| Net Income | $20,690 | $15,354 | 34.8 |
| Diluted Earnings Per Share | $0.50 | $0.37 | 35.1 |
| Operational Data: | | | |
| Number of stores | 265 | 253 | 4.7 |
| Same Store Sales | (0.8)% | (0.7)% | |

(1) Beginning with fiscal year 2001, the Company changed to a 52-53 week year ending the Saturday closest to January 31; previously, the Company's fiscal year ended on the Saturday closest to December 31.

### Stores Open at End of the Year




### Net Sales (dollars in millions)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# Letter to our Shareholders

## Dear fellow stockholders,

Our 2002 financial performance was markedly improved over the previous year, although the retail environment impeded the achievement of our initial plan. The Company earned $20.7 million or $0.50 per share in 2002, significantly ahead of the $15.4 million or $0.37 per share earned last year, and a sizeable accomplishment considering annual net sales were actually down slightly (-0.8%) on a comparable store basis.

Because the challenging external environment hampered sales growth, it became imperative to look elsewhere for profitability. Stein Mart's success in 2002 came from making strategic improvements in our core business, and we believe that this progress will prove crucial in 2003.

## Disciplined inventory management and improved sales productivity

Despite negative comparable store sales and the resulting inability to leverage occupancy costs, the Company's gross profit grew by nearly $32 million in 2002, increasing from 24.0% of sales to 24.7% of sales. This key indicator was the result of two Company-wide initiatives – more disciplined inventory management and greater sales-per-square foot productivity.

Our merchants, who excel at choosing the right merchandise, worked with their planning and allocation partners to make strategic reductions in inventory in 2002. These reductions were the result of streamlined purchases, a more aggressive markdown schedule and an improved basic stock replenishment system which reduced back stock of certain items. The result was a fresher assortment, greater mobility in the stores for customers, increased inventory turnover and fewer markdowns. At year-end, inventories in the average store were reduced by four percent.

To increase sales per square foot productivity, floor space was reallocated in Spring '02, with additional space given to areas with greater profit opportunities such as Boutique, Gifts and Accessories. At the same time, merchandise in Men's and Children's was reduced and confined to specific categories. Gifts and Accessories were the most positively impacted by the changes, while the Boutique re-format has not been as successful given the weak sales environment. We also replaced one of our two shoe department lessees, and our fledgling partnership with DSW Shoe Warehouse is already showing great promise for additional profitability.

## Growth in the store network

We opened 16 new stores and closed four under-performing ones. By choosing a conservative opening schedule and refining our location/siting process, we enjoyed a class of new stores with the best sales-to-operating plan performance we've had in recent history.

In the fall of 2002, a smaller-format concept store, known as "*collections of Stein Mart*", debuted in Rolling Hills, California. This prototype is less than half the size of our traditional Stein Mart store, and is being tested to see if it will allow us to enter more resort and premium markets where a full-size Stein Mart may not be feasible. Initial results are promising, and at least two more "*collections of Stein Mart*" stores are included in the 2003 store opening plans.

## Financial strength

Our more disciplined approach to inventory control decreased our capital needs and lowered interest expense. At year-end, our borrowings were down nearly thirty percent from the end of 2001 and our interest expense decreased by one-third. And although nearly two million shares remain on our stock repurchase authorization, we chose to be conservative with cash in this environment and limit our share repurchases to 220,000 shares.

## Looking ahead

Stein Mart's premise of great fashion for the wardrobe and the home at exceptional prices is as fresh and relevant as ever, and we continue to believe there is significant future opportunity for our Company.

The productivity initiatives begun in 2002 continue this year. In 2003, we remain dedicated to improving our core business model, using tactical decision-making, technology and training to create profitability progress. We will continue to employ a disciplined inventory strategy, assess the opportunities in each store and each family of business, and use our capital wisely.

For 2003, we will open 14 stores based on our updated process for new store site selection. Using proprietary market research in addition to traditional demographics, we expect more successful new store performances such as the ones enjoyed in 2002. Also during 2003, we will close 16 stores that remain unprofitable despite concerted efforts to stimulate sales. These concurrent activities should help improve the overall quality of the Company's portfolio of stores.

Thanks to the initiatives put in place this year, and the 15,000 associates who have worked so hard to produce these results, our Company stands to reap greater benefits when the external environment becomes more advantageous. Our promise to you, as stockholders, is to be conservative stewards of your investment, and to honor the trust you have placed in our Company.

Michael D. Fisher

*President and Chief Executive Officer*

This is my last annual letter to you. By the time you read this, Mike Fisher will have been installed as our president and chief executive officer – the second non-family CEO in Stein Mart's history.

As I step aside from an active officer's role, my deepest gratitude goes to Jay Stein for the opportunities he has given me during the past 23 years. It has been my privilege to help him build Stein Mart into a successful company, filled with many talented people, and in which we take great pride. Over the years, our complementary strengths and mutual respect for one another have created an enduring partnership, and I greatly appreciate his faith and trust in my abilities.

The world that we have operated in since September 11, 2001 has been different and more difficult than any time in our Company's history. I'm sorry to say that the results of the last two years have not satisfied anyone, especially us. At the same time, our key executive team has worked hard to protect the core business for the future benefit of our Company and its stockholders, with the goal of prudently managing the Company's capital, and investing in systems and people who will produce better results as conditions improve.

The planned transition of key leadership has allowed us to put in place a team with the capacity, talent and motivation to take Stein Mart forward. It is with confidence and pride that the corporate reins have been turned over to them. I wish them and you the best in the future…

John H. Williams, Jr.

*Vice Chairman of the Board*

# Highlights of 2002

## Merchandise

The expansion of our Home area fueled much of our progress in 2002. With the continued relative strength of the housing market, our customers were intently focused on making their homes more beautiful. Additional space was allocated to the Gifts area and a successful test of Home Décor was conducted in a limited number of stores. A full rollout of Home Décor, including small furniture, mirrors and decorative pieces, is scheduled for 2003.

Our core customer research also prompted us to expand our Ladies' Accessories offerings to target our loyal customers, namely 35-65 year old women. Decorated reading glasses, aromatherapy, a revamped hosiery/slipper/casual footwear department and colorful jewelry offerings that coordinate with apparel offerings were all part of the Ladies Accessories' emphasis.

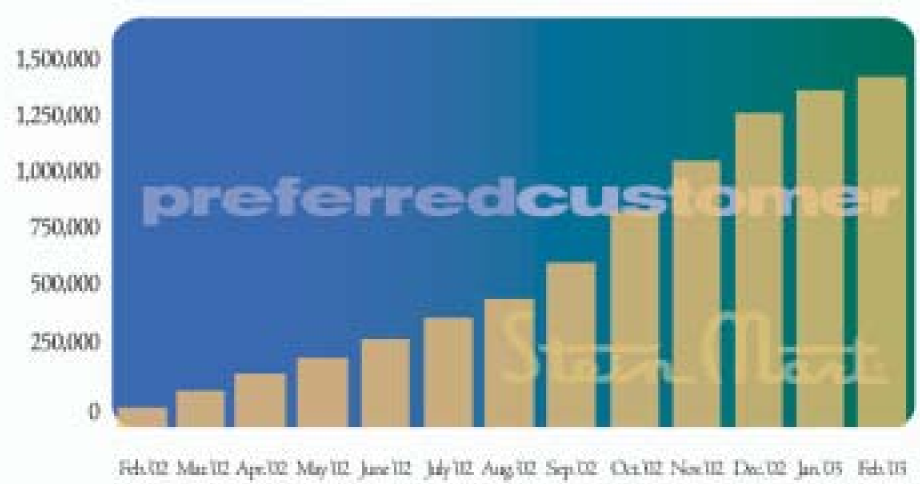
The recovery of our Men's business was particularly heartening, after a difficult two years industry-wide in the Men's business. We succeeded with a proprietary men's designer label and a top line presence in Men's golf apparel. Even as we trimmed the square footage in this area, the offerings got sharper and customers responded, and we are looking forward to progress in this area for 2003.

## collections of Stein Mart

While continuing to expand our core store base, our goal is to attract new customers in niche markets with a smaller, more flexible concept. In October 2002, the *"collections of Stein Mart"* concept debuted in Rolling Hills, California. This smaller (sub-15,000 SF), more highly-focused format is being piloted by the Company to enter resort and premium markets where a full-sized store might not be feasible. By the end of 2003, three *"collections of Stein Mart"* stores will be in operation, with one more planned for early 2004.


## DSW shoes

DSW Shoe Warehouse was chosen in mid-2002 to merchandise the shoe department in approximately sixty percent of Stein Mart stores. With an outstanding shoe selection, DSW was a natural choice to upgrade our footwear offerings in 160 stores with an excellent complement to our fashion apparel. This transition began in fall 2002 and was complete in early 2003. DSW Shoe Warehouse joins Nine West Group, Inc. as the two shoe lessees operating in the Stein Mart chain.


## Growth in the Preferred Customer card

The Preferred Customer program is designed to identify, attract and reward our most loyal customers and reward them on a more personal level through direct marketing. Since the launch of our Preferred Customer loyalty program in May 2001, more than 1.5 million customers have enrolled in our stores or on-line at www.steinmart.com. They are now receiving periodic mailings throughout the year with various offers ranging from percentage off one item, percentage off entire purchase, previews of sales and events, and special shopping days.

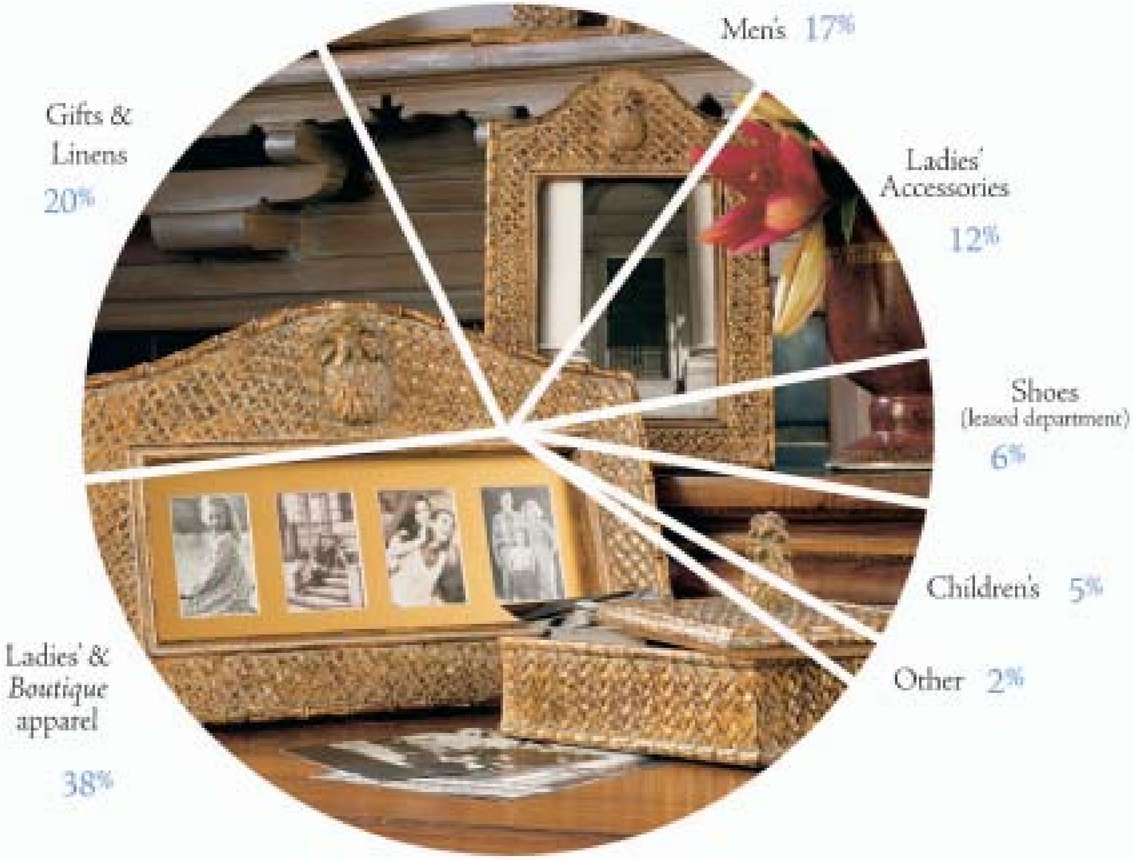
# Highlights of 2002

*Left to right: Margaret Krausnick, Jane Carruthers, Ann Stevens, Jan Bell*

## 25th anniversary of Memphis

In September 2002, Stein Mart celebrated the 25th anniversary of the opening of the Company's Memphis store. It was the Company's first "extension" of the original store in Greenville, Mississippi and the start of the expansion of the Company from the single store it had been since 1908 into the national retail chain it has become. A most exciting part of the celebration was honoring the original four Memphis Boutique ladies – they remain the exemplar for the more than 3,000 Boutique Ladies in service to Stein Mart today.

## 2002 Merchandise Mix



# Stein Mart, Inc. Selected Financial Data

(Dollars In Thousands Except Per Share Amounts and Operating Data) For the Fiscal Year Ended

| STATEMENT OF INCOME DATA: | Feb. 1, 2003 | Feb. 2, 2002 [1] | Dec. 30, 2000 | Jan. 1, 2000 | Jan. 2, 1999 |
|---|---|---|---|---|---|
| Net Sales | $1,408,648 | $1,320,190 | $1,206,624 | $1,034,561 | $897,821 |
| Cost of Merchandise Sold | 1,060,117 | 1,003,567 | 896,560 | 781,038 | 677,334 |
| Gross Profit | 348,531 | 316,623 | 310,064 | 253,523 | 220,487 |
| Selling, General and Administrative Expenses [2] | 326,509 | 301,937 | 257,042 | 244,100 | 195,460 |
| Other Income, Net | 13,953 | 14,078 | 13,766 | 12,129 | 10,420 |
| Income From Operations | 35,975 | 28,764 | 66,788 | 21,552 | 35,447 |
| Interest Expense | 2,604 | 4,000 | 3,309 | 2,485 | 2,368 |
| Income Before Income Taxes | 33,371 | 24,764 | 63,479 | 19,067 | 33,079 |
| Provision For Income Taxes | 12,681 | 9,410 | 24,122 | 7,245 | 12,570 |
| Net Income | $ 20,690 | $ 15,354 | $ 39,357 | $ 11,822 | $ 20,509 |
| Earnings Per Share - Basic [3] | $0.50 | $0.37 | $0.92 | $0.26 | $0.45 |
| Earnings Per Share - Diluted [3] | $0.50 | $0.37 | $0.91 | $0.26 | $0.44 |
| **SELECTED OPERATING DATA:** | | | | | |
| Stores Open at End of Period | 265 | 253 | 226 | 205 | 182 |
| Average Sales Per Store (000's) [4] | $5,741 | $5,922 | $6,068 | $5,663 | $5,958 |
| Average Sales Per Square Foot of Selling Area [5] | $184 | $189 | $192 | $176 | $185 |
| Comparable Store Net Sales (Decrease) Increase [6] | (0.8%) | (0.7%) | 9.7% | 2.3% | 1.2% |
| **BALANCE SHEET DATA:** | | | | | |
| Working Capital | $145,787 | $179,212 | $120,602 | $117,284 | $110,985 |
| Total Assets | 410,217 | 417,672 | 389,989 | 354,094 | 318,012 |
| Long-term Debt [7] | – | 57,750 | – | – | – |
| Total Stockholders' Equity | 223,307 | 201,895 | 194,028 | 179,912 | 177,979 |

[1] Beginning with fiscal 2001, the Company changed to a 52-53 week year ending on the Saturday closest to January 31; previously, the Company's fiscal year ended on the Saturday closest to December 31. See Note 12 to the Financial Statements for financial data for the five-week Transition Period ended February 3, 2001.

[2] Selling, General and Administrative Expenses include store closing/asset impairment charges of $2.7 million in 2002; $2.9 million in 2001; and $15.9 million in 1999. A $3.4 million credit related to store closings was recorded in 2000.

[3] Basic and Diluted Earnings Per Share are presented for all periods in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share."

[4] Average sales per store (including sales from leased shoe and fragrance departments) for each period have been calculated by dividing (a) total sales during such period by (b) the number of stores open at the end of such period, in each case exclusive of stores open for less than 12 months. All periods are calculated on a 52-week basis.

[5] Includes sales and selling space of the leased shoe and fragrance departments. Selling area excludes administrative, receiving and storage areas. All periods are calculated on a 52-week basis.

[6] Comparable store information for a period reflects stores open throughout that period and for the same 52-week period in the prior year.

[7] Notes payable to banks of $41,350 at February 1, 2003 is classified as current (see Note 4 to the Financial Statements).

# Management's Discussion & Analysis

This document includes a number of forward-looking statements which reflect the Company's current views with respect to future events and financial performance. Wherever used, the words "plan", "expect", "anticipate", "believe", "estimate" and similar expressions identify forward-looking statements.

All such forward-looking statements contained in this document are subject to risks and uncertainties that could cause the Company's actual results of operations to differ materially from historical results or current expectations. These risks include, without limitation, ongoing competition from other retailers many of whom are larger and have greater financial and marketing resources, the availability of suitable new store sites at acceptable lease terms, ability to successfully implement strategy to exit or improve under-performing stores, changes in store closings, changing preferences in apparel, changes in the level of consumer spending due to current events and/or general economic conditions, adequate sources of designer and brand-name merchandise at acceptable prices, and the Company's ability to attract and retain qualified employees to support planned growth.

The Company does not undertake to publicly update or revise its forward-looking statements even if experience or future changes make clear that any projected results expressed or implied therein will not be realized.

The following should be read in conjunction with the "Selected Financial Data" and the notes thereto and the Financial Statements and notes thereto of the Company.

## Results of Operations

The following table sets forth, for the periods indicated, the percentage of the Company's net sales represented by each line item presented:

| | 52 Weeks Ended | | |
|---|---|---|---|
| | Feb. 1, 2003 | Feb. 2, 2002 | Dec. 30, 2000 |
| Net sales | 100.0% | 100.0% | 100.0% |
| Cost of merchandise sold | 75.3 | 76.0 | 74.3 |
| Gross profit | 24.7 | 24.0 | 25.7 |
| Selling, general and administrative expenses | 23.1 | 22.9 | 21.3 |
| Other income, net | 1.0 | 1.1 | 1.2 |
| Income from operations | 2.6 | 2.2 | 5.6 |
| Interest expense | 0.2 | 0.3 | 0.3 |
| Income before income taxes | 2.4% | 1.9% | 5.3% |

## 2003 Store Closings

The Company regularly reviews under-performing stores and implements strategies designed to improve their performance. In Spring 2003, following more than two years of retail economic weakness, it was determined that a group of these under-performing stores would be unlikely to achieve profitability despite the Company's efforts to stimulate sales. In order to improve the quality of the Company's portfolio of stores, management decided in April to close 13 stores in addition to the three already planned for closure in 2003 (see Notes 10 and 14 to the Financial Statements). In accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," the estimated pretax charges that will be recorded in 2003 are approximately $19 million to recognize the present value of store closing costs. In addition, approximately $10 million in markdowns will be required to liquidate inventory in those stores.

## Year Ended February 1, 2003 Compared to Year Ended February 2, 2002

In 2002 the Company opened 16 stores and closed four stores bringing to 265 the number of stores in operation at year-end. The Company revised its approach to selecting locations for new stores effective with stores opening in 2002. Prior to that time, the Company's principal consideration was population demographics, including data relating to income, education levels, age and occupation. The availability of prime real estate locations, existing and potential competitors, and the number of Stein Mart stores that a market can support was also considered. The Company has since expanded its analysis to consider psychographics (such as fashion consciousness in the marketplace) as well as local area market research. The Company has also retained a third-party consulting firm to analyze each potential market. Finally, a committee of senior officers considers the collected data and analysis, and approves any potential new store location. While it is too early to provide assurances, the Company's initial results suggest that this new approach will significantly improve the Company's ability to successfully predict performance of new store locations.

Net sales of $1.409 billion were achieved for the fiscal year 2002, an increase of $88.5 million, or 6.7 percent over net sales of

$1.320 billion for the fiscal year 2001. The 16 new stores opened in 2002 contributed $56.5 million to net sales. Comparable store net sales decreased 0.8 percent from 2001.

Gross profit for 2002 was $348.5 million or 24.7 percent of net sales compared to $316.6 million or 24.0 percent of net sales for 2001. The 0.7 percent increase in the gross profit percent primarily resulted from inventory control initiatives which resulted in lower markdowns, somewhat offset by higher occupancy costs as a percent of sales.

Selling, general and administrative expenses were $326.5 million or 23.1 percent of net sales for 2002, as compared to $301.9 million or 22.9 percent of net sales in 2001. The 0.2 percent increase was primarily due to a lack of sales leverage slightly offset by lower pre-opening costs. Selling, general and administrative expenses include a pre-tax asset impairment charge of $2.7 million in 2002. As described in Note 10 to the Financial Statements, this charge reduces the carrying value of property and equipment of three stores that will close in 2003 and fifteen other under-performing stores to their respective estimated fair value. In 2001, selling, general and administrative expenses included a pre-tax charge of $2.9 million, including $2.2 million for lease termination costs and $0.7 million for asset impairments, for four stores that were closed in fiscal 2002.

Pre-opening expenses for the 16 stores opened in 2002 amounted to $3.1 million and for the 30 stores opened in 2001, amounted to $5.0 million.

Other income, primarily from in-store leased shoe departments, was $14.0 million in 2002, a slight decrease from the $14.1 million for 2001. In 2002, a new shoe lessee, whose offerings more closely mirror the Stein Mart apparel assortment, was chosen for approximately 60% of the stores. During the period preceding the turnover date, a decrease in shoe sales of the predecessor shoe lessee resulted in lower sublease income.

Interest expense for 2002 was $2.6 million, compared to $4.0 million in 2001. The decrease resulted from lower average borrowings as a result of decreased inventory levels on a per store basis, as well as lower interest rates this year compared to last year.

Net income for 2002 was $20.7 million or $0.50 per diluted share compared to net income of $15.4 million or $0.37 per diluted share for 2001.

## Year Ended February 2, 2002 Compared to Year Ended December 30, 2000

In November 2001, the Company changed its year end (see Note 1 to the Financial Statements). The following discussion compares the 52 weeks ended February 2, 2002 to the 52 weeks ended December 30, 2000.

In 2001 the Company opened 30 stores and closed three stores bringing to 253 the number of stores in operation at year-end.

Net sales of $1.320 billion were achieved for the fiscal year 2001, an increase of $113.6 million, or 9.4 percent over net sales of $1.207 billion for the fiscal year 2000. The 30 new stores opened in 2001 contributed $74.3 million to net sales. Comparable store net sales, which decreased 0.7 percent from 2000, began to decline in early 2001, reversing strong, double digit increases from 2000. This trend continued in the fall season as shopping declined following the September 11 terrorist attacks.

Gross profit for 2001 was $316.6 million or 24.0 percent of net sales compared to $310.1 million or 25.7 percent of net sales for 2000. The 1.7 percent decrease in the gross profit percent resulted primarily from higher markdowns as a percent of sales and decreased leverage of occupancy expenses in 2001. Markdowns were particularly high during the fall season, primarily in the weeks following September 11, in order to reduce in-store inventories through promotion and markdowns.

Selling, general and administrative expenses were $301.9 million or 22.9 percent of net sales for 2001, as compared to $257.0 million or 21.3 percent of net sales in 2000. In 2001, selling, general and administrative expenses included a pre-tax charge of $2.9 million for four stores that were closed in fiscal 2002. Fiscal 2000 includes a $3.4 million store closing credit related to adjustments of store closing reserves recorded in fiscal 1999. The increase of 1.6 percent of net sales is primarily due to the effect of the store closing charge and credit, increased advertising and decreased leverage of selling and administrative expenses.

Pre-opening expenses for the 30 stores opened in 2001 amounted to $5.0 million and for the 22 stores opened in 2000, amounted to $3.4 million.

Other income, primarily from in-store leased shoe departments, was $14.1 million in 2001, a slight increase over the $13.8 million for 2000. The increase was primarily from the additional stores operated during 2001.

Interest expense for 2001 was $4.0 million, compared to $3.3 million in 2000. The increase resulted from higher average borrowings offset by lower interest rates during 2001 compared to 2000. The increased borrowings were used to fund operating activities and to repurchase common stock.

Net income for 2001 was $15.4 million or $0.37 per diluted share compared to net income of $39.4 million or $0.91 per diluted share for 2000.

## Five-Week Transition Period Ended February 3, 2001

See Note 12 to the Financial Statements for audited financial data for the five-week transition period of December 31, 2000 through February 3, 2001. This period preceded the start of the 2001 fiscal year and no comparable period information is presented herein.

## Liquidity and Capital Resources

The Company's primary capital requirements are to support inventory and capital investments for the opening of new stores, to maintain and improve existing stores, and to meet seasonal working capital needs. The Company's capital requirements and working capital needs are funded through a combination of internally generated funds, a bank line of credit and credit terms from vendors. As of February 1, 2003, the Company had $9.9 million in cash and cash equivalents. During the course of the Company's seasonal business cycle, working capital is needed to support inventory for existing stores, especially during peak selling seasons. Historically, the Company's working capital needs are lowest in the first quarter and peak in either the third or fourth quarter in anticipation of the fourth quarter selling season.

Net cash provided by operating activities for 2002 amounted to $34.7 million, compared to $29.7 million for 2001. Net cash provided by operating activities in 2002 increased from the prior year primarily due to increased net income and less cash required for the procurement of merchandise due to the Company's inventory control initiatives which resulted in a 4.2 percent decrease in inventories in an average store in 2002 compared to 2001. The net decrease in accounts payable in 2002 compared to 2001 is primarily due to a shift in the timing of merchandise receipts during the fourth quarter resulting in more payments being made prior to year-end.

For 2002 and 2001, cash flows used in investing activities amounted to $19.1 million and $25.0 million, respectively, primarily for the acquisition of store fixtures, equipment and leasehold improvements and for information system enhancements. The decrease was primarily due to fewer stores opened in 2002.

Cash used in financing activities was $16.1 million in 2002 and $5.5 million in 2001. During 2002, cash was used to repurchase 220,000 shares of the Company's common stock for $1.5 million and in 2001, 657,600 shares were repurchased for $6.0 million. As of February 1, 2003, there are 2,044,200 shares which can be repurchased pursuant to the Board of Directors current authorizations. The decision to repurchase stock is primarily dependent on market conditions.

To facilitate an understanding of the Company's contractual obligations, the following data is provided:

| | Payments Due By Period | | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 Year | 1 – 2 Years | 3 – 5 Years | After 5 Years |
| Notes payable to banks | $ 41,350 | $ 41,350 | $ – | $ – | $ – |
| Operating leases | 415,403 | 61,302 | 58,584 | 146,185 | 149,322 |
| Total | $456,753 | $102,652 | $58,584 | $146,185 | $149,322 |

The Company has a revolving credit agreement with a group of banks, which extends through June 2004. The agreement, which was amended in April 2002, provides a $135 million senior revolving credit facility, including a $10 million letter of credit sub-facility. Borrowings are secured by trade and other receivables, inventories and certain other assets. Due to the seasonal nature of the Company's business, the Company's bank borrowings fluctuate during the year, typically reaching their highest levels during the third or fourth quarter, as the Company builds its inventory for the Christmas selling season. At February 1, 2003 and February 2, 2002, there was $41.3 million and $57.8 million outstanding under the agreement, respectively.

The agreement requires the Company to maintain certain financial ratios and meet required net worth and indebtedness tests. Notes payable to banks is classified as current at February 1, 2003 because management's projections indicate that the Company will not be in compliance with certain of the financial covenants as of the end of the first quarter 2003. The Company is in the process of negotiating a new credit agreement which is expected to close by June 2003.

The cost of opening a typical new store generally ranges from $450,000 to $650,000 for fixtures, equipment, leasehold improvements and pre-opening costs (primarily advertising, stocking and training). Pre-opening costs are expensed at the time of opening. Initial inventory investment for a new store is approximately $1.1 million (a portion of which is normally financed through vendor credit). The Company's total capital expenditures for 2003 (including amounts budgeted for new store expansion, improvements to existing stores and information system enhancements) are anticipated to be approximately $17 million.

The Company believes that expected net cash provided by operating activities, bank borrowings and vendor credit will be sufficient to fund anticipated current and long-term capital expenditures and working capital requirements.

## Seasonality

The Company's business is seasonal in nature with a higher percentage of the Company's merchandise sales and earnings generated in the fall and holiday selling seasons. Accordingly, selling, general and administrative expenses are typically higher as a percent of net sales during the first three quarters of each year.

## Critical Accounting Policies

The preparation of the Company's financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, expenses and related disclosure of contingent assets and liabilities. Management bases its estimates and judgments on historical experience and other relevant factors, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. While the Company believes that the historical experience and other factors considered provide a meaningful basis for the accounting policies applied in the preparation of the financial statements, the Company cannot guarantee that its estimates and assumptions will be accurate, which could require the Company to make adjustments to these estimates in future periods. Following is a summary of the more significant accounting policies:

### *Inventories*

Merchandise inventories are valued at the lower of average cost or market, on a first-in first-out basis, using the retail inventory method (RIM). RIM is an averaging method that is widely used in the retail industry. The use of RIM results in inventories being valued at the lower of cost or market as markdowns are taken as a reduction of the retail values of inventories.

Based on a review of historical markdowns, current business trends and seasonal inventory categories, additional inventory reserves may be recorded to reflect estimated markdowns which may be required to liquidate certain inventories and reduce inventories to the lower of cost or market. Management believes its inventory valuation methods approximate the net realizable value of clearance inventory and result in valuing inventory at the lower of cost or market.

### *Long-Lived Assets*

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Factors used in the review include management's plans for future operations, recent operating results and projected cash flows. An impairment loss is recognized if the sum of the expected future undiscounted cash flows from the use of the asset is less than the net book value of the assets. An impairment loss is recognized if the carrying value of the asset exceeds its fair value.

### *Insurance Reserve Estimates*

The Company uses a combination of insurance and self-insurance for various risks including workers' compensation, general liability and associate-related health care benefits, a portion of which is paid by the covered employees. The Company is responsible for paying the claims that are under the insured limits. The reserves recorded for these claims are estimated actuarially, based on claims filed and claims incurred but not reported. These reserve estimates are adjusted based upon actual claims filed and settled. The estimated accruals for these reserves could be significantly affected if future claims differ from historical trends and other actuarial assumptions.

For a complete listing of our significant accounting policies, please see Note 1 to the Company's Financial Statements.

## New Accounting Pronouncements

SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," was issued in June 2002. SFAS No. 146 requires the recognition of costs associated with exit or disposal activities when they are incurred rather than at the date of commitment to an exit or disposal plan. The provisions of the Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Company did not incur any new liability related to a disposal cost or exit activity between the effective date of this statement and the end of the fiscal year on February 1, 2003. See Note 14 to the Financial Statements regarding management's plans to close certain under-performing stores in 2003.

SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure," was issued in December 2002 and amends SFAS No. 123, "Accounting for Stock-Based Compensation." This standard provides two additional alternative transition methods for recognizing an entity's voluntary decision to change its method of accounting for stock-based employee compensation to the fair-value method. In addition, the standard amends the disclosure requirements of SFAS No. 123 so that entities will have to make more prominent disclosures regarding the pro forma effects of using the fair-value method of accounting for stock-based compensation and present those disclosures in a more accessible format in the footnotes to the annual and interim financial statements. Amendment of the transition and annual disclosure requirements are effective for fiscal years ending after December 15, 2002. The additional disclosures required under SFAS No. 148 are presented in Note 8 to the Financial Statements.

## Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to interest rate risk primarily through borrowings under its revolving credit facility. At February 1, 2003, direct borrowings aggregated $41.3 million. The facility, as amended in April 2002, permits debt commitments up to $135.0 million, has a June 2004 maturity date and bears interest at spreads over LIBOR. The average outstanding borrowings during fiscal 2002, 2001 and 2000 were $66.0 million, $82.3 million and $48.8 million, respectively, at weighted-average interest rates of 3.9%, 4.9% and 6.7% respectively. Management believes that its exposure to market risk associated with its borrowings is not material.

# Stein Mart, Inc. Balance Sheets

| (In thousands) | February 1, 2003 | February 2, 2002 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 9,859 | $ 10,276 |
| Trade and other receivables | 4,919 | 5,201 |
| Inventories | 297,230 | 296,158 |
| Prepaid expenses and other current assets | 4,361 | 11,324 |
| Total current assets | 316,369 | 322,959 |
| Property and equipment, net | 86,351 | 88,601 |
| Other assets | 7,497 | 6,112 |
| Total assets | $410,217 | $417,672 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 70,472 | $ 93,675 |
| Accrued liabilities | 53,407 | 46,001 |
| Income taxes payable | 5,353 | 4,071 |
| Notes payable to banks | 41,350 | – |
| Total current liabilities | 170,582 | 143,747 |
| Notes payable to banks | – | 57,750 |
| Other liabilities | 16,328 | 14,280 |
| Total liabilities | 186,910 | 215,777 |
| COMMITMENTS AND CONTINGENCIES | | |
| Stockholders' equity: | | |
| Preferred stock - $.01 par value; 1,000,000 shares authorized; no shares outstanding | | |
| Common stock - $.01 par value; 100,000,000 shares authorized; 41,618,678 and 41,495,876 shares issued and outstanding, respectively. | 416 | 415 |
| Paid-in capital | 721 | – |
| Retained earnings | 222,170 | 201,480 |
| Total stockholders' equity | 223,307 | 201,895 |
| Total liabilities and stockholders' equity | $410,217 | $417,672 |

The accompanying notes are an integral part of these financial statements.

# Statements of Income

| (In thousands except per share amounts) | For The 52 Weeks Ended February 1, 2003 | February 2, 2002 | December 30, 2000 |
|---|---|---|---|
| Net sales | $1,408,648 | $1,320,190 | $1,206,624 |
| Cost of merchandise sold | 1,060,117 | 1,003,567 | 896,560 |
| Gross profit | 348,531 | 316,623 | 310,064 |
| Selling, general and administrative expenses | 326,509 | 301,937 | 257,042 |
| Other income, net | 13,953 | 14,078 | 13,766 |
| Income from operations | 35,975 | 28,764 | 66,788 |
| Interest expense | 2,604 | 4,000 | 3,309 |
| Income before income taxes | 33,371 | 24,764 | 63,479 |
| Provision for income taxes | 12,681 | 9,410 | 24,122 |
| Net income | $ 20,690 | $ 15,354 | $ 39,357 |
| Earnings per share – Basic | $0.50 | $0.37 | $0.92 |
| Earnings per share – Diluted | $0.50 | $0.37 | $0.91 |
| Weighted–average shares outstanding – Basic | 41,575 | 41,176 | 42,909 |
| Weighted–average shares outstanding – Diluted | 41,764 | 41,493 | 43,409 |

The accompanying notes are an integral part of these financial statements.

# Stein Mart, Inc. Statements of Stockholders' Equity

| (In thousands) | Common Stock | Paid-in Capital | Retained Earnings | Total Stockholders' Equity |
|---|---|---|---|---|
| **Balance at January 1, 2000** | $439 | $21,364 | $158,109 | $179,912 |
| Net income | | | 39,357 | 39,357 |
| Common shares issued under stock option plan and related income tax benefits | 3 | 2,192 | | 2,195 |
| Common shares issued under employee stock purchase plan | 2 | 955 | | 957 |
| Reacquired shares | (29) | (24,511) | (3,853) | (28,393) |
| **Balance at December 30, 2000** | 415 | – | 193,613 | 194,028 |
| Transition period December 31, 2000 to February 3, 2001: | | | | |
| Net loss | | | (5,614) | (5,614) |
| Common shares issued under stock option plan and related income tax benefits | | 62 | | 62 |
| Common shares issued under employee stock purchase plan | | 469 | | 469 |
| Reacquired shares | | (454) | | (454) |
| **Balance at February 3, 2001** | 415 | 77 | 187,999 | 188,491 |
| Net income | | | 15,354 | 15,354 |
| Common shares issued under stock option plan and related income tax benefits | 5 | 3,067 | | 3,072 |
| Common shares issued under employee stock purchase plan | 2 | 995 | | 997 |
| Reacquired shares | (7) | (4,139) | (1,873) | (6,019) |
| **Balance at February 2, 2002** | 415 | – | 201,480 | 210,895 |
| Net income | | | 20,690 | 20,690 |
| Common shares issued under stock option plan and related income tax benefits | 2 | 1,193 | | 1,195 |
| Common shares issued under employee stock purchase plan | 1 | 1,027 | | 1,028 |
| Reacquired shares | (2) | (1,499) | | (1,501) |
| **Balance at February 1, 2003** | $416 | $ 721 | $222,170 | $223,307 |

The accompanying notes are an integral part of these financial statements.

# Stein Mart, Inc. Statements of Cash Flows

| (In thousands) | For The 52 Weeks Ended February 1, 2003 | February 2, 2002 | December 30, 2000 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $20,690 | $15,354 | $39,357 |
| Adjustments to reconcile net income to | | | |
| net cash provided by operating activities: | | | |
| Depreciation and amortization | 18,770 | 16,822 | 14,373 |
| Impairment of property and other assets | 2,709 | 1,114 | 1,038 |
| Deferred income taxes | 9,193 | (4,999) | 2,910 |
| Tax benefit from exercise of stock options | 385 | 1,024 | 810 |
| Changes in assets and liabilities: | | | |
| Trade and other receivables | 282 | (1,752) | (286) |
| Inventories | (1,072) | (13,260) | (32,267) |
| Prepaid expenses and other current assets | 32 | (641) | 4 |
| Other assets | (1,542) | (619) | (648) |
| Accounts payable | (23,203) | 13,180 | 4,465 |
| Accrued liabilities | 7,406 | 2,801 | 18,143 |
| Income taxes payable | 1,282 | (728) | 3,818 |
| Other liabilities | (214) | 1,356 | (9,281) |
| Net cash provided by operating activities | 34,718 | 29,652 | 42,436 |
| Cash flows used in investing activities: | | | |
| Capital expenditures | (19,072) | (24,982) | (20,914) |
| Cash flows from financing activities: | | | |
| Net borrowings under notes payable to banks | (16,400) | (2,486) | – |
| Proceeds from exercise of stock options | 810 | 2,048 | 1,385 |
| Proceeds from employee stock purchase plan | 1,028 | 997 | 957 |
| Purchase of common stock | (1,501) | (6,019) | (28,393) |
| Net cash used in financing activities | (16,063) | (5,460) | (26,051) |
| Net decrease in cash and cash equivalents | (417) | (790) | (4,529) |
| Cash and cash equivalents at beginning of year | 10,276 | 11,066 | 17,055 |
| Cash and cash equivalents at end of year | $ 9,859 | $10,276 | $12,526 |
| Supplemental disclosures of cash flow information: | | | |
| Interest paid | $ 2,567 | $ 3,980 | $ 3,141 |
| Income taxes paid | 2,392 | 14,221 | 16,887 |

The accompanying notes are an integral part of these financial statements.

February 1, 2003

(Dollars in tables in thousands except per share amounts)

## 1. Summary of Significant Accounting Policies

At February 1, 2003 the Company operated a chain of 265 off-price retail stores in 29 states. Each store offers women's, men's and children's apparel, as well as accessories, gifts, linens and shoes.

### Change in Fiscal Year End

In November 2001, the Company changed its fiscal year end from the Saturday closest to December 31 to the Saturday closest to January 31. The five-week transition period of December 31, 2000 through February 3, 2001 (the "Transition Period") preceded the start of the 2001 fiscal year. Audited financial information for the Transition Period is presented in Note 12. Results for 2002, 2001 and 2000 are for the 52 weeks ended February 1, 2003, February 2, 2002 and December 30, 2000, respectively.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits and short-term investments with original maturities of three months or less.

### Inventories

Merchandise inventories are valued at the lower of average cost or market, on a first-in first-out basis, using the retail inventory method.

### Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is provided on a straight-line method using estimated useful lives of 3-10 years. Leasehold improvements are amortized over the shorter of the estimated useful lives of the improvements or the term of the lease.

### Impairment of Long Lived Assets

The Company follows Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which requires impairment losses to be recorded on long-lived assets used in operations whenever events or changes in circumstances indicate that the net carrying amounts may not be recoverable. An impairment loss is recognized if the sum of the expected future undiscounted cash flows from the use of the assets is less than the net book value of the assets. An impairment loss is recognized if the carrying value of the asset exceeds its fair value. Impairment reviews are performed for individual stores. Factors used in the review include management's plans for future operations, recent operating results and projected cash flows. See Note 10.

### Insurance Reserves

The Company uses a combination of insurance and self-insurance for various risks including workers' compensation, general liability and associate-related health care benefits. Claim liabilities are estimated actuarially, based on claims filed and claims incurred but not reported.

### Store Pre-Opening Costs

New store pre-opening costs are expensed as incurred.

### Advertising Expense

Advertising costs are expensed as incurred. Advertising expenses of $52,086,000, $47,007,000, $2,256,000, and $43,092,000 are reflected in Selling, general and administrative expenses in the Statements of Income for 2002, 2001, the Transition Period and 2000, respectively.

### Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

### Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding plus common stock equivalents related to stock options for each period. Stock options are not included in the diluted loss per share calculation for the Transition Period because they are anti-dilutive.

A reconciliation of weighted-average number of common shares to weighted-average number of common shares plus common stock equivalents is as follows (000's):

| | 2002 | 2001 | Transition Period | 2000 |
|---|---|---|---|---|
| Weighted-average number of common shares | 41,575 | 41,176 | 41,476 | 42,909 |
| Stock options | 189 | 317 | – | 500 |
| Weighted-average number of common shares plus common stock equivalents | 41,764 | 41,493 | 41,476 | 43,409 |

### New Accounting Pronouncements

SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," was issued in July 2002. SFAS No. 146 requires the recognition of costs associated with exit or disposal activities when they are incurred rather than at the date of commitment to an exit or disposal plan. The provisions of the Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Company did not incur any new liability related to a disposal cost or exit activity between the effective date of this statement and the end of the fiscal year on February 1, 2003. See Note 14 regarding management's plans to close certain under-performing stores in 2003.

SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure," was issued in December 2002 and amends SFAS No. 123, "Accounting for Stock-Based Compensation." This standard provides two additional alternative transition methods for recognizing an entity's voluntary decision to change its method of accounting for stock-based employee compensation to the fair-value method. In addition, the standard amends the disclosure requirements of SFAS No. 123 so that entities will have to make more prominent disclosures regarding the pro forma effects of using the fair-value method of accounting for stock-based compensation and present those disclosures in a more accessible format in the footnotes to the annual and interim financial statements. Amendment of the transition and annual disclosure requirements are effective for fiscal years ending after December 15, 2002. The additional disclosures required under SFAS No. 148 are presented in Note 8 to the Financial Statements.

## 2. Property and Equipment, Net

Property and equipment and the related accumulated depreciation and amortization are as follows:

| | Feb. 1, 2003 | Feb. 2, 2002 |
|---|---|---|
| Furniture, fixtures and equipment | $145,285 | $133,072 |
| Leasehold improvements | 49,471 | 46,677 |
| | 194,756 | 179,749 |
| Less: accumulated depreciation and amortization | 108,405 | 91,148 |
| | $ 86,351 | $ 88,601 |

## 3. Accrued Liabilities

The major components of accrued liabilities are as follows:

| | Feb. 1, 2003 | Feb. 2, 2002 |
|---|---|---|
| Taxes, other than income taxes | $15,095 | $16,256 |
| Salary, wages, bonuses and benefits | 14,846 | 10,246 |
| Other | 23,466 | 19,499 |
| | $53,407 | $46,001 |

## 4. Notes Payable to Banks

In June 2001, the Company entered into a new revolving credit agreement with a group of banks, which extends through June 2004. The agreement, which was amended in April 2002, provides a $135 million senior revolving credit facility, including a $10 million letter of credit sub-facility. Borrowings are secured by trade and other receivables and inventories. Interest is payable at rates based on spreads over the London Interbank Offering Rate (LIBOR) or the Prime Rate. A quarterly commitment fee ranging from 0.375% to 0.50% per annum is paid on the unused portion of the commitment. The weighted average interest rates on borrowings during 2002, 2001, the Transition Period and 2000 were 3.9%, 4.9%, 6.4% and 6.7%, respectively. The agreement requires the Company to maintain certain financial ratios and indebtedness tests. At February 1, 2003, the Company was in compliance with all requirements of the amended agreement.

Notes payable to banks is classified as current at February 1, 2003 because management's projections indicate that the Company will not be in compliance with certain of the financial covenants as of the end of the first quarter 2003. The Company is in the process of negotiating a new credit agreement which is expected to close by June 2003.

## 5. Leased Facilities and Commitments

The Company leases all of its retail and support facilities. Annual store rent is generally comprised of a fixed minimum amount plus a contingent amount based on a percentage of sales exceeding a stipulated amount. Most leases also require additional payments covering real estate taxes, common area costs and insurance.

Rent expense is as follows:

| | 2002 | 2001 | Transition Period | 2000 |
|---|---|---|---|---|
| Minimum rental | $60,805 | $55,278 | $4,335 | $48,329 |
| Contingent rentals | 678 | 889 | 52 | 689 |
| | $61,483 | $56,167 | $4,387 | $49,018 |

At February 1, 2003, for the majority of its retail and corporate facilities, the Company was committed under noncancellable leases with remaining terms of up to 15 years. Future minimum payments under noncancellable leases are:

| | |
|---|---|
| 2003 | $ 61,302 |
| 2004 | 58,584 |
| 2005 | 53,990 |
| 2006 | 48,641 |
| 2007 | 43,554 |
| Thereafter | 149,332 |
| | $415,403 |

During all periods presented, the Company subleased the space for shoe and fragrance departments in all of its stores. As of March 2003, the Company owns and operates the fragrance department. Sales from leased departments are excluded from sales of the Company. Sublease rental income of $12,519,000, $12,610,000, $752,000 and $12,710,000 is included in Other income, net in the Statements of Income for 2002, 2001, the Transition Period and 2000, respectively.

## 6. Income Taxes

The income tax provision (benefit) is as follows:

| | 2002 | 2001 | Transition Period | 2000 |
|---|---|---|---|---|
| Current: | | | | |
| Federal | $ 3,212 | $13,271 | $(3,387) | $19,537 |
| State | 276 | 1,138 | (290) | 1,675 |
| Total | 3,488 | 14,409 | (3,677) | 21,212 |
| Deferred: | | | | |
| Federal | 8,467 | (4,604) | 217 | 2,680 |
| State | 726 | (395) | 19 | 230 |
| Total | 9,193 | (4,999) | 236 | 2,910 |
| Income tax provision (benefit) | $12,681 | $ 9,410 | $(3,441) | $24,122 |

Income tax expense (benefit) differed from the amounts computed by applying the federal statutory rate of 35 percent to income before taxes as follows:

| | 2002 | 2001 | Transition Period | 2000 |
|---|---|---|---|---|
| Federal tax at the statutory rate | $11,680 | $8,667 | $(3,169) | $22,218 |
| State income taxes, net of federal benefit | 1,001 | 743 | (272) | 1,904 |
| | $12,681 | $9,410 | $(3,441) | $24,122 |
| Effective income tax rate | 38.0% | 38.0% | 38.0% | 38.0% |

Temporary differences, which give rise to deferred tax assets and liabilities, are as follows:

| | Feb. 1, 2003 | Feb. 2, 2002 |
|---|---|---|
| Deferred tax assets: | | |
| NOL carryforward | $ – | $ 5,417 |
| Store closing and asset impairment reserves | 3,162 | 2,158 |
| Accrued liabilities | 3,368 | 2,012 |
| Other | 1,082 | 2,034 |
| | 7,612 | 11,621 |
| Deferred tax liabilities: | | |
| Depreciation | 14,248 | 12,019 |
| Inventory | 3,060 | – |
| Other | 1,931 | 2,036 |
| | 19,239 | 14,055 |
| Net deferred tax liability | $(11,627) | $(2,434) |

At February 2, 2002, the Company had approximately $14 million in federal and state net operating loss ("NOL") carryforwards, which were fully utilized in 2002. The NOL carryforwards were generated in the five-week tax period ended February 2, 2002 which resulted from the Company's change in fiscal year (see Note 1).

On March 14, 2002, the Internal Revenue Service released new rules (Rev. Proc. 2002-19), which allowed the Company an accelerated deduction of certain components of the Company's deferred tax asset relating to inventories. As a result, the Company's income tax payable and the corresponding deferred tax asset as of February 2, 2002 relating to inventories were reduced by $3.8 million in the first quarter of fiscal 2002.

Deferred tax assets and liabilities are reflected on the Company's Balance Sheets as follows:

| | Feb. 1, 2003 | Feb. 2, 2002 |
|---|---|---|
| Current deferred tax assets (included in Prepaid expenses and other current assets) | $ 196 | $ 7,127 |
| Non-current deferred tax liabilities (included in Other liabilities) | (11,823) | (9,561) |
| Net deferred tax liabilities | $(11,627) | $(2,434) |

The exercise of certain stock options which have been granted under the Company's stock option plans gives rise to compensation which is includable in the taxable income of the applicable employees and deductible by the Company for federal and state income tax purposes. Such compensation results from increases in the market value of the Company's common stock subsequent to the date of grant of the applicable exercised stock options, and in accordance with Accounting Principles Board Opinion No. 25, such compensation is not recognized as an expense for financial accounting purposes and the related tax benefits are recorded directly in Paid-in capital.

## 7. Stockholders' Equity

During 2002, 2001, the Transition Period and 2000, the Company repurchased 220,000, 657,600, 40,800 and 2,910,600 shares of its common stock in the open market at a total cost of $1,501,000, $6,019,000, $454,000 and $28,393,000, respectively. As of February 1, 2003, there are 2,044,200 shares which can be repurchased pursuant to the Board of Directors' current authorizations.

## 8. Stock Option and Purchase Plans

In 2001, the shareholders approved a new stock option plan (the "Omnibus Plan"), under which a maximum of 4,500,000 shares of the Company's common stock may be issued. Shares covered by unexercised options that terminate or shares that are forfeited may be subject to new awards. The Omnibus Plan replaced the Company's Employee Stock and Director Stock Option Plans (the "Previous Plans") under which there were 3,669,438 options to purchase shares outstanding as of February 1, 2003. Upon approval of the Omnibus Plan, no further options have been or will be issued under the Previous Plans. The term of the Omnibus Plan is indefinite, except that no incentive stock option award can be granted after the tenth anniversary of the plan.

The Omnibus Plan, consistent with the Previous Plans, provides that shares of common stock may be granted to certain key employees and outside directors through non-qualified stock options, incentive stock options, stock appreciation rights, performance awards, restricted stock, or any other award made under the terms of the plan. The Board of Directors, or its delegated authority, determines the exercise price and all other terms of all grants. In general, one-third of the options granted in the past have become exercisable on the third, fourth and fifth anniversary dates of grant and expire ten years after the date of grant. No stock appreciation rights or restricted stock awards have been granted under this or the prior plan.

Activity for these fixed-price option plans is as follows:

| | Number of Shares (000) | Weighted-Average Exercise Price |
|---|---|---|
| Outstanding at January 1, 2000 | 4,625 | $10.69 |
| Granted | 614 | 9.11 |
| Exercised | (260) | 4.89 |
| Forfeited | (396) | 12.65 |
| Outstanding at December 30, 2000 | 4,583 | 10.64 |
| Granted | – | – |
| Exercised | (8) | 5.28 |
| Forfeited | (33) | 12.68 |
| Outstanding at February 3, 2001 | 4,542 | 10.63 |
| Granted | 1,146 | 8.54 |
| Exercised | (549) | 3.58 |
| Forfeited | (359) | 13.90 |
| Outstanding at February 2, 2002 | 4,780 | 10.70 |
| Granted | 514 | 10.63 |
| Exercised | (166) | 4.58 |
| Forfeited | (97) | 10.49 |
| Outstanding at February 1, 2003 | 5,031 | $10.90 |

Exercisable stock options were 2.625 million, 2.004 million, 1.860 million and 1.870 million at February 1, 2003, February 2, 2002, February 3, 2001 and December 30, 2000, respectively.

The following table summarizes information about fixed-price stock options outstanding at February 1, 2003:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number Outstanding (000) | Weighted-Average Remaining Contractual Life (Years) | Weighted-Average Exercise Price | Number Exercisable (000) | Weighted-Average Exercise Price |
| $ 2.50 – 5.75 | 453 | 5.5 | $ 5.58 | 159 | $ 5.62 |
| $ 6.53 – 9.63 | 1,656 | 7.2 | 8.09 | 348 | 7.91 |
| $10.00 – 13.81 | 2,387 | 5.3 | 12.86 | 1,738 | 13.47 |
| $14.25 – 16.59 | 535 | 5.2 | 15.31 | 380 | 15.15 |
| | 5,031 | 5.9 | $10.90 | 2,625 | $12.50 |

The Company has adopted the disclosure-only provisions of SFAS No. 123, as amended by SFAS No. 148, "Accounting for Stock-Based Compensation," and intends to retain the intrinsic value method of accounting for stock-based compensation which it currently uses. Accordingly, no compensation cost has been recognized for the stock option plans. Had compensation cost of the Company's stock option plans been determined consistent with the provisions of SFAS No. 123, the Company's net income (loss) and earnings (loss) per share would have been reduced to the following pro forma amounts:

| | 2002 | 2001 | Transition Period | 2000 |
|---|---|---|---|---|
| Net income (loss) – as reported | $20,690 | $15,354 | $(5,614) | $39,357 |
| Stock option compensation – net of tax | 1,741 | 2,087 | 179 | 2,891 |
| Net income (loss) – pro forma | $18,949 | $13,267 | (5,793) | $36,466 |
| Basic earnings (loss) per share – as reported | $0.50 | $0.37 | $(0.14) | $0.92 |
| Diluted earnings (loss) per share – as reported | 0.50 | 0.37 | (0.14) | 0.91 |
| Basic earnings (loss) per share – pro forma | $0.46 | $0.32 | $(0.14) | $0.85 |
| Diluted earnings (loss) per share – pro forma | 0.45 | 0.32 | (0.14) | 0.84 |

The effects of applying this Statement for pro forma disclosures are not likely to be representative of the effects on reported net income for future years, because options vest over several years and additional awards are made each year. No options were granted during the Transition Period. In determining the pro forma compensation cost, the weighted-average fair value of options granted during fiscal 2002, 2001 and 2000 was estimated to be $5 using the Black-Scholes options pricing model. The following weighted-average assumptions were used for grants made during 2002, 2001 and 2000: dividend yield of 0.0%, expected volatility of 51.9%, 51.7% and 51.1%, respectively, risk-free interest rate of 3.8%, 4.8% and 5.2%, respectively and expected lives of 5.0, 7.0 and 7.0 years, respectively.

The Company has an Employee Stock Purchase Plan (the "Stock Purchase Plan") whereby all employees who complete six months employment with the Company and who work on a full-time basis or are regularly scheduled to work more than 20 hours per week are eligible to participate in the Stock Purchase Plan. Participants in the Stock Purchase Plan are permitted to use their payroll deductions to acquire shares at 85% of the fair market value of the Company's stock determined at either the beginning or end of each option period. In 2002, 2001, the Transition Period and 2000, the participants acquired 173,048 shares, 127,220 shares, 53,856 shares and 198,051 shares of the Company's common stock at weighted average per-share prices of $5.94, $7.84, $8.71 and $4.83 per share, respectively.

On May 7, 2001, the shareholders approved an amendment to the Stock Purchase Plan, increasing the number of shares eligible for issuance under the Plan by 1,000,000 and extending the Plan until December 31, 2005.

## 9. Employee Benefit Plans

The Company has a defined contribution retirement plan covering employees who are at least 21 years of age, have completed at least one year of service and who work at least 1,000 hours annually. Under the profit sharing portion of the plan, the Company makes discretionary contributions, which vest at a rate of 20 percent per year after two years of service. Under the 401(k) portion of the plan, the Company matches 50 percent of the employee's voluntary pre-tax contributions up to a maximum of four percent of the employee's compensation. The Company's matching portion vests in accordance with the plan's vesting schedule. Total Company contributions under the retirement plan were $1,627,000, $1,571,000, $66,000 and $1,750,000 for 2002, 2001, the Transition Period and 2000, respectively.

The Company has an executive split dollar life insurance plan wherein eligible executives are provided with pre-retirement life insurance protection based upon three to five times base salary. Upon retirement, the executive is provided with life insurance protection based upon one and one-half to two and one-half times final base salary. The expense for this plan was $331,000, $293,000 and $248,000 in 2002, 2001 and 2000, respectively. There was no expense recorded during the Transition Period.

The Company also has an executive deferral plan providing officers and key executives with the opportunity to participate in an unfunded, deferred compensation program. Effective November 1, 2002, the plan was amended to include director-level employees. Under the program, participants may defer up to 100% of their base compensation and bonuses earned. The Company will match the officers and key executives' contributions 100%, and the directors' contributions 50%, up to the first 10% of income deferred. A participant's Company matching contributions and related investment earnings are 20% vested after four years of participation in the plan and increase 20% per year through the eighth year, at which time a participant is fully vested. The total of participant deferrals, which is reflected in Accrued liabilities, was $1,223,000 at February 1, 2003, $814,000 at February 2, 2002 and $402,000 at February 3, 2001. The expense for this plan was $611,000, $495,000, $25,000 and $486,000 in 2002, 2001, the Transition Period and 2000, respectively.

In connection with the above two plans, whole life insurance contracts were purchased on the related participants. At February 1, 2003 and February 2, 2002 the cash surrender value of these policies was $3,132,000 and $2,773,000, respectively, and is included in Other assets.

## 10. Store Closing Charges and Impairment of Long-Lived Assets

In April 2003 the Company decided to close 13 additional under-performing stores in 2003. See Note 14.

During the fourth quarter of 2002, management approved a plan to close three stores in 2003. The Company does not expect to incur significant lease exit costs upon closing these stores. However, a pretax non-cash asset impairment charge of $2.7 million was recorded during the fourth quarter of 2002 to reduce the carrying value of property and equipment of these three closing stores and fifteen other under-performing stores to their respective estimated fair value. The estimated future undiscounted cash flows from the under-performing stores are not expected to exceed the current net book value of their property and equipment. This charge is included in Selling, general and administrative expenses in the Statement of Income for 2002.

During the fourth quarter of 2001, the Company recorded a pre-tax charge of $2.9 million, including $2.2 million for the estimated cost of lease terminations and $0.7 million for the impairment of certain property and equipment for four stores that were closed in 2002. The charge is included in Selling, general and administrative expenses in the Statement of Income for 2001.

During 2000, the Company recorded a net pre-tax credit of $3.4 million related to certain store closing reserves recorded in 1999. The credit resulted from adjustments to estimated lease obligations for changes in anticipated closing dates and for favorable lease settlements ($2.5 million), unsatisfactory lease negotiations to close two stores ($1.9 million), offset by a $1.0 million charge for the write-down of furniture, fixtures and equipment related to store closings. The store closing credit is included in Selling, general and administrative expenses in the Statement of Income for 2000.

Activity in the store closing reserve is as follows:

| | 2002 | 2001 | Transition Period | 2000 |
|---|---|---|---|---|
| Balance at beginning of period | $5,680 | $4,984 | $6,037 | $12,589 |
| Additions | 113 | 2,206 | – | – |
| Payments | (811) | (1,510) | (1,053) | (2,067) |
| Adjustments | – | – | – | (4,485) |
| Balance at end of period | $4,982 | $5,680 | $4,984 | $ 6,037 |

The store closing reserve at February 1, 2003 includes primarily the remaining lease obligations for the four stores that closed in 2002 and the remaining lease obligation for one store closed in December 1999. Payments during 2002 include lease termination and ongoing lease costs. The store closing reserve includes a current portion of $1.5 million and a long-term portion of $3.5 million which are included in Accrued liabilities and Other liabilities, respectively.

## 11. Quarterly Results of Operations (Unaudited)

As discussed in Note 1, the Company changed its fiscal year in 2001. The 13 week periods of 2002 and 2001 reflect this change.

| | 13 Weeks Ended | | | |
|---|---|---|---|---|
| Year Ended February 1, 2003 | May 4, 2002 | Aug. 3, 2002 | Nov. 2, 2002 | Feb. 1, 2003 |
| Net sales | $355,979 | $311,427 | $332,847 | $408,395 |
| Gross profit | 96,531 | 78,104 | 73,685 | 100,211 |
| Net income (loss) | 11,368 | 2,775 | (3,843) | 10,390 |
| Earnings (loss) per share – Basic | $ 0.27 | $ 0.07 | $ (0.09) | $ 0.25 |
| Earnings (loss) per share – Diluted | $ 0.27 | $ 0.07 | $ (0.09) | $ 0.25 |

| | 13 Weeks Ended | | | |
|---|---|---|---|---|
| Year Ended February 2, 2002 | May 5, 2001 | Aug. 4, 2001 | Nov. 3, 2001 | Feb. 2, 2002 |
| Net sales | $317,069 | $291,473 | $304,367 | $407,281 |
| Gross profit | 83,077 | 71,810 | 64,179 | 97,557 |
| Net income | 9,132 | 3,048 | (5,828) | 9,002 |
| Earnings (loss) per share – Basic | $ 0.22 | $ 0.07 | $ (0.14) | $ 0.22 |
| Earnings (loss) per share – Diluted | $ 0.22 | $ 0.07 | $ (0.14) | $ 0.22 |

## 12. Transition Period Financial Information

Statement of Income for the five-week Transition Period ended February 3, 2001:

| | |
|---|---|
| Net sales | $84,013 |
| Cost of merchandise sold | 70,609 |
| Gross profit | 13,404 |
| Selling, general and administrative expenses | 23,106 |
| Other income, net | 833 |
| Loss from operations | (8,869) |
| Interest expense | 186 |
| Loss before income tax benefit | (9,055) |
| Income tax benefit | 3,441 |
| Net loss | $ (5,614) |
| Loss per share – Basic and Diluted | $ (0.14) |

## 12. Transition Period Financial Information *(continued)*

Statement of Cash Flows for the five-week Transition Period ended February 3, 2001:

| | |
|---|---|
| Cash flows from operating activities: | |
| Net loss | $ (5,614) |
| Adjustments to reconcile net loss to net cash used in operating activities: | |
| Depreciation and amortization | 1,299 |
| Tax benefit from exercise of stock options | 22 |
| Deferred income taxes | 236 |
| Changes in assets and liabilities: | |
| Trade and other receivables | 1,309 |
| Inventories | (5,445) |
| Prepaid expenses and other current assets | 529 |
| Other assets | 50 |
| Accounts payable | (41,083) |
| Accrued liabilities | (8,556) |
| Income taxes payable | (3,705) |
| Other liabilities | 55 |
| Net cash used in operating activities | (60,903) |
| Cash flows used in investing activities: | |
| Capital expenditures | (848) |
| Cash flows from financing activities: | |
| Net borrowings under notes payable to banks | 60,236 |
| Proceeds from exercise of stock options | 40 |
| Proceeds from employee stock purchase plan | 469 |
| Purchase of common stock | (454) |
| Net cash provided by financing activities | 60,291 |
| Net decrease in cash and cash equivalents | (1,460) |
| Cash and cash equivalents at December 30, 2000 | 12,526 |
| Cash and cash equivalents at February 3, 2001 | $11,066 |

Interest and taxes paid during the five-week Transition Period ended February 3, 2001 were $1,072,000 and $17,000, respectively.

## 13. Legal Proceedings

The Company is involved in various routine legal proceedings incidental to the conduct of its business. Management does not believe that any of these legal proceedings will have a material adverse effect on the Company's financial condition or results of operations.

## 14. Subsequent Event

The Company regularly reviews under-performing stores and implements strategies designed to improve their performance. In Spring 2003, following more than two years of retail economic weakness, it was determined that a group of these under-performing stores would be unlikely to achieve profitability despite the Company's efforts to stimulate sales. In order to improve the quality of the Company's portfolio of stores, management decided in April to close 13 stores in addition to the three already planned for closure in 2003 (see Note 10). In accordance with SFAS No. 146, the estimated charges that will be recorded in 2003 are approximately $19 million to recognize the present value of store closing costs. In addition, approximately $10 million in markdowns will be required to liquidate inventory in those stores.

# Report of Independent Certified Public Accountants

PRICEWATERHOUSECOOPERS

To the Board of Directors
and Stockholders of Stein Mart, Inc.

In our opinion, the accompanying financial statements appearing on pages 12 through 24 of this annual report present fairly, in all material respects, the financial position of Stein Mart, Inc. at February 1, 2003 and February 2, 2002, and the results of its operations and its cash flows for the 52 weeks ended February 1, 2003 and February 2, 2002, for the five-week Transition Period ended February 3, 2001, and for the 52 weeks ended December 30, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Jacksonville, Florida
March 28, 2003, except for Note 14, as to which the date is April 16, 2003

# Stein Mart, Inc. Corporate Officers & Board of Directors

## Executive Officers

**Michael D. Fisher**
*President & Chief Executive Officer*

**Gwen K. Manto**
*Vice Chairman & Chief Merchandising Officer*

**James G. Delfs**
*Senior Vice President & Chief Financial Officer*

**D. Hunt Hawkins**
*Senior Vice President, Human Resources*

**Michael D. Ray**
*Senior Vice President, Director of Stores*

## Vice Presidents

### Corporate

W. Michael Allen, Real Estate
David W. Bothe, Marketing, Advertising and Sales Promotion
Carl D. Davis, Administration
Ronald G. Hughes, Distribution and Traffic
Joseph Martinolich, Internal Audit, Safety and Security
Roseann McLean, Planning and Allocation
Clayton E. Roberson, Jr., Controller
Matthew K. Votaw, Information Systems

### Regional Directors of Stores

E. L. Berley
Robert H. Brooks
Jim C. Love
Roy E. Roberts
Diane Tarman

### General Merchandising Managers

Richard J. Marini, Dresses, Ladies' Accessories, Children's, Intimate Apparel
John H. Pennell, Men's
Patricia A. Stagner, Gifts, Linens

## Board of Directors

Jay Stein, Chairman of the Board, Stein Mart, Inc. Formerly a director of American Heritage Life Insurance Company and Promus Hotel Corporation.

Linda McFarland Farthing, Former President and Director of Friedman's, Inc. and Cato Corporation. *Chairperson, Audit committee; Corporate Governance committee.*

Martin E. "Hap" Stein, Jr. Chairman and Chief Executive Officer of Regency Centers Corporation. Director of Patriot Transportation Holding, Inc. and Florida Rock Industries, Inc. *Compensation committee; Corporate Governance committee.*

John H. Williams, Jr., Vice Chairman of the Board and former President and Chief Executive Officer, Stein Mart, Inc. Director of SunTrust Bank, North Florida N.A.

Mitchell W. Legler, Esquire, Kirschner & Legler, P.A. General counsel to the Company since 1991.

J. Wayne Weaver, Chairman and Chief Executive Officer of LC Footwear, L.L.C., the licensed shoe division of Liz Claiborne, Inc.; Chairman of Shoe Carnival, Inc.; and Chairman, Chief Executive Officer and majority owner of the Jacksonville Jaguars. *Corporate Governance committee.*

Alvin R. "Pete" Carpenter, Former Vice Chairman, CSX Corporation. Also a director of Regency Centers Corporation and Florida Rock Industries, Inc. *Chairman, Compensation committee; Corporate Governance committee.*

Michael D. Rose, Private Investor. Chairman, Gaylord Entertainment. Former Chairman, Promus Hotel Corporation and Harrah's Entertainment, Inc. Director of Darden Restaurants, Inc., First Tennessee National Corporation and Felcor Lodging Trust, Inc. *Lead Director. Audit committee; Corporate Governance committee.*

James H. Winston, Chairman, LPMC, a real estate investment firm based in Jacksonville, Florida. President of Omega Insurance Company and Citadel Life & Health Insurance Company. Also a director of Patriot Transportation Holding, Inc., Winston Hotels and Scott-McRae Group, Inc. *Audit committee; Compensation committee; Corporate Governance committee.*

For additional information about Stein Mart's Corporate Governance, go to www.steinmart.com and click on Investor Relations.

## Corporate headquarters

Stein Mart, Inc.
1200 Riverplace Boulevard
Jacksonville, FL 32207
(904) 346-1500
*www.steinmart.com*

## Annual meeting of stockholders

The annual meeting of stockholders will be held at two o'clock in the afternoon, Monday, June 9, 2003 at The Cummer Gallery of Art and Gardens, Jacksonville, Florida.

## Transfer Agent and Registrar

Mellon Investor Services LLC
P. O. Box 3315
South Hackensack, NJ 07606-1915
1-800-756-3353
*www.melloninvestor.com*

## Legal Counsel

Mitchell W. Legler
Kirschner & Legler, P.A.
300A Wharfside Way
Jacksonville, Florida 32207

## Independent Auditors

PricewaterhouseCoopers LLP
Jacksonville, Florida

## Common stock information

Stein Mart's common stock trades on The Nasdaq Stock Market® under the trading symbol SMRT. On April 11, 2003, there were 1,135 stockholders of record.

The following table reflects the high and low sales prices of the common stock for each fiscal quarter in 2001 and 2002.

## Stock prices by quarter

| Quarter ending dates | High | Low |
|---|---|---|
| May 5, 2001 | $ 12.31 | $ 8.69 |
| August 4, 2001 | $ 12.47 | $ 7.85 |
| November 3, 2001 | $ 9.08 | $ 6.12 |
| February 2, 2002 | $ 9.20 | $ 7.96 |
| | | |
| May 4, 2002 | $ 12.12 | $ 8.74 |
| August 3, 2002 | $ 12.32 | $ 6.89 |
| November 2, 2002 | $ 8.75 | $ 5.37 |
| February 1, 2003 | $ 7.85 | $ 5.20 |

The Company intends to reinvest future earnings in the business and accordingly does not anticipate paying dividends in the foreseeable future.

## Financial information

Copies of the Annual Report, Form 10-K and other financial reports are available without charge by written request to: Stockholder Relations, Stein Mart, Inc., 1200 Riverplace Boulevard, Jacksonville, FL 32207.

Current and past news releases, all SEC filings, current stock price and stock history are available on line at www.steinmart.com; click on Investor Relations.

## Investor and Media Inquiries

If you are a member of the financial community or the news media and need to address specific financial information, please call Susan Datz Edelman, Director of Stockholder Relations, at (904) 346-1506.

# Mission Statement

## Vision

To be the preeminent upscale off-price retailer in America.

## The Stein Mart Mission

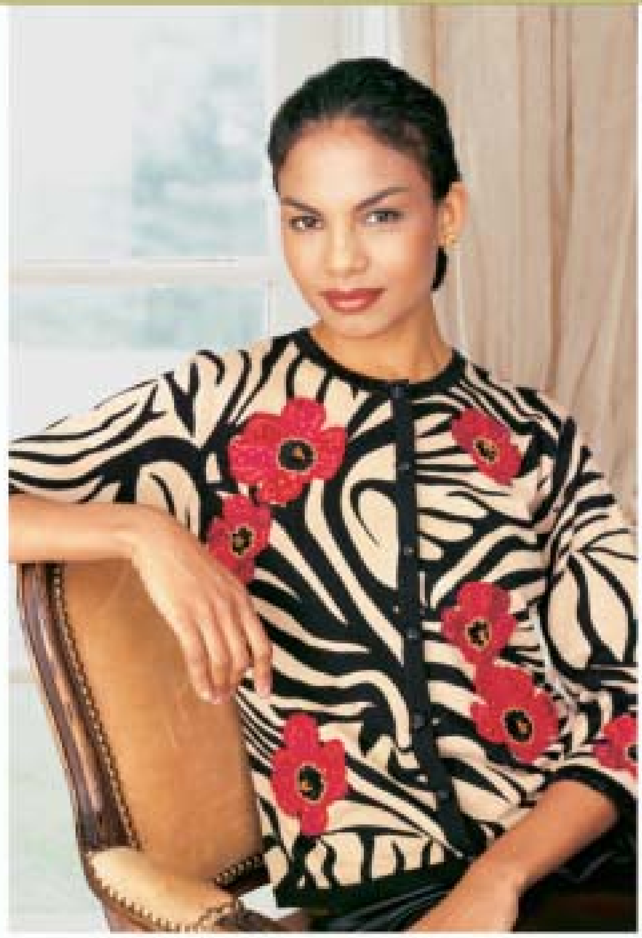
To serve our customers and community efficiently and effectively; to act with integrity toward customers, associates and vendors; to maintain profitable growth and build long-term value for our shareholders.



Printed on recycled paper

The production of this Stein Mart annual report was based on a Company commitment to provide current and prospective stockholders with accurate, thorough, and timely information about the Company while incurring only modest production costs.

www.steinmart.com

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