CELESTICA INC
Form 425
March 10, 2004

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Subject Company: Manufacturers' Services Limited
Commission File No.: 333-110362

The following is a press release issued by Celestica Inc. ("Celestica") and Manufacturers' Services Limited ("MSL") on March 9, 2004 regarding the share exchange ratio in connection with Celestica Inc.'s pending acquisition of MSL.

**FOR IMMEDIATE RELEASE** **Tuesday, March 9, 2004 (5:30 p.m. EST)**

# CELESTICA AND MSL ANNOUNCE SHARE EXCHANGE RATIO IN MSL ACQUISITION

TORONTO, Canada and CONCORD, Massachusetts Celestica Inc. (NYSE, TSX: CLS), a world leader in electronics manufacturing services (EMS), and Manufacturers' Services Limited (MSL) (NYSE: MSV), a full-service global electronics manufacturing services and supply chain services company, announced today that the share exchange ratio for Celestica's previously announced acquisition of MSL has been confirmed, pursuant to the terms of the merger agreement, at 0.375 of a subordinate voting share for each share of MSL common stock. At the effective time of the merger:

- each outstanding share of MSL common stock will be converted into the right to receive 0.375 of a subordinate voting share of Celestica; and

- each outstanding share of MSL Series A and Series B preferred stock will be converted into the right to receive US$52.50 per share plus accrued dividends of US$0.525 per Series A share or US$0.45 per Series B share in cash or, at the stockholder's election, 2.914 Celestica subordinate voting shares per share of MSL Series A preferred stock and 3.178 Celestica subordinate voting shares plus a "make whole" payment of US$2.25 per share of MSL Series B preferred stock.

Celestica and MSL also announced that the "make-whole" payment will be paid in cash to all holders of Series B preferred stock who have validly elected to receive subordinate voting shares as merger consideration.

The transaction is expected to close immediately after MSL's special meeting of stockholders to be held on Friday, March 12, 2004.

**About Celestica**

Celestica is a world leader in the delivery of innovative electronics manufacturing services (EMS). Celestica operates a highly sophisticated global manufacturing network with operations in Asia, Europe and the Americas, providing a broad range of integrated services and solutions to leading OEMs (original equipment manufacturers). A recognized leader in quality, technology and supply chain management, Celestica provides competitive advantage to its customers by improving time-to-market, scalability and manufacturing efficiency.

For further information on Celestica, visit its website at www.celestica.com.

The company's security filings can also be accessed at www.sedar.com and www.sec.gov.

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**About MSL**

MSL is a multi-national company that manufactures electronic hardware for companies that sell branded electronic equipment or utilize electronic components in their products. The company builds a variety of products, including medical devices, avionics, individual controls and communications equipment. MSL also manages the worldwide acquisition of components and supplies for the products it manufactures and provides complementary design, logistics and repair service.

***Celestica Safe Harbour and Fair Disclosure Statement***

*This news release contains forward-looking statements, within the meaning of The Private Securities Litigation Reform Act of 1995, related to our future growth, trends in our industry and our financial and operational results and performance that are based on current expectations, forecasts and assumptions involving risks and uncertainties that could cause actual outcomes and results to differ materially. These risks and uncertainties include, but are not limited to: the ability to complete the proposed merger and to achieve the anticipated benefits of the merger; the challenges of effectively managing our operations during uncertain economic conditions; the challenge of responding to lower-than-expected customer demand; the effects of price competition and other business and competitive factors generally affecting the EMS industry; our dependence on the information technology and communications industries; our dependence on a limited number of customers and on industries affected by rapid technological change; component constraints; variability of operating results among periods; and the ability to manage our restructuring and the shift of production to lower cost geographies. These and other risks and uncertainties and factors are discussed in the Company's various public filings at www.sedar.com and http://www.sec.gov, including our Annual Report on Form 20-F and subsequent reports on Form 6-K filed with the Securities and Exchange Commission. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

***MSL Safe Harbour and Fair Disclosure Statement***

*Any statements in this press release about future expectations, plans and prospects for the Company, including the Company's expectations for third quarter operating results and any statements containing the words "believes," "anticipates," "plans," "estimates," "expects," "will," and similar expressions, constitute forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those indicated by such forward-looking statements as a result of various important factors, including: our dependence upon a relatively small number of customers; risks associated with our acquisitions of other companies or businesses; the incurrence of indebtedness and associated interest expense to fund our business strategy; the availability of critical components, particularly those from sole-source suppliers; the impact of competition within our industry; cancellations of or delays in customer orders; general economic conditions within our industry; the impact of foreign currency fluctuations and other factors specifically affecting our international operations. The Company anticipates that subsequent events and developments will cause the Company's estimates to change. However, while the Company may elect to update these forward-looking statements at some point in the future, the Company specifically disclaims any obligation to do so.*

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**ADDITIONAL INFORMATION ABOUT THE ACQUISITION AND WHERE TO FIND IT**

Celestica filed a registration statement with the SEC containing a proxy statement/prospectus regarding its acquisition of MSL. MSL stockholders are urged to read the proxy statement/prospectus filed with the SEC on February 9, 2004 and any other relevant materials filed by Celestica or MSL with the SEC because they contain, or will contain, important information about Celestica, MSL and this acquisition. The proxy statement/prospectus and other relevant materials (when they become available), and any other documents filed by Celestica or MSL with the SEC, may be obtained free of charge at the SEC's Web site at www.sec.gov. In addition, you may obtain free copies of the documents filed with the SEC by Celestica by contacting Celestica Inc., 1150 Eglinton Avenue East, Toronto, Ontario M3C 1H7, Canada, Attention: Investor Relations, (416) 448-2211. You may obtain free copies of the documents filed with the SEC by MSL by contacting Manufacturers' Services Limited, 300 Baker Avenue, Suite 106, Concord, Massachusetts 01742, Attention: Investor Relations, (978) 371-5495.

QuickLinks

CELESTICA AND MSL ANNOUNCE SHARE EXCHANGE RATIO IN MSL ACQUISITION

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$ 62,737

$ 73,225

On December 20, 2002, the Company entered into a $110,000 credit facility (the "Loan and Security Agreement") to refinance the existing credit facility (the "1998 Credit Agreement"). The Loan and Security Agreement provides a Senior Revolving Facility (the "2002 Senior Revolver"), with the total amount available to borrow determined by a defined, asset-based formula with certain specified reductions, including the amounts outstanding under letters of credit. On December 20, 2002, $80,660 was drawn on the 2002 Senior Revolver to extinguish all balances outstanding under the 1998 Credit Agreement, including the Senior Revolving Facility, the Senior Term Facility and the Swingline Facility.

The Loan and Security Agreement is secured by a first priority security interest in substantially all the personal and real property of the Company. The Loan and Security Agreement matures on December 20, 2006, and the 2002 Senior Revolver has no scheduled paydown provisions prior to maturity. The Company pays 3/8 of 1% per annum on any unused portion ("Excess Availability") of the 2002 Senior Revolver. At February 1, 2003, the total amount available to borrow was $87,064, borrowings totaled $62,737, resulting in Excess Availability of $24,327.

The Loan and Security Agreement provides for the drawings on the 2002 Senior Revolver to bear interest based on either the Prime rate or LIBOR, at the discretion of the Company. Under the terms of the Loan and Security Agreement, the interest rates available to the Company through May 31, 2003 are either LIBOR plus 3.00% or Prime plus .50%. Thereafter, the interest will be adjusted at the beginning of each fiscal quarter. The adjustment is based on the average Excess Availability during the previous fiscal quarter. From December 20, 2002 through February 1, 2003, the 2002 Senior Revolver bore interest at LIBOR plus 3.00%. Interest is typically payable monthly in arrears.

The Loan and Security Agreement restricts the payment of cash dividends. Cash dividends are primarily restricted to the repurchase of PHC Retail common stock from retiring management shareholders, and those cash dividends are limited to $2,000 in any fiscal year. In addition, after January 1, 2004 and subject to certain Excess Availability restrictions, cash dividends may be paid to PHC Retail to facilitate a cash dividend to shareholders.

The Company deferred $2,130 in financing fees to facilitate the Loan and Security Agreement. Those deferred financing fees are being amortized as interest expense over a four-year period ending December 20, 2006. Prior to entering into the Loan and Security Agreement, the 1998 Credit Agreement provided a Senior Term Facility, Senior Revolving Facility and a Swingline Facility. The Senior Term Facility included two notes, Senior Term Note A and Senior Term Note B. Senior Term Note A was retired October 31, 2002, and Senior Term Note B was scheduled to mature April 30, 2004. Senior Term Note A and Senior Term Note B bore interest at LIBOR plus 2.00% and LIBOR plus 2.50%, respectively. The Senior Revolving Facility was scheduled to mature April 30, 2003, bore interest at LIBOR plus 2.00%, and the Company paid a fee of 1/2 of 1% per annum on any unused portion of the Revolver. Loans under the Swingline Facility were drawn and repaid daily, based on the operating activity of the Company, and aggregate amounts outstanding could not exceed $5 million. The Swingline Facility bore interest at prime plus .75%.

The 1998 Credit Agreement required 75% of annual excess cash flow, as defined, be used to reduce borrowings under the Senior Term Facility as an excess cash flow ("ECF") prepayment amount. The ECF prepayments were funded through the Revolver and reduced Senior Term Note A and Senior Term Note B ratably. The 2001 ECF prepayment was $7,694 and was paid in May 2002.

In November 2001, the Company entered into two interest rate swap agreements (together, the "Swap Agreements") with notional amounts of $10,000 and $40,000, respectively, and expiration dates of November 20, 2002 and 2003, respectively. The Swap Agreements meet the definition of a cash flow hedge under the provisions of SFAS No. 133. In 2002 and 2001, interest expense was increased by $832 and $148, respectively, representing the difference between the Swap Agreements fixed rates and the floating rate, the 30-day LIBOR rate. At February 1, 2003 and February 2, 2002, The Company had current liabilities of $758 and $336, respectively, related to the Swap Agreements and a net unrealized loss of $470 and $209, respectively, included in OCI.

The Company had commitments under letters of credit of $2,300 and $1,850 at February 1, 2003 and February 2, 2002, respectively. The letters of credit, issued by a bank, are primarily to secure international shipments of merchandise.

The restrictive debt covenants of the 1998 Credit Agreement limited the payment of cash dividends to repurchase PHC Retail common stock from retiring management stockholders and could not exceed $750 in any fiscal year. In 2002 and 2001, $146 and $696 of PHC Retail common stock was repurchased, respectively, from retiring management shareholders.

The Company made cash interest payments of $4,090 and $6,653 for 2002 and 2001, respectively. Aggregate scheduled principal payments on the long-term debt are as follows: $62,737 in 2006.

NOTE E-LEASES

The Company leases substantially all of its store locations under capital and operating leases with initial terms ranging from 1 to 25 years and renewal options of 1 to 10 years expiring at various dates through 2052. Total rental expense under operating leases was as follows:

| | 2002 | 2001 |
|---|---|---|

| | | |
|---|---|---|
| Minimum | $ 16,282 | $ 15,580 |
| Contingent | 175 | 243 |
| | $ 16,457 | $ 15,823 |

Contingent rentals are based upon a percentage of annual sales in excess of specified amounts.

Future minimum lease payments under capital leases and non-cancellable operating leases at February 1, 2003 were as follows:

| Fiscal Year | Capital Leases | Operating Leases |
|---|---|---|
| 2003 | $ 180 | $ 13,585 |
| 2004 | 181 | 12,111 |
| 2005 | 60 | 10,881 |
| 2006 | - | 9,335 |
| 2007 | - | 8,288 |
| Thereafter | - | 41,100 |
| Total minimum lease payments | 421 | 95,300 |
| Less: amounts representing interest | (51) | - |
| Present value of net minimum lease payments, including current maturities of $146, with an interest rate of 12.0% | $ 370 | $ 95,300 |

NOTE F-EMPLOYEE BENEFIT PLANS

The Company sponsors one defined benefit pension plan, The Employees Retirement Plan of Peebles Inc. (the "Plan"), and several Supplemental Benefits Programs. The Plan covers certain participants who, in 1997, had reached certain age and years of service requirements. The Plan was closed to new participants at February 1, 1998. The Supplemental Benefits Programs provide certain key executives supplemental retirement income equal to 60% of final average compensation. The Company's funding policy for all plans is to make minimum annual contributions required by applicable regulations.

The following information relative to the above plans is disclosed in accordance with the requirements of SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits".

| | **2002** | **2001** |
|---|---|---|
| **Change in Benefit Obligation:** | | |
| Benefit obligation at beginning of year | $ 6,651 | $ 7,568 |
| Service cost | 204 | 226 |
| Interest cost | 446 | 534 |
| Actuarial loss (gain) | 876 | (403) |
| Benefit payments | (582) | (1,274) |
| Benefit obligation at end of year | $ 7,595 | $ 6,651 |
| **Change in Plan Assets:** | | |
| Fair value of plan assets at beginning of year | $ 3,067 | $ 4,707 |
| Actual return on plan assets | (291) | (366) |
| Employer contribution | - | - |
| Benefit payments | (582) | (1,274) |
| Fair value of plan assets at end of year | $ 2,194 | $ 3,067 |
| **Funded Status:** | | |

| | | |
|---|---|---|
| Funded status | $ (5,401) | $ (3,584) |
| Unrecognized actuarial loss | 2,954 | 1,816 |
| Unrecognized prior service cost | 351 | 421 |
| Accrued pension liability | $ (2,096) | $ (1,347) |
| | | |
| **Components of Net Periodic Pension Cost:** | | |
| Service cost | $ 204 | $ 226 |
| Interest cost | 446 | 534 |
| Expected return on plan assets | (251) | (384) |
| Prior service cost recognized | 70 | 70 |
| Recognized losses | 281 | 322 |
| Net periodic pension cost | $ 750 | $ 768 |
| | | |
| Weighted Average Assumptions as of Measurement Date: | | |
| Discount rate | 6.50% | 7.00% |
| Expected return on plan assets | 8.50% | 9.00% |
| Rate of compensation increase | 5.00% | 5.00% |

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for the Supplemental Benefits Program with accumulated benefit obligations in excess of plan assets were $4,451, $2,968 and $0, respectively, as of February 1, 2003 and $3,299, $2,144 and $0, respectively, as of February 2, 2002.

The Company also maintains a qualified profit sharing and retirement savings plan, The Peebles Inc. 401 (k) Profit Sharing Plan, which under Section 401 (k) of the Internal Revenue Code, allows tax deferred contributions from eligible employees of up to 12% of their annual compensation. The Company matches employee contributions up to 50% of an employee's first 6% of eligible compensation. The Company's matching contributions, included in selling, general and administrative expenses, totaled $343 and $346 in 2002 and 2001, respectively.

NOTE G - INCOME TAXES

The provisions for income taxes consisted of the following:

| | | 2002 | 2001 |
|---|---|---|---|
| Current: | Federal | $ 8,157 | $ 8,593 |
| | State | 1,449 | 1,766 |
| Deferred: | Federal | 301 | (233) |
| | State | 68 | (48) |
| | | $ 9,975 | $ 10,078 |

Income taxes differ from the amounts computed by applying the applicable federal statutory rates due to the following:

| | 2002 | 2001 |
|---|---|---|
| Taxes at the federal statutory rate | $ 9,835 | $ 8,603 |
| Increases (decreases): | | |
| State income taxes, net of federal tax | 772 | 1,086 |
| Amortization of goodwill | - | 531 |
| Other | (632) | (142) |

| | | |
|---|---|---|
| | $ 9,975 | $ 10,078 |

The Company received approximately $400 of state tax refunds in fiscal 2002 resulting in a decrease in the Company's effective state income tax rate. At February 1, 2003, the Company has net operating loss carryforwards of approximately $1,900 for income tax purposes, which expire in 2010. Due to Internal Revenue Service regulations, utilization of the net operating loss carryforwards may be limited in a particular year.

Significant components of deferred tax liabilities and assets are as follows:

| | February 1, 2003 | February 2, 2002 |
|---|---|---|
| Deferred tax liabilities: | | |
| Inventory valuation | $ 2,172 | $ 2,005 |
| Depreciation and amortization | 12,274 | 11,612 |
| Other | 678 | 474 |
| | 15,124 | 14,091 |
| Deferred tax assets: | | |
| Doubtful accounts | (1,418) | (1,103) |
| Net operating loss carryforwards | (765) | (907) |
| Other | (2,064) | (915) |
| | (4,247) | (2,925) |
| Net deferred tax liabilities | $ 10,877 | $ 11,166 |

Peebles made cash income tax payments of $10,411 and $9,336 for 2002 and 2001, respectively.

## NOTE H - VALUATION AND QUALIFYING ACCOUNTS

Activity related to valuation and qualifying accounts is as follows:

| | Allowance for Doubtful Accounts | Net LIFO/Market Reserve |
|---|---|---|
| Balance February 3, 2001 | $ 2,400 | $ 222 |
| Charges (credits) to expense | 3,568 | (222) |
| Deductions - net write-off of uncollectible accounts | (3,168) | - |
| Balance February 2, 2002 | 2,800 | - |
| Charges (credits) to expense | 5,847 | - |
| Deductions - net write-off of uncollectible accounts | (5,047) | - |
| Balance February 1, 2003 | $ 3,600 | $ - |

**Peebles Inc.**
**Unaudited Consolidated Condensed Balance Sheets**
*(in thousands, except shares and per share amounts)*

| | **November 1, 2003** | **February 1, 2003** |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash | $ 303 | $ 739 |
| Accounts receivable, net of allowance for doubtful accounts of $3,200 and $3,600 | 31,880 | 39,431 |
| Merchandise inventories | 99,796 | 82,355 |

| | | |
|---|---|---|
| Prepaid expenses | 2,891 | 1,809 |
| Other | 272 | 83 |
| Total current assets | 135,142 | 124,417 |
| | | |
| Property and equipment, net | 44,993 | 47,255 |
| Other assets | | |
| Excess of cost over net assets acquired, net | 35,223 | 35,223 |
| Deferred financing costs, net | 1,709 | 2,079 |
| Beneficial leaseholds, net | 1,939 | 2,189 |
| Other | 4,240 | 3,575 |
| | 43,111 | 43,066 |
| | $ 223,246 | $ 214,738 |
| | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities | | |
| Account payable | $ 28,837 | $ 16,531 |
| Deferred income taxes | 1,480 | 1,192 |
| Accrue compensation and other expenses | 8,966 | 11,368 |
| Total current liabilities | 39,283 | 29,091 |
| | | |
| Long-term debt | 53,736 | 62,737 |
| Other long-term liabilities | 3,979 | 3,871 |
| Deferred income taxes | 9,685 | 9,685 |
| Total liabilities | 106,683 | 105,384 |
| | | |
| Stockholders' equity | | |
| Preferred stock - no par value, authorized 1,000,000 shares, none issued or outstanding | - | - |
| Common stock - par value $.10 per share, authorized 5,000,000 shares, 1,000 issued and outstanding | 1 | 1 |
| Additional capital | 59,490 | 59,490 |
| Accumulated other comprehensive loss | (813) | (1,283) |
| Retained earnings | 57,885 | 51,146 |
| Stockholders' equity | 116,563 | 109,354 |
| Total liabilities and stockholders' equity | $ 223,246 | $ 214,738 |

*See notes to unaudited consolidated condensed financial statements*

**Peebles Inc.**

**Unaudited Consolidated Condensed Statements of Income**

*(in thousands)*

| | Thirty-Nine Weeks Ended | |
|---|---|---|
| | **November 1, 2003** | **November 2, 2002** |
| Net sales | $ 211,488 | $ 216,678 |

| | | |
|---|---|---|
| Costs and expenses | | |
| Cost of sales | 126,376 | 126,231 |
| Selling, general and administrative expenses | 64,248 | 64,647 |
| Depreciation and amortization | 7,038 | 7,372 |
| | 197,662 | 198,250 |
| Operating income | 13,826 | 18,428 |
| Interest expense | 3,112 | 3,615 |
| Income before income taxes | 10,714 | 14,813 |
| Income taxes | 3,911 | 5,777 |
| **Net income** | **$ 6,803** | **$ 9,036** |

*See notes to unaudited consolidated condensed financial statements*

**Peebles Inc.**
**Unaudited Consolidated Condensed Statements of Cash Flows**
*(in thousands)*

| | Thirty-Nine Weeks Ended | |
|---|---|---|
| | **November 1, 2003** | **November 2, 2002** |
| *Cash flows from operating activities:* | | |
| Net income | $ 6,803 | $ 9,036 |
| Adjustment to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 6,525 | 6,907 |
| Amortization | 912 | 752 |
| Provision for doubtful accounts | 3,108 | 4,518 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 4,443 | 2,503 |
| Merchandise inventories | (17,441) | (25,256) |
| Account payable | 12,306 | 3,499 |
| Other assets and liabilities | (3,610) | (3,579) |
| Net cash provided by operating activities | 13,046 | (1,620) |
| *Cash flows from investing activities:* | | |
| Purchase of property and equipment | (8,621) | (4,306) |
| Proceeds from sale of distribution center | 4,204 | - |
| Other | - | 197 |
| Net cash used in investing activities | (4,417) | (4,109) |
| *Cash flows from financing activities:* | | |
| Proceeds from revolving line of credit | 288,493 | 317,984 |
| Reduction in revolving line of credit and long-term debt | (297,494) | (313,670) |
| Dividend to PHC Retail | (64) | (54) |

| | | |
|---|---|---|
| Net cash (used in) provided by financing activities | (9,065) | 4,260 |
| Decrease in cash and cash equivalents | (436) | (1,469) |
| Cash and cash equivalents beginning of period | 739 | 1,773 |
| Cash and cash equivalents end of period | $ 303 | $ 304 |

*See notes to unaudited consolidated condensed financial statements*

Peebles Inc.

Notes to Unaudited Consolidated Condensed Financial Statements

(unaudited)

The accompanying Unaudited Consolidated Condensed Financial Statements of Peebles Inc. ("Peebles" or the "Company") do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Those adjustments that are, in the opinion of management, necessary for a fair presentation of the results of the interim periods, have been made. The results of operations for such interim periods are not necessarily indicative of the results of operations for a full year. The Unaudited Consolidated Condensed Financial Statements should be read in conjunction with the Audited Consolidated Financial Statements and notes thereto filed with this Form 8-K/A.

NOTE A-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Organization and Nature of Operations*: Peebles Inc. ("Peebles" or the "Company") is a wholly owned subsidiary of PHC Retail Holding Company ("PHC Retail"). PHC Retail, a closely held company, has no significant assets other than the entire equity interest of Peebles Inc. common stock, $.10 par value (the "Common Stock"). Peebles operates retail department stores offering predominately fashion merchandise for the entire family and selected home accessories. At November 1, 2003, the Company was operating 136 stores located primarily in small and medium sized communities, which typically do not have a mall-based department store. The stores serve communities in 17 states, located primarily in the Southeast and Mid-Atlantic.

Principles of Consolidation:

The consolidated financial statements include the accounts of Peebles Inc. and its wholly owned subsidiary. All intercompany balances and transactions have been eliminated.

**NOTE B- SUBSEQUENT EVENT**

On November 4, 2003, Stage Stores, Inc. acquired Peebles. The acquisition was made pursuant to an Agreement and Plan of Merger, dated as of October 7, 2003, and a First Amendment to Agreement and Plan of Merger, dated November 3, 2003, with PHC Retail Holding Company, the parent of Peebles. The purchase price for Peebles was approximately $174.9 million, including acquisition costs and net of cash acquired and debt assumed.

PRO FORMA FINANCIAL STATEMENTS

The following unaudited pro forma combined condensed financial statements give effect to the acquisition of Peebles Inc. ("Peebles") by Stage Stores, Inc. ("Stage Stores" or the "Company") (the "Acquisition"). The Acquisition, which was effective November 4, 2003 (the "Closing Date"), was made pursuant to an Agreement and Plan of Merger, dated as of October 7, 2003, and a First Amendment to Agreement and Plan of Merger, dated as of November 3, 2003, by and among the Company, Specialty Retailers (TX) LP, a wholly owned subsidiary of the Company, Stage Acquisition Corporation, a wholly owned subsidiary of the Company, and PHC Retail Holding Company ("PHC Retail"), the parent of Peebles. PHC Retail, a closely held company, had no significant assets or operations other than the entire equity interest of Peebles.

This Acquisition is being accounted for using the purchase method of accounting with an effective date for accounting purposes of November 1, 2003, the end of the Company's third fiscal quarter. The estimates of the fair value of the acquired assets and liabilities, and related estimated useful lives are based on valuations that are preliminary. These valuations may be updated with respect to deferred taxes, fixed assets, intangible assets and certain assumed liabilities, and may change from the amounts shown. The unaudited pro forma combined condensed financial statements are based on assumptions that the Company believes are reasonable under the circumstances and are presented for illustrative purposes only. They are not necessarily indicative of the operating results and financial position that might have been achieved had the transaction occurred as of an earlier or later date, nor are they necessarily indicative of operating results and financial position that may occur in the future.

The unaudited pro forma combined condensed financial statements have been prepared from, and should be read in conjunction with, the historical consolidated financial statements and notes thereto in (1) Stage Stores Annual Report on Form 10-K for the year ended February 1, 2003, (2) Stage Stores Quarterly Report on Form 10-Q for the thirty-nine weeks ended November 1, 2003, and (3) Peebles consolidated financial statements included in Appendices A and B to this Form 8-K/A.

The Acquisition was funded principally with proceeds from the sale of the Company's private label credit card portfolio on September 12, 2003 (the "Credit Card Portfolio Sale"). Accordingly, pro forma adjustments are being reflected to remove the historical operating results associated with the Company's private label credit card program as previously disclosed in the Form 8-K filed on September 22, 2003.

The unaudited pro forma combined condensed balance sheet as of November 1, 2003 gives effect to the Acquisition as of November 1, 2003. The unaudited pro forma combined condensed balance sheet as of November 1, 2003 has been derived from the unaudited historical consolidated balance sheets of Stage Stores and Peebles as of November 1, 2003.

As required by the rules of the Securities and Exchange Commission, the unaudited pro forma combined condensed statements of income for the thirty-nine weeks ended November 1, 2003 and the year ended February 1, 2003 give effect to the Acquisition as if it had occurred on the first day of the Company's 2002 fiscal year, with the exception that the purchase accounting adjustments were estimated based on the Closing Date.

The unaudited pro forma combined condensed statements of income for the year ended February 1, 2003 and for the thirty-nine weeks ended November 1, 2003 give effect to the Acquisition and the Credit Card Portfolio Sale, and have been derived from the audited historical consolidated statements of income of Stage Stores and Peebles for the year ended February 1, 2003 and the unaudited historical consolidated statements of income of Stage Stores and Peebles for the thirty-nine weeks ended November 1, 2003.

**Unaudited Pro Forma Combined Condensed Balance Sheet**
**As of November 1, 2003**
(in thousands, except par values)

| | Historical Stage Stores, Inc. | Historical Peebles Inc. | Pro Forma Adjustments | | Pro Forma Combined |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | $ 170,990 | $ 303 | $ (157,004) | **1, 3(a)** | $ 14,289 |
| Accounts receivable, net | - | 31,880 | (307) | **2(a)** | 31,573 |
| Merchandise inventories, net | 248,485 | 99,796 | (7,596) | **2(b)** | 340,685 |
| Deferred income taxes | 14,315 | - | 8,797 | **3(c), 3(d)** | 23,112 |
| Prepaid expenses and other current assets | 18,719 | 3,163 | (396) | **2(c)** | 21,486 |
| Total current assets | 452,509 | 135,142 | (156,506) | | 431,145 |
| Property, equipment and leasehold improvements, net | 139,690 | 44,993 | 416 | **2(d)** | 185,099 |
| Deferred income taxes | 12,493 | - | (12,493) | **3(d)** | - |
| Goodwill | - | 35,223 | 47,326 | **2(e)** | 82,549 |
| Intangible - trademark | - | - | 14,910 | **2(f)** | 14,910 |
| Other non-current assets, net | 9,045 | 7,888 | (4,273) | **2(g), 2(h)** | 12,660 |
| **Total assets** | **$ 613,737** | **$ 223,246** | **$ (110,620)** | | **$ 726,363** |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | | | |
| Accounts payable | $ 81,130 | $ 28,837 | $ - | | $ 109,967 |
| Deferred income taxes | - | 1,480 | (1,480) | **3(d)** | - |
| Current portion of long-term debt | 200 | - | - | | 200 |
| Accrued expenses and other current liabilities | 50,933 | 8,966 | 1,367 | **1, 2(h)** | 61,266 |
| Total current liabilities | 132,263 | 39,283 | (113) | | 171,433 |
| Long-term debt | 482 | 53,736 | 16,234 | **3(a)** | 70,452 |
| Deferred income taxes | - | 9,685 | (7,224) | **3(c), 3(d)** | 2,461 |
| Other long-term liabilities | 29,962 | 3,979 | (2,954) | **2(h)** | 30,987 |
| Total liabilities | 162,707 | 106,683 | 5,943 | | 275,333 |
| Commitments and contingencies | | | | | |
| Common stock, par value $0.01, 20,278 shares issued and outstanding | 203 | 1 | (1) | **3(b)** | 203 |
| Additional paid-in capital | 366,564 | 59,490 | (59,490) | **3(b)** | 366,564 |
| Treasury stock - at cost (1,169 shares) | (25,461) | - | - | | (25,461) |
| Retained earnings | 111,744 | 57,885 | (57,885) | **3(b)** | 111,744 |
| Accumulated other comprehensive loss | (2,020) | (813) | 813 | **3(b)** | (2,020) |
| Stockholders' equity | 451,030 | 116,563 | (116,563) | | 451,030 |
| **Total liabilities and stockholders' equity** | **$ 613,737** | **$ 223,246** | **$ (110,620)** | | **$ 726,363** |

**Unaudited Pro Forma Combined Condensed Statement of Income**
**For the Year Ended February 1, 2003**
(in thousands, except earnings per share)

| | Historical Stage Stores, Inc. | Historical Peebles Inc. | Pro Forma Adjustments - Peebles Acquisition | | Pro Forma Adjustments - Sale of Stage Credit Card Portfolio | | Pro Forma Combined |
|---|---|---|---|---|---|---|---|
| Net sales | $ 875,557 | $ 314,067 | $ - | | $ - | | $ 1,189,624 |
| Cost of sales and related buying, occupancy and distribution expenses | 610,365 | 183,783 | 32,978 | **4** | - | | 827,126 |
| Gross profit | 265,192 | 130,284 | (32,978) | | - | | 362,498 |
| Selling, general and administrative expenses | 176,202 | 97,262 | (33,541) | **4, 5, 6** | 15,051 | **9, 10** | 254,974 |
| Store opening costs | 869 | - | - | | - | | 869 |
| Interest expense, net | 1,777 | 4,923 | 413 | **7** | - | | 7,113 |
| Income before income tax | 86,344 | 28,099 | 150 | | (15,051) | | 99,542 |
| Income tax expense | 31,947 | 9,975 | 478 | **8** | (5,569) | **8** | 36,831 |
| **Net income** | **$ 54,397** | **$ 18,124** | **$ (328)** | | **$ (9,482)** | | **$ 62,711** |
| Net income per common share-basic | $ 2.78 | | | | | | $ 3.21 |
| Net income per common share-diluted | $ 2.60 | | | | | | $ 2.99 |
| Weighted average common shares outstanding - basic | 19,550 | | | | | | 19,550 |
| Weighted average common shares outstanding - diluted | 20,959 | | | | | | 20,959 |

**Unaudited Pro Forma Combined Condensed Statement of Income**
**For Thirty-Nine Weeks Ended November 1, 2003**
(in thousands, except earnings per share)

| | Historical Stage Stores, Inc. | Historical Peebles Inc. | Pro Forma Adjustments - Peebles Acquisition | | Pro Forma Adjustments - Sale of Stage Credit Card Portfolio | | Pro Forma Combined |
|---|---|---|---|---|---|---|---|
| Net sales | $ 603,657 | $ 211,488 | $ - | | $ - | | $ 815,145 |
| Cost of sales and related buying, occupancy and distribution expenses | 427,602 | 126,376 | 25,108 | **11** | - | | 579,086 |
| Gross profit | 176,055 | 85,112 | (25,108) | | - | | 236,059 |
| Selling, general and administrative expenses | 129,194 | 71,286 | (25,531) | **11, 12,13** | 10,871 | **16, 17** | 185,820 |
| Store opening costs | 1,574 | - | - | | - | | 1,574 |
| Interest expense, net | 1,736 | 3,112 | 309 | **14** | - | | 5,157 |
| Gain on sale on proprietary credit card portfolio, net | (12,218) | - | - | | 12,218 | **18** | - |
| Income before income tax | 55,769 | 10,714 | 114 | | (23,089) | | 43,508 |
| Income tax expense | 20,356 | 3,911 | 40 | **15** | (8,427) | **15** | 15,880 |
| **Net income** | **$ 35,413** | **$ 6,803** | **$ 74** | | **$ (14,662)** | | **$ 27,628** |
| Net income per common share-basic | $ 1.87 | | | | | | $ 1.46 |
| Net income per common share-diluted | $ 1.77 | | | | | | $ 1.38 |
| Weighted average common shares outstanding - basic | 18,930 | | | | | | 18,930 |
| Weighted average common shares outstanding - diluted | 20,036 | | | | | | 20,036 |

Stage Stores, Inc.

Notes to Unaudited Pro Forma Combined Condensed Financial Statements

(in thousands)

Basis of Presentation

On November 4, 2003, the Company completed the acquisition of Peebles. The Acquisition is accounted for using the purchase method of accounting. Under the purchase method of accounting, the purchase price is allocated to assets acquired, including identifiable intangible assets, and liabilities assumed based on their respective fair values on the Closing Date. Purchase price in excess of net tangible, and identifiable intangible, assets and liabilities assumed has been recorded as goodwill.

Purchase Price Allocation

The following table sets forth the components of the purchase price:

| | |
|---|---|
| Cash consideration paid at closing | $ 173,238 |
| Estimated accrued acquisition costs | 1,651 |
| Total purchase consideration | 174,889 |
| Less: Historical net book value of net assets acquired | (116,563) |
| Purchase price in excess of historical net book value | 58,326 |
| Add: Adjustments to fair value of acquired net assets | 24,223 |
| **Estimated goodwill** | **$ 82,549** |

In accordance with the provisions of Statement of Financial Accounting Standard No.142, *Goodwill and Other Intangible Assets*, the Company will not amortize goodwill and the trademark asset recorded in connection with the acquisition of Peebles. The Company will perform an annual impairment test of the goodwill and the trademark asset but has not yet determined what effect these tests will have on the results of operations or the financial position of the Company in future periods.

Pro Forma Adjustments

Balance Sheet Adjustments:

1. Record payment of $173,238 in cash to Peebles shareholders and for related acquisition costs, and the accrual of unpaid acquisition costs of $1,651.

2. Record allocation of purchase price to Peebles' assets and liabilities, which includes:

(a) On January 9, 2004, the Company entered into a definitive purchase and sale agreement with a subsidiary of Alliance Data System Corporation ("ADS") to sell Peebles' private label credit card portfolio. Closing is expected to occur during the first quarter of the 2004 fiscal year. The purchase and sale agreement provides for the Company to receive at closing an amount which approximates the amount of account balances outstanding at the time of closing. The Company will be obligated to reimburse ADS up to a total of $3.5 million during the first three years after the sale based on the non-attainment of a defined net portfolio yield performance. The adjustment to accounts receivable primarily reflects the Company's $3.5 million obligation related to the proposed sale of the private label credit card portfolio.

(b) Adjust inventory to eliminate the cost basis difference between LIFO and cost inventory using the retail method which reflects estimated net realizable value, less allowance for normal selling margin.

(c) Adjust supply inventory to conform to the Company's policy of expensing consumable store supplies when received.

(d) Write-up to fixed assets for fair value adjustment based on appraisals and estimated depreciated replacement cost. See pro forma adjustments 5 and 12 for increase in depreciation related to increase in fair value. Amount is net of write-off of historical purchase accounting adjustments by Peebles related to prior acquisitions.

(e) Write-off historical goodwill and record estimated goodwill resulting from the purchase price paid in excess of fair value of net tangible and identifiable intangibles assets and liabilities assumed.

(f) Record trademark asset of $14,910.

(g) Write-off of historical deferred financing costs and certain other intangible assets.

(h) Adjust the obligation related to the defined benefit pension plan to an amount equal to the excess of the projected benefit obligation over the fair value of plan assets at November 1, 2003 and to write-off assets and liabilities associated with certain other supplemental benefit plans which were paid and terminated at closing of acquisition.

3. Other adjustments:

(a) Borrowings of $69,970 made under the Company's credit facility to pay consideration for the transaction and repay debt assumed of $53,736.

(b) Elimination of Peebles' equity balances as of November 1, 2003.

(c) Recognition of deferred taxes on adjustments to fair value of acquired net assets and acquisition costs.

(d) Reclassification of deferred tax liabilities for the financial statements presentation.

_Statement of Income Adjustments for the fiscal year ended February 1, 2003:_

4. Reclassify buying, occupancy and distribution expenses of $32,978 to cost of sales to conform historical Peebles' presentation to that of Stage Stores.

5. Record additional depreciation of $92 related to adjustment to fair value of fixed assets.

6. Reduce pension costs by $655 related to supplemental employee retirement plan and benefit restoration plan which were terminated at closing of the acquisition.

7. Record interest expense of $413 on incremental borrowings had the transaction occurred on February 2, 2002.

8. Adjust income tax provision to reflect the Company's statutory tax rate at 37%.

9. Reflect the removal of the historical income contribution related to the Credit Card Portfolio Sale:

| | **Year Ended February 1, 2003** |
|---|---|
| Service charge and late fee income, net of charge-offs of $11,503 | $ 71,081 |
| Other revenues | 670 |
| Provision for bad debts | (33,693) |
| General and administrative costs | (14,734) |
| Subtotal before interest expense and other adjustments | 23,324 |
| Interest expense on securitization facility borrowings | (4,924) |
| Difference due to securitization accounting | 493 |
| Net credit income | $ 18,893 |

On January 9, 2004 the Company entered into a definitive purchase and sale agreement with a subsidiary of ADS to sell Peebles' private label credit card portfolio. Closing of the transaction is expected to occur during the first quarter of the 2004 fiscal year. The table below reflects the historical income contribution of the credit operations of Peebles for the year ended February 1, 2003 which is reflected as a reduction to selling, general and administrative expenses of Peebles. However, these amounts are not reflected as pro forma adjustments to the pro forma financial statements as the sale has not yet been consummated:

| | **Year Ended February 1, 2003** |
|---|---|
| Service charge and late fee income | $ 7,920 |
| Provision for bad debts | (5,847) |
| General and administrative costs | (2,060) |
| Credit contribution before cost of funds | $ 13 |

10. The Company received prepaid marketing funds of $13.4 million at closing of the Credit Card Portfolio Sale, which will be recognized as an offset to marketing expenses pro-rata over the ten year term of a Private Label Credit Card Program Agreement between the Company and a subsidiary of ADS (the "Program Agreement"). In the event of certain early termination events, the Company would be required to repay a pro-rata portion of the prepaid marketing funds. The Program Agreement additionally provides for reimbursement to the Company of defined eligible marketing expenses up to $2.5 million in the initial year of the Program Agreement and up to 0.6% of the prior year's credit sales annually thereafter. Under the terms of the Program Agreement, the Company is obligated to continue to promote use of the private label credit card and expects to incur marketing costs in excess of the amounts underwritten. Such credit card marketing costs are included in advertising expense. The pro forma results for Stage Stores reflect recognition of $3.8 million in marketing expenses reimbursements calculated as one-tenth of the prepaid marketing funds ($1.3 million) plus an additional reimbursement of $2.5 million for defined marketing expenses in the first year of the Program Agreement.

Among other provisions in the Program Agreement related to the Credit Card Portfolio Sale, during the initial year, credit sales will be processed at no charge (i.e. discount) to the Company. In future years, so long as the defined net yield of the portfolio remains within a specified range, credit sales will continue to be processed at no charge to the Company. Beginning October 1, 2004, and adjusted quarterly thereafter based on the then trailing twelve month portfolio performance, if the defined net yield is above or below the specified range, the Company will receive a premium or pay a discount equal to 50% of the excess or shortfall of the specified yield range divided by the defined portfolio turn rate. No premium or discount has been included in presenting the pro forma results for Stage Stores.

Statements of Income Adjustments for the thirty-nine week period ended November 1, 2003:

11. Reclassify buying, occupancy and distribution expenses of $25,108 to cost of sales to conform historical Peebles' presentation to that of Stage Stores.

12. Record additional depreciation of $69 related to adjustment to fair value of fixed assets.

13. Reduce pension costs by $492 related to supplemental employee retirement plan and benefit restoration plan which were terminated at closing of the acquisition.

14. Record interest expense of $309 on incremental borrowings had the transaction occurred on February 2, 2002.

15. Adjust income tax provision to reflect the Company's statutory tax rate of 36.5%.

16. Reflect the removal of the historical income contribution related to the Credit Card Portfolio Sale:

| | Thirty-Nine Weeks Ended November 1, 2003 |
|---|---|
| Service charge and late fee income, net of charge-offs of $6,815 | $ 41,342 |
| Other revenues | 349 |
| Provision for bad debts | (15,939) |
| General and administrative costs | (8,718) |
| Subtotal before interest expense and other adjustments | 17,034 |
| Interest expense on securitization facility borrowings | (2,106) |
| Difference due to securitization accounting | (1,341) |
| Net credit income | $ 13,587 |

On January 9, 2004, the Company entered into a definitive purchase and sale agreement with a subsidiary of ADS to sell Peebles' private label credit card portfolio. Closing of the transaction is expected to occur during the first quarter of the 2004 fiscal year. The table below reflects the historical income contribution of the credit operations of Peebles for thirty-nine weeks ended November 1, 2003 which is reflected as a reduction to selling, general and administrative expenses of Peebles. However, these amounts are not reflected as pro forma adjustments to the pro forma financial statements as the sale has not yet been consummated:

| | Thirty-Nine Weeks Ended November 1, 2003 |
|---|---|
| Service charge and late fee income | $ 5,456 |
| Provision for bad debts | (3,108) |
| General and administrative costs | (1,516) |
| Credit contribution before cost of funds | $ 832 |

17. The Company received prepaid marketing funds of $13.4 million at closing of the Credit Card Portfolio Sale, which will be recognized as an offset to marketing expenses pro-rata over the ten year term of the Program Agreement. In the event of certain early termination events, the Company would be required to repay a pro-rata portion of the prepaid marketing funds. The Program Agreement additionally provides for reimbursement to the Company of defined eligible marketing expenses up to $2.5 million in the initial year of the Program Agreement and up to 0.6% of the prior year's credit sales annually thereafter. Under the terms of the Program Agreement, the Company is obligated to continue to promote use of the private label credit card and expects to incur marketing costs in excess of the amounts underwritten. Such credit card marketing costs are included in advertising expense. The pro forma results for Stage Stores reflect recognition of $2.7 million in marketing expenses reimbursements calculated as one-tenth of the prepaid marketing funds ($1.3 million) plus an additional reimbursement of $2.3 million (calculated as 0.6% of fiscal year 2002 private label credit card sales) multiplied by 75% for a nine-month period presentation.

Among other provisions in the Program Agreement related to the Credit Card Portfolio Sale, during the initial year, credit sales will be processed at no charge (i.e. discount) to the Company. In future years, so long as the defined net yield of the portfolio remains within a specified range, credit sales will continue to be processed at no charge to the Company. Beginning October 1, 2004, and adjusted quarterly thereafter based on the then trailing twelve month portfolio performance, if the defined net yield is above or below the specified range, the Company will receive a premium or pay a discount equal to 50% of the excess or shortfall of the specified yield range divided by the defined portfolio turn rate. No premium or discount has been included in presenting the pro forma results for Stage Stores.

18. Eliminate the gain on sale of credit card portfolio of $12,218.