

A woman with long, wavy brown hair is smiling and posing. She is wearing a black and white fashion ensemble consisting of a long-sleeved button-down shirt with a white front panel and black collar and cuffs, and a black jacket with white piping. Her hands are on her hips. The background is a bright, soft white light.

2003 Annual Report

# Dillard's

## Corporate Profile

Dillard's, Inc. ranks among the nations largest fashion apparel and home furnishings retailers with annual revenues exceeding \$7.8 billion. The Company focuses on delivering maximum value to its shoppers, with fairly priced merchandise complemented by exceptional customer service. Dillard's stores offer a broad selection of merchandise, including products sourced and marketed under Dillard's exclusive brand names. The Company comprises 328 stores, spanning 29 states, all operating with one name – Dillard's.

## Financial Highlights

(in thousands of dollars, except per share amounts)	2003	2002	2001	2000*	1999
<b>Income Statement Data:</b>					
Net sales	\$ 7,598,934	\$ 7,910,996	\$ 8,154,911	\$ 8,566,560	\$ 8,676,711
Income before cumulative effect of accounting change	9,344	131,926	71,798	124,141	163,729
Cumulative effect of accounting change, net of taxes	—	(530,331) <sup>(1)</sup>	—	(129,991) <sup>(2)</sup>	—
Net income (loss)	9,344	(398,405)	71,798	(5,850)	163,729
<b>Diluted earnings per common share:</b>					
Income before cumulative effect of accounting change	0.11	1.55	0.85	1.36	1.55
Cumulative effect of accounting change	—	(6.22)	—	(1.42)	—
Net income (loss)	0.11	(4.67)	.85	(.06)	1.55
<b>Balance Sheet Data:</b>					
Current assets	\$ 3,023,691	3,130,251	2,814,510	2,842,948	3,423,725
Current liabilities	\$ 1,336,087	886,441	928,071	876,697	810,594
Long-term debt	1,855,065	2,193,006	2,124,577	2,374,124	2,894,616
Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures	200,000	531,579	531,579	531,579	531,579
Stockholders' equity	2,237,097	2,264,196	2,668,397	2,629,820	2,832,834
<b>Operational Data:</b>					
Number of employees - average	53,598	55,208	57,257	58,796	61,824
Gross square footage (in thousands)	56,000	56,700	56,800	56,500	57,000
Number of stores	328	333	338	337	342

\*53 Weeks

(1) During fiscal 2002, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets". See Management's Discussion and Analysis of Financial Condition and Results of Operations.

(2) During fiscal 2000, the Company changed its method of accounting for inventories under the retail method. See Management's Discussion and Analysis of Financial Condition and Results of Operations.

# To Our Shareholders

We were disappointed with our results for 2003. We reduced our operating expenses by \$66 million, our depreciation and rental expense by almost \$15 million and our interest expense by \$8.7 million. However, we also experienced a 4% sales decline and a 160 basis point reduction in gross margin. This resulted in a large profit decline in 2003.

To improve our sales and margins, we have introduced several new brands that we believe will broaden Dillard's appeal to the customer seeking better and more upscale merchandise. We plan to continue the review of our merchandise offering to add other appropriate brands and to reduce or eliminate brands that are not performing with satisfactory sales and gross margins.

We remain committed to differentiating Dillard's from our competition. In 2003, we increased the storewide penetration of our exclusive brands from 18.2% of sales to 20.9%. We intend to continue to expand the exclusive brand merchandise offering where appropriate.

Furthermore, we will fine-tune our merchandise mix by store location to meet the differing needs of the local demographic in our ongoing effort to set ourselves apart as the favorite hometown store with a national appeal.

We plan to continue our review of expenses and, where possible, eliminate or reduce those that do not negatively impact our customer service. We have continued to invest in

the development of our associates to better service the customer and we believe this is another way to distinguish Dillard's from the competition.

We were pleased with the improvement in our balance sheet. We strengthened our financial position in 2003 by committing available cash resources to paying \$261 million in debt, capping a five-year debt reduction of approximately \$1.4 billion. We reinforced our liquidity by amending and extending our revolving line of credit to \$1 billion with a maturity of December 2008. We remain financially flexible and firmly committed to further strengthening our overall financial position.

During the year, we further improved our base of store locations. We entered the quad-city area of Iowa for the first time with the opening of our Davenport store in July. We opened new Dillard's stores in the established markets of Cleveland, Ohio, Richmond, Virginia (2) and Houston, Texas. In Richmond and Houston, we repositioned the Dillard's franchise by opening new locations and closing less-promising ones. During 2003, we closed nine under-performing locations in our continuing effort to prune our store base. Our store ownership percentage is 78% - one of the highest ownership percentages in our market sector.

This is an exciting time to be in fashion apparel and home retailing and we continue to position ourselves to capitalize on the needs of confident customers who are focused on fashion, service and value. We will build on the strength of the Dillard's franchise and proudly continue our 65-year legacy of distinctive merchandising and service. Our team remains committed to this plan and we thank you, our shareholders, for your continued support.



**William Dillard, II**  
Chairman of the Board and Chief  
Executive Officer

**Alex Dillard**  
President

# Exclusively Yours

When America goes shopping, brand names are one of the most important factors that affect buying preferences. And when it comes to nationally known brands, Dillard's customers are beginning to realize that Exclusively Yours really means Exclusively Ours. Dillard's shoppers across the country are, more and more, looking for the names that mean fashion, quality and superior value and associating those names with the understanding that they are available only at Dillard's. It's a benefit to our customers and ultimately, a benefit to our shareholders.



Nurture

## Footwear



Thanks to the trend in prime-time television everybody seems to be talking about shoe fashions and fashionable shoes: Continuing our commitment to the female shoe shopper, we launched our Nurture comfort line in the Fall of 2003. Dillard's customers are stepping out front with exclusive styles from Antonio Melani, Gianni Bini, Nurture and Michelle D.

## Women's Apparel & Accessories



Preston & York Handbags

Pick a category, Career Wear, Casual, Sportswear, Hosiery or Accessories, women shop at our stores because they already know what to expect. And their expectations are rising. New fashions, new styles, and a whole vocabulary of new, and exclusive, brand names have become associated with Dillard's...names such as Preston & York, Antonio Melani, Q.U.E, Westbound, Katherine Kelly, Allison Daley and Cabernet.

Antonio Melani Sportswear – Footwear – Handbags



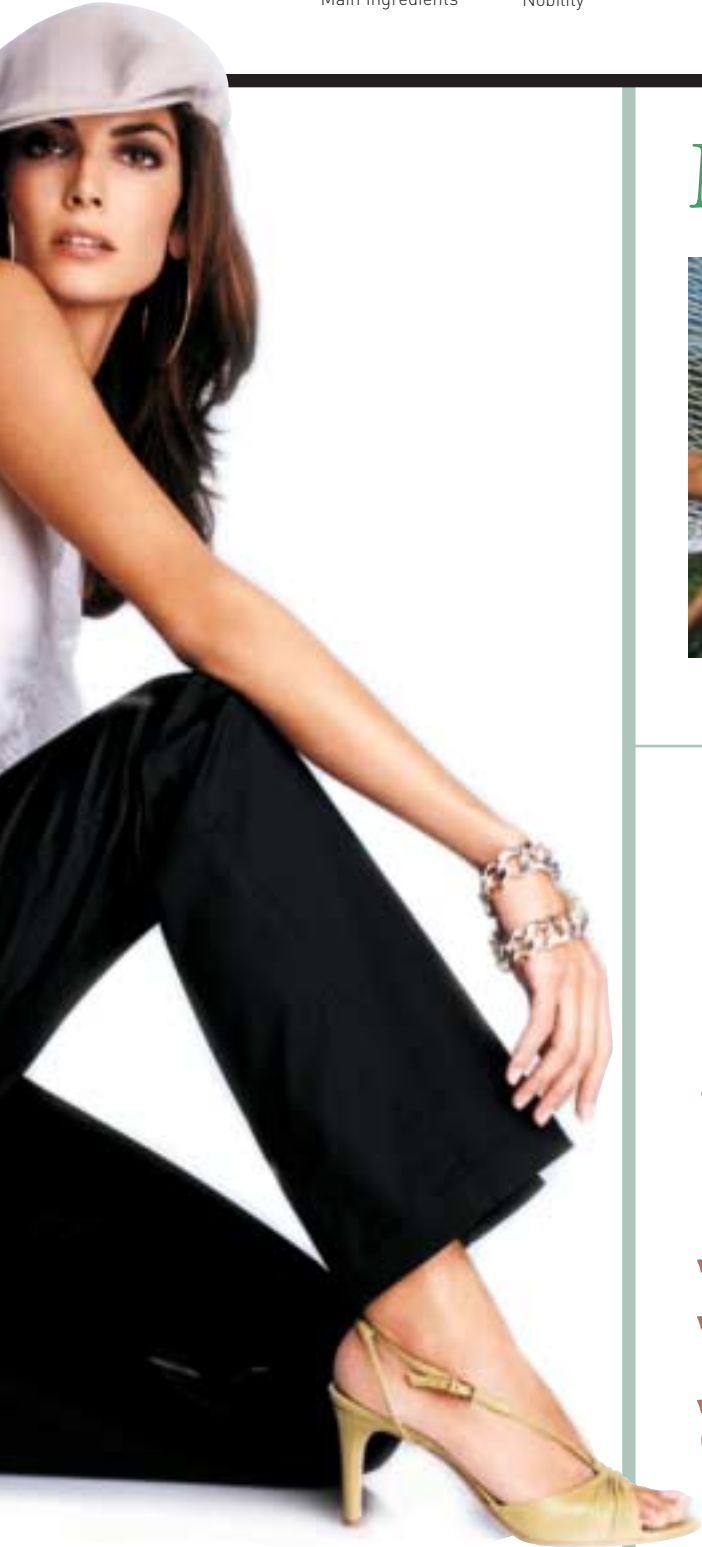
Main Ingredients



Nobility

# For The Home

Starting out or starting over, furnishing the home is an exciting undertaking and Dillard's shoppers depend on us to provide the latest fashions and top quality merchandise. Kitchen, den, bedrooms, throughout the house, our exclusive brands like Nobility, Main Ingredients, Signature Home and Status Quo are becoming decorating standards.



## Menswear



Roundtree & Yorke

Clothes really do make the man and most men trust the brands they know. From business classic to contemporary sportswear, the American male (and the women who shop for them) return to the trusted exclusive brands in Dillard's men's department: including Roundtree & Yorke, Daniel Cremieux, Murano and Turnbury.

## Children's Wear



Copper Key



Class Club

Moms all across the country apply a common criteria to the business of clothing their children and that criteria is based on dependable quality, fashion and value. They depend on Class Club for boys and Copper Key for girls and juniors to deliver time after time.

## Juniors

## Corporate Organization

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<b>William Dillard, II</b> Chief Executive Officer	<b>Alex Dillard</b> President	<b>Mike Dillard</b> Executive Vice President
<b>Drue Corbusier</b> Executive Vice President	<b>James I. Freeman</b> Chief Financial Officer	<b>Paul J. Schroeder, Jr.</b> General Counsel

## Vice Presidents

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<b>W.R. Appleby, II</b>	<b>Neil Christensen</b>	<b>William H. Hite</b>	<b>Anthony Menzie</b>	<b>Terry Smith</b>	<b>Phillip R. Watts</b>
<b>H. Gene Baker</b>	<b>William T. Dillard, III</b>	<b>William L. Holder, Jr.</b>	<b>Richard Moore</b>	<b>Burt Squires</b>	<b>Kay White</b>
<b>Donald A. Bogart</b>	<b>Gianni Duarte</b>	<b>Dan W. Jensen</b>	<b>Cindy Myers-Ray</b>	<b>Alan Steinberg</b>	<b>Keith White</b>
<b>Tom Bolin</b>	<b>Karl G. Ederer</b>	<b>Mark Killingsworth</b>	<b>Steven K. Nelson</b>	<b>Sandra Steinberg</b>	<b>Ronald Wiggins</b>
<b>Michael Bowen</b>	<b>Christine A. Ferrari</b>	<b>Colleen Kirk</b>	<b>Tom C. Patterson</b>	<b>James D. Stockman</b>	<b>Kent Wiley</b>
<b>Joseph P. Brennan</b>	<b>Ann Franzke</b>	<b>Gaston Lemoine</b>	<b>Michael E. Price</b>	<b>Ralph Stuart</b>	<b>Richard B. Willey</b>
<b>Kent Burnett</b>	<b>John Grahek, Jr.</b>	<b>Denise Mahaffy</b>	<b>Grizelda Reeder</b>	<b>Tom Sullivan</b>	<b>Sherrill E. Wise</b>
<b>Larry Cailteux</b>	<b>Walter C. Grammer</b>	<b>Paul E. McLynch</b>	<b>Robin Sanderford</b>	<b>Julie A. Taylor</b>	
<b>Les Chandler</b>	<b>Marva Harrell</b>	<b>Michael S. McNiff</b>	<b>Sidney A. Sanders</b>	<b>David Terry</b>	
<b>James W. Cherry, Jr.</b>	<b>Gene D. Heil</b>	<b>Jeff Menn</b>	<b>Linda Sholtis-Tucker</b>	<b>Lloyd Keith Tidmore</b>	

## Merchandising Division Management

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<b>Ft. Worth Division</b>	<b>Little Rock Division</b>	<b>Phoenix Division</b>	<b>St. Louis Division</b>	<b>Tampa Division</b>
<b>Drue Corbusier</b> President	<b>Mike Dillard</b> President	<b>Kent Burnett</b> President	<b>Joseph P. Brennan</b> President	<b>Robin Sanderford</b> President
<b>Jeff Menn</b> Vice President, Merchandising	<b>David Terry</b> Vice President, Merchandising	<b>Tom Sullivan</b> Vice President, Merchandising	<b>Mark Killingsworth</b> Vice President, Merchandising	<b>Sandra Steinberg</b> Vice President, Merchandising
<b>Anthony Menzie</b> Vice President, Merchandising	<b>Keith White</b> Vice President, Merchandising	<b>Julie A. Taylor</b> Vice President, Merchandising	<b>Ronald Wiggins</b> Vice President, Merchandising	<b>James D. Stockman</b> Vice President, Merchandising
<b>Lloyd Tidmore</b> Director of Sales Promotion	<b>Ken Eaton</b> Director of Sales Promotion	<b>James Benson</b> Director of Sales Promotion	<b>Mark Gastman</b> Director of Sales Promotion	<b>Louise Platt</b> Director of Sales Promotion

## Board of Directors

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<b>Robert C. Connor</b> Investments	<b>Mike Dillard</b> Executive Vice President of Dillard's, Inc.	<b>John Paul Hammerschmidt</b> Retired Member of Congress Harrison, Arkansas	<b>William H. Sutton</b> Managing Partner of Friday, Eldredge and Clark, Attorneys Little Rock, Arkansas
<b>Drue Corbusier</b> Executive Vice President of Dillard's, Inc.	<b>William Dillard, II</b> Chairman of the Board and Chief Executive Officer of Dillard's, Inc.	<b>Bob L. Martin</b> Independent Business Executive Former President and Chief Executive Officer Wal- Mart International Rogers, Arkansas	<b>J.C. Watts, Jr.</b> Former Member of Congress and Chairman of J.C. Watts Companies Arlington, Virginia
<b>Will D. Davis</b> Partner with Heath, Davis, & McCalla, Attorneys Austin, Texas	<b>James I. Freeman</b> Senior Vice President and Chief Financial Officer of Dillard's, Inc.	<b>Warren A. Stephens</b> President and Chief Executive Officer of Stephens Group and Stephens, Inc. Little Rock, Arkansas	
<b>Alex Dillard</b> President Dillard's, Inc.			

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K**

(Mark One)

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

For the fiscal year ended **January 31, 2004**

OR

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

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

Commission file number 1-6140

**DILLARD'S, INC.**

(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction  
of incorporation or organization)

71-0388071  
(IRS Employer  
Identification Number)

1600 CANTRELL ROAD, LITTLE ROCK, ARKANSAS 72201  
(Address of principal executive office)  
(Zip Code)

(501) 376-5200  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each Class	Name of each exchange on which registered
Class A Common Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

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

Indicated by checkmark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  No

Indicate by checkmark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K.

State the aggregate market value of the voting stock held by non-affiliates of the Registrant as of February 28, 2004: \$1,357,737,216.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock as of February 28, 2004:

CLASS A COMMON STOCK, \$.01 par value	79,480,069
CLASS B COMMON STOCK, \$.01 par value	4,010,929

## **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held May 15, 2004 (the "Proxy Statement") are incorporated by reference into Part III.



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## **PART I**

### **ITEM 1. BUSINESS.**

#### General

Dillard's, Inc. (the "Company" or "Registrant") is an outgrowth of a department store originally founded in 1938 by William Dillard. The Company was incorporated in Delaware in 1964. The Company operates retail department stores located primarily in the Southwest, Southeast and Midwest.

We conduct our retail merchandise business under highly competitive conditions. Although we are a large regional department store, we have numerous competitors at the national and local level that compete with our individual stores, including specialty, off-price, discount, internet, and mail-order retailers. Competition is characterized by many factors including location, reputation, assortment, advertising, price, quality, service and credit availability. We believe that our stores are in a strong competitive position with regard to each of these factors. The Company's earnings depend to a significant extent on the results of operations for the last quarter of its fiscal year. Due to holiday buying patterns, sales for that period average approximately one-third of annual sales.

For additional information with respect to the Registrant's business, reference is made to information contained under the headings "Net sales," "Net income," "Total assets" and "Number of employees-average," under item 6 hereof.

The Company's annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K are available free of charge on the Dillard's, Inc. Web site:

[www.dillards.com](http://www.dillards.com)

The information contained on the Company's web site is not incorporated by reference into this Form 10-K and should not be considered to be a part of this Form 10-K. These reports are available as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission.

### **ITEM 1A. EXECUTIVE OFFICERS OF THE REGISTRANT.**

The following table lists the names and ages of all Executive Officers of the registrant, the nature of any family relationship between them and all positions and offices with the Registrant presently held by each person named. All of the Executive Officers listed below have been in managerial positions with the registrant for more than five years.

The following is a listing of executive officers of the Company, their age, position and office, and family relationship, if any.

<u>Name</u>	<u>Age</u>	<u>Position &amp; Office</u>	<u>Family Relationship</u>
William Dillard, II	59	Director; Chief Executive Officer	None
Alex Dillard	54	Director; President	Brother of William Dillard, II
Mike Dillard	52	Director; Executive Vice President	Brother of William Dillard, II
H. Gene Baker	65	Vice President	None
Joseph P. Brennan	59	Vice President	None
G. Kent Burnett	59	Vice President	None
Drue Corbusier	57	Director; Executive Vice President	Sister of William Dillard, II
James I. Freeman	54	Director; Senior Vice President; Chief Financial Officer	None
Randal L. Hankins	53	President of Dillard National Bank	None
Gaston Lemoine	60	Vice President	None
Steven K. Nelson	46	Vice President	None
Robin Sanderford	57	Vice President	None
Paul J. Schroeder	55	Vice President	None
Burt Squires	54	Vice President	None
Charles Unfried	57	Chief Executive Officer of Dillard National Bank	None

## **ITEM 2. PROPERTIES.**

All of the Registrant's stores are owned or leased from wholly owned subsidiaries or from third parties. The Registrant's third-party store leases typically provide for rental payments based on a percentage of net sales with a guaranteed minimum annual rent. Lease terms between the Registrant and its wholly owned subsidiaries vary. In general, the Company pays the cost of insurance, maintenance and any increase in real estate taxes related to the leases. At January 31, 2004 there were 328 stores in operation with gross square footage approximating 56.0 million feet. The Company owned or leased, from wholly owned subsidiaries, a total of 257 stores with 43.9 million square feet. The Company leased 71 stores from third parties, which totaled 12.1 million square feet. Additional information is contained in Notes 1, 2, 12 and 13 of "Notes to Consolidated Financial Statements," in Item 8 hereof and reference is made to information contained under the heading "Number of stores," under item 6 hereof.

### ITEM 3. LEGAL PROCEEDINGS.

From time to time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. Such issues may relate to litigation with customers, employment related lawsuits, class action lawsuits, purported class action lawsuits and actions brought by governmental authorities. As of April 3, 2004, we are not a party to any legal proceedings that, individually or in the aggregate, are reasonably expected to have a material adverse effect on our business, results of operations, financial condition or cash flows. However, the results of these matters cannot be predicted with certainty, and an unfavorable resolution of one or more of these matters could have a material adverse effect on our business, results of operations, financial condition or cash flows.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matter was submitted to a vote of security holders during the fourth quarter of the year ended January 31, 2004.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Company's common stock trades on the New York Stock Exchange under the Ticker Symbol "DDS".

#### Stock Prices and Dividends by Quarter

	2003		2002		Dividends per Share	
	High	Low	High	Low	2003	2002
First	\$15.10	\$12.49	\$25.87	\$12.94	\$0.04	\$0.04
Second	15.08	12.77	30.47	21.70	0.04	0.04
Third	16.92	13.98	27.98	15.59	0.04	0.04
Fourth	17.86	14.46	19.32	15.00	0.04	0.04

#### Equity Compensation Plan Information

	Number of securities to be issued upon exercise of outstanding options	Weighted average exercise prices of outstanding options	Number of securities available for future issuance under equity compensation plans(excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by shareholders	7,870,739	\$22.45	9,773,141
Total	7,870,739	\$22.45	9,773,141

As of February 28, 2004, there were 4,827 record holders of the Company's Class A Common Stock and 8 record holders of the Company's Class B Common Stock.

## ITEM 6. SELECTED FINANCIAL DATA.

### Table of Selected Financial Data

(In thousands of dollars, except per share data)

	2003	2002	2001	2000*	1999
Net sales	\$7,598,934	\$7,910,996	\$8,154,911	\$8,566,560	\$8,676,711
Percent change	-4%	-3%	-5%	-1%	12%
Cost of sales	5,170,173	5,254,134	5,507,702	5,802,147	5,762,431
Percent of sales	68.0%	66.4%	67.5%	67.8%	66.4%
Interest and debt expense	181,065	189,779	192,344	169,609	249,514
Income before taxes	15,994	204,261	120,963	183,531	283,949
Income taxes	6,650	72,335	49,165	59,390	120,220
Income before cumulative effect of accounting change	9,344	131,926	71,798	124,141	163,729
Cumulative effect of accounting change	-	(530,331) (1)	-	(129,991) (2)	-
Net income (loss)	9,344	(398,405)	71,798	(5,850)	163,729
Pro forma inventory change	-	-	-	-	(8,963) (3)
Pro forma net income (loss)	9,344	(398,405)	71,798	(5,850)	154,766
Per Diluted Common Share					
Income before cumulative effect of accounting change	0.11	1.55	0.85	1.36	1.55
Cumulative effect of accounting change	-	(6.22)	-	(1.42)	-
Net income (loss)	0.11	(4.67)	0.85	(0.06)	1.55
Pro forma inventory change	-	-	-	-	(0.08)
Pro forma net income (loss)	0.11	(4.67)	0.85	(0.06)	1.47
Dividends	0.16	0.16	0.16	0.16	0.16
Book value	26.79	26.71	31.81	30.94	28.68
Average number of shares outstanding	83,899,974	85,316,200	84,486,747	91,199,184	105,617,503
Accounts receivable (4)	1,232,456	1,387,835	1,112,325	1,011,481	1,137,458
Merchandise inventories	1,632,377	1,594,308	1,561,863	1,616,186	2,047,830
Property and equipment	3,197,469	3,370,502	3,455,715	3,508,331	3,619,191
Total assets	6,411,097	6,675,932	7,074,559	7,199,309	7,918,204
Long-term debt (4)	1,855,065	2,193,006	2,124,577	2,374,124	2,894,616
Capitalized lease obligations	17,711	18,600	20,459	22,453	24,659
Deferred income taxes	617,236	645,020	643,965	638,648	702,467
Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures	200,000	531,579	531,579	531,579	531,579
Stockholders' equity	2,237,097	2,264,196	2,668,397	2,629,820	2,832,834
Number of employees - average	53,598	55,208	57,257	58,796	61,824
Gross square footage (in thousands)	56,000	56,700	56,800	56,500	57,000
Number of stores					
Opened	5	4	6	4	8
Acquired	0	0	4	0	0
Closed	10	9	9	9	1
Total - end of year	328	333	338	337	342

\* 53 Weeks

- (1) During fiscal 2002, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets". See Management's Discussion and Analysis of Financial Condition and Results of Operations.
- (2) During fiscal 2000, the Company changed its method of accounting for inventories under the retail method
- (3) Pro forma effect of applying the cumulative effect of accounting change for inventories in fiscal 2000.
- (4) The Company had \$300 million in off-balance-sheet debt and accounts receivable for the fiscal years ending 2001, 2000 and 1999, respectively. See Note 15 to the Consolidated Financial Statements.

The items below are included in the Selected Financial Data.

### 2003

The items below amount to a net \$18.6 million pretax charge (\$12.8 million after tax or \$0.15 per diluted share).

- a \$43.7 million pretax charge (\$28.9 million after tax or \$0.34 per diluted share) for asset impairment and store closing charges related to certain stores (see Note 13 of the Notes to Consolidated Financial Statements).
- a call premium resulting in additional interest expense of \$15.6 million (\$10.0 million after tax or \$0.12 per diluted share) associated with a \$125.9 million call of debt.
- a pretax gain of \$15.6 million (\$10.0 million after tax or \$0.12 per diluted share) pertaining to the Company's sale of its interest in Sunrise Mall and its associated center in Brownsville, Texas (see Note 1 of the Notes to Consolidated Financial Statements).
- a pretax gain of \$12.3 million (\$7.9 million after tax or \$0.09 per diluted share) recorded due to the resolution of certain liabilities originally recorded in conjunction with the purchase of Mercantile Stores Company, Inc.
- an \$8.7 million pretax gain (\$5.6 million after tax or \$0.07 per diluted share) related to the sale of certain store properties.
- \$4.1 million (\$2.6 million after tax or \$0.03 per diluted share) received from the Internal Revenue Service as a result of the Company's filing of an interest-netting claim related to previously settled tax years.

### 2002

The items below amount to a net \$3.0 million pretax gain (\$1.8 million after tax or \$0.02 per diluted share).

- a pretax gain of \$64.3 million (\$41.1 million after tax or \$0.48 per diluted share) pertaining to the Company's sale of its interest in FlatIron Crossing, a Broomfield, Colorado shopping center (see Note 1 of the Notes to Consolidated Financial Statements).
- a pretax asset impairment and store closing charge of \$52.2 million (\$33.4 million after tax or \$0.39 per diluted share) related to certain stores (see Note 13 of the Notes to Consolidated Financial Statements).
- a call premium resulting in additional interest expense of \$11.6 million (\$7.4 million after tax or \$0.09 per diluted share) associated with a \$143.0 million call of debt.
- a pretax charge of \$5.4 million (\$3.5 million after tax or \$0.04 per diluted share) on the amortization of off-balance-sheet accounts receivable securitization (see Note 15 of the Notes to Consolidated Financial Statements).
- a pretax gain of \$4.8 million (\$3.0 million after tax or \$0.04 per diluted share) on the early extinguishment of debt.

- a pretax gain of \$3.1 million (\$2.0 million after tax or \$0.02 per diluted share) from an investee partnership of the Company who received an unusual distribution in the settlement of a receivable.

## 2001

The items below amount to a net \$5.6 million pretax charge (\$3.6 million after tax or \$0.04 per diluted share).

- a pretax asset impairment and store closing charge of \$3.8 million (\$2.4 million after tax or \$0.03 per diluted share) related to certain stores (see Note 13 of the Notes to Consolidated Financial Statements).
- a pretax gain of \$9.4 million (\$6.0 million after tax or \$0.07 per diluted share) on the early extinguishment of debt.

## 2000

The items below amount to a net \$38.2 million pretax charge (\$21.3 million after tax or \$0.23 per diluted share).

- a pretax asset impairment and store closing charge of \$51.4 million (\$36.0 million after tax or \$0.40 per diluted share) related to certain stores.
- a pretax gain of \$42.7 million (\$27.3 million after tax or \$0.30 per diluted share) on the early extinguishment of debt.
- a pretax gain of \$46.9 million (\$30.0 million after tax or \$0.33 per diluted share) on the Company's change in its method of accounting for inventories under the retail inventory method.

## 1999

The items below amount to a net \$83.5 million pretax charge (\$64.3 million after tax or \$0.63 per diluted share).

- a pretax asset impairment and store closing charge of \$69.7 million (\$55.5 million after tax or \$0.55 per diluted share) related to certain stores.
- a pretax loss of \$13.8 million (\$8.8 million after tax or \$0.08 per diluted share) on the Company's change in its method of accounting for inventories under the retail inventory method.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

### **EXECUTIVE OVERVIEW**

Dillard's, Inc. ("the Company" or "we") operates 328 retail department stores in 29 states. Our stores are located in suburban shopping malls and offer a broad selection of fashion apparel and home furnishings. We offer an appealing and attractive assortment of merchandise to our customers at a fair price. We seek to enhance our income by maximizing the sale of this merchandise to our customers. We do this by promoting and advertising our merchandise and by making our stores an attractive and convenient place for our customers to shop.

Fundamentally, the Company's business model is to offer the customer a compelling price/value relationship through the combination of high quality products and services at a competitive price. The Company seeks to deliver a high level of profitability and cash flow by:

- maximizing the effectiveness of our pricing and brand awareness;
- minimizing costs through leveraging our centralized overhead expense structure;
- Sourcing;
- Credit operations;

- reinvesting operating cash flows into store growth, distribution initiatives, improving product quality in our proprietary brands; and
- returning profits to shareholders through dividends, share repurchases and increased share price.

The consumer retail sector is extremely competitive. Many different retail establishments compete for our customers' business. These include other department stores, specialty retailers, discounters, internet and mail order retailers. We also attempt to enhance our income by managing our operating costs without sacrificing service to our customers.

### Trends and uncertainties

The following key uncertainties have been identified by the Company whose fluctuations can have a material effect on the operating results.

- Cash flow from operating activities are a primary source of liquidity that is adversely affected when the industry faces market driven challenges and new and existing competitors seek areas of growth to expand their businesses. If our customers do not purchase our merchandise offerings in sufficient quantities, we respond by taking markdowns. If we have to reduce our prices, the cost of goods sold on our income statement will correspondingly rise, thus reducing our income.
- Success of brand – The success of our exclusive brand merchandise is dependent upon customer fashion preferences.
- Store growth – Our growth is dependent on a number of factors which could prevent the opening of new stores, such as identifying suitable markets and locations.

### 2004 Guidance

A summary of guidance on key financial measures for 2004, on a GAAP basis, is shown below. There have been no changes in the guidance for 2004 since the Company released its fourth quarter earnings on March 10, 2004.

(In millions of dollars)	2004 Estimated	2003 Actual
Depreciation and amortization	\$ 290	\$ 291
Rental expense	64	64
Interest and debt expense	155	181
Capital expenditures	240	227

### General

**Net Sales.** Net sales include sales of comparable stores, non-comparable stores and lease income on leased departments. Comparable store sales include sales for those stores which were in operation for a full period in both the current month and the corresponding month for the prior year. Non-comparable store sales include sales in the current fiscal year from stores opened during the previous fiscal year before they are considered comparable stores, sales from new stores opened in the current fiscal year and sales in the previous fiscal year for stores that were closed in the current fiscal year.

**Service Charges, Interest and Other Income.** Service Charges, Interest and Other Income include interest and service charges, net of service charge write-offs, related to the Company's proprietary credit card sales. Other income relates to joint ventures accounted for by the equity method, rental income, shipping and handling fees and gains (losses) on the sale of property and equipment and joint ventures.

**Cost of Sales.** Cost of sales includes the cost of merchandise sold, bankcard fees, freight to the distribution centers, employee and promotional discounts and direct payroll for salon personnel.

**Advertising, selling, administrative and general expenses.** Advertising, selling, administrative and general expenses include buying and occupancy, selling, distribution, warehousing, store management and corporate expenses, including payroll and employee benefits, insurance, employment taxes, advertising, management information systems, legal, bad debt costs and other corporate level expenses. Buying expenses consist of payroll, employee benefits and travel for design, buying and merchandising personnel.



**Depreciation and amortization.** Depreciation and amortization expenses include depreciation on property and equipment and amortization of goodwill prior to February 3, 2002.

**Rentals.** Rentals include expenses for store leases and data processing equipment rentals.

**Interest and debt expense.** Interest and debt expense includes interest relating to the Company's unsecured notes, mortgage notes, credit card receivables financing, the Guaranteed Beneficial Interests in the Company's subordinated debentures, gains and losses on note repurchases, amortization of financing intangibles and interest on capital lease obligations.

**Asset impairment and store closing charges.** Asset impairment and store closing charges consist of write-downs to fair value of under-performing properties and exit costs associated with the closure of certain stores. Exit costs include future rent, taxes and common area maintenance expenses from the time the stores are closed.

**Cumulative effect of accounting change.** Effective February 3, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142 changes the accounting for goodwill from an amortization method to an "impairment only" approach. Under SFAS No. 142, goodwill is no longer amortized but reviewed for impairment annually or more frequently if certain indicators arise. The Company tested goodwill for impairment as of the adoption date using the two-step process prescribed in SFAS No. 142. The Company identified its reporting units under SFAS No. 142 at the store unit level. The fair value of these reporting units was estimated using the expected discounted future cash flows and market values of related businesses, where appropriate. The cumulative effect of the accounting change as of February 3, 2002 was to decrease net income for fiscal year 2002 by \$530 million or \$6.22 per diluted share.

#### **Critical Accounting Policies and Estimates**

The Company's accounting policies are more fully described in Note 1 of Notes to Consolidated Financial Statements. As disclosed in Note 1 of Notes to Consolidated Financial Statements, the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions about future events that affect the amounts reported in the consolidated financial statements and accompanying notes. Since future events and their effects cannot be determined with absolute certainty, actual results will differ from those estimates. The Company evaluates its estimates and judgments on an ongoing basis and predicates those estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results will differ from these under different assumptions or conditions.

Management of the Company believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in preparation of the Consolidated Financial Statements.

**Merchandise inventory.** Approximately 97% of the inventories are valued at lower of cost or market using the retail last-in, first-out ("LIFO") inventory method. Under the retail inventory method ("RIM"), the valuation of inventories at cost and the resulting gross margins are calculated by applying a calculated cost to retail ratio to the retail value of inventories. RIM is an averaging method that has been widely used in the retail industry due to its practicality. Additionally, it is recognized that the use of RIM will result in valuing inventories at the lower of cost or market if markdowns are currently taken as a reduction of the retail value of inventories. Inherent in the RIM calculation are certain significant management judgments including, among others, merchandise markon, markups, and markdowns, which significantly impact the ending inventory valuation at cost as well as the resulting gross margins. Management believes that the Company's RIM provides an inventory valuation which results in a carrying value at the lower of cost or market. The remaining 3% of the inventories are valued at lower of cost or market using the specific identified cost method.

**Allowance for doubtful accounts.** The accounts receivable from the Company's proprietary credit card sales are subject to credit losses. The Company maintains allowances for uncollectible accounts for estimated losses resulting from the inability of its customers to make required payments. The adequacy of the allowance is based on historical experience with similar customers including write-off trends, current aging information and year-end balances. Bankruptcies and recoveries used in the allowance calculation are projected based on qualitative factors such as current and expected consumer and economic trends. Management believes that the allowance for uncollectible accounts is adequate to cover anticipated losses in the reported credit card receivable portfolio under current conditions; however, significant deterioration in any of the above-noted factors or in the overall health of the economy could materially change these expectations.

**Vendor allowances.** The Company receives concessions from its vendors through a variety of programs and arrangements, including co-operative advertising, payroll reimbursements and markdown reimbursement programs. Co-operative advertising allowances are reported as a reduction of advertising expense in the period in which the advertising occurred. Payroll reimbursements are reported as a reduction of payroll expense in the period in which the reimbursement occurred. All other vendor allowances are recognized as a reduction of cost purchases. Accordingly, a reduction or increase in vendor concessions has an inverse impact on cost of sales and/or selling and administrative expenses.

**Insurance accruals.** The Company's consolidated balance sheets include liabilities with respect to self-insured workers' compensation and general liability claims. The Company estimates the required liability of such claims, utilizing an actuarial method, based upon various assumptions, which include, but are not limited to, our historical loss experience, projected loss development factors, actual payroll and other data. The required liability is also subject to adjustment in the future based upon the changes in claims experience, including changes in the number of incidents (frequency) and changes in the ultimate cost per incident (severity).

**Finite-lived assets.** The Company evaluates the fair value and future benefits of finite-lived assets whenever events and changes in circumstances suggest. The Company performs an analysis of the anticipated undiscounted future net cash flows of the related finite-lived assets. If the carrying value of the related asset exceeds the undiscounted cash flows, the carrying value is reduced to its fair value. Various factors including future sales growth and profit margins are included in this analysis. To the extent these future projections or the Company's strategies change, the conclusion regarding impairment may differ from the current estimates.

**Goodwill.** The Company evaluates goodwill annually and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable from its estimated future cash flows. To the extent these future projections or our strategies change, the conclusion regarding impairment may differ from the current estimates.

**Accounts receivable securitizations.** As part of the credit card securitizations, the Company transfers credit card receivable balances to the Trust in exchange for certificates representing undivided interests in such receivables. The Trust securitizes balances by issuing certificates representing undivided interests in the Trust's receivables to outside investors. In each securitization the Company retains certain subordinated interests that serve as a credit enhancement to outside investors and expose the Trust assets to possible credit losses on receivables sold to outside investors. The investors and the Trust have no recourse against the Company beyond Trust assets. In order to maintain the committed level of securitized assets, the Trust reinvests cash collections on securitized accounts in additional balances. Interest paid to outside investors is recorded as interest expense.

Currently all borrowings under our receivable financing conduit are recorded on balance sheet and included in "Long-term Debt" on the consolidated balance sheet. As of January 31, 2004 and February 1, 2003 we had \$400 million of debt, respectively, outstanding under this agreement. Prior to May 2002, we accounted for securitizations of credit card receivables as sales of receivables, thus off balance sheet.

**Income taxes.** Temporary differences arising from differing treatment of income and expense items for tax and financial reporting purposes result in deferred tax assets and liabilities that are recorded on the balance sheet. These balances, as well as income tax expense, are determined through management's estimations, interpretation of tax law for multiple jurisdictions and tax planning. If the Company's actual results differ from estimated results due to changes in tax laws, new store locations or tax planning, the Company's effective tax rate and tax balances could be affected. As such these estimates may require adjustment in the future as additional facts become known or as circumstances change.

**Discount rate.** The discount rate that the Company utilizes for determining future pension obligations is based on the Moody's AA corporate bond index. The indices selected reflect the weighted average remaining period of benefit payments. The discount rate determined on this basis had decreased to 6.0% as of January 31, 2004 from 6.75% as of February 1, 2003.

## Results of Operations

The following table sets forth the results of operations, expressed as a percentage of net sales, for the periods indicated:

(in millions of dollars)	For the years ended					
	January 31, 2004		February 1, 2003		February 2, 2002	
	Amount	% of Net Sales	Amount	% of Net Sales	Amount	% of Net Sales
Net sales	\$7,598.9	100.0%	\$7,911.0	100.0%	\$8,154.9	100.0%
Cost of sales	5,170.2	68.0	5,254.1	66.4	5,507.7	67.5
Gross profit	2,428.7	32.0	2,656.9	33.6	2,647.2	32.5
Advertising, selling, administrative and general expenses	2,097.9	27.6	2164.0	27.3	2,191.4	26.9
Depreciation and amortization	290.7	3.8	301.4	3.8	310.7	3.8
Rentals	64.1	0.8	68.1	0.9	72.8	0.9
Interest and debt expense	181.1	2.4	189.8	2.4	192.3	2.4
Asset impairment and store closing charges	43.7	0.6	52.2	0.7	3.8	-
Total operating expenses	2,677.5	35.2	2,775.5	35.1	2,771.0	34.0
Service charges, interest and other income	264.8	3.4	322.9	4.1	244.8	3.0
Income before income taxes	16.0	0.2	204.3	2.6	121.0	1.5
Income taxes	6.7	0.1	72.4	0.9	49.2	0.6
Income before cumulative effect of accounting change	9.3	0.1	131.9	1.7	71.8	0.9
Cumulative effect of accounting change	-	-	(530.3)	(6.7)	-	-
Net income (loss)	\$ 9.3	0.1%	\$(398.4)	(5.0)%	\$ 71.8	0.9%

## Sales

The percent change by category in the Company's sales for the past two years is as follows:

	% Change	
	03-02	02-01
Cosmetics	-1.1	-2.5
Women's and Juniors' Clothing	-4.8	-2.8
Children's Clothing	-8.9	-1.9
Men's Clothing and Accessories	-5.8	-5.9
Shoes, Accessories and Lingerie	-0.8	-0.8
Home	-4.3	-3.6

Sales decreased 4% for the 52-week period ended January 31, 2004 compared to the 52-week period ended February 1, 2003 on both a total and comparable store basis. Sales declined in all merchandising categories with the largest declines in children's, men's clothing and accessories and women's and juniors' clothing. Sales in the home categories were in line with the average sales performance while sales in accessories, shoes, lingerie and cosmetics were strongest and exceeded the Company's average sales performance for the period. Dillard's management reiterates their strong belief that merchandise differentiation by the Company is crucial to its future success in the marketplace. The Company continues to work diligently to build penetration and recognition of its exclusive brand merchandise as a means to provide superior price and value choices to its customers. During the fiscal years 2003, 2002 and 2001, sales of private brand merchandise as a percent of total sales were 20.9%, 18.2% and 15.4%, respectively.

Sales decreased 3% for the 52-week period ended February 1, 2003 compared to the 52-week period ended February 2, 2002 on both a total and comparable store basis. The sales decrease for 2002 is due to lower levels of comparable store sales particularly in the latter half of fiscal 2002 due to a notably weak retail environment. Sales declined in all merchandising categories with the largest declines in men's clothing and accessories and home, which decreased 6% and 4%, respectively.

## **Cost of Sales**

Cost of sales as a percentage of sales increased to 68.0% during 2003 compared with 66.4% for 2002. The decline of 160 basis points in gross margin during fiscal 2003 was due to competitive pressures in the Company's retail sector and the resulting effort to maintain a competitive position with increased markdown activity. The higher level of markdown activity increased cost of sales by 3.7% of sales. Improved levels of markups partially offset this promotional activity during fiscal 2003. The increased markup percentage was responsible for a decrease in cost of sales of 2.1% of sales. All product categories had decreased gross margins during 2003 except cosmetics, which increased 10 basis points from 2002. The Company has continued to build penetration and recognition of its private brand merchandise as a means for increased control over merchandise mix and better gross margin performance with the goal of replacing under-performing branded vendors with Dillard's private brands.

Inventory in comparable stores at January 31, 2004 increased 140 basis points comparing to inventory in comparable stores at February 1, 2003. This increase was due to lower than expected sales in the fourth quarter of fiscal 2003.

Cost of sales as a percentage of sales decreased to 66.4% during 2002 compared with 67.5% for 2001. The Company experienced lower than expected consumer demand in its fourth quarter of 2002 necessitating increased promotional efforts to clear slower moving merchandise. This higher level of markdown activity increased the cost of sales by 1.5% of sales in response to a heavily promotional retail environment and comparatively weak sales trends in the holiday merchandise category compared to the prior year. Significantly improved levels of markups offset this promotional activity during 2002 compared with 2001. The increased markup percentage was responsible for a decrease in cost of sales of 2.6% of sales. All product categories had improved gross margins during 2002 except cosmetics, which was unchanged from 2001.

## **Expenses**

### **2003 Compared to 2002**

Advertising, selling, administrative and general ("SG&A") expenses increased to 27.6% of sales for fiscal 2003 compared to 27.3% for fiscal 2002. The percentage increase is primarily due to a lack of sales leverage as SG&A expenses decreased \$66.1 million in 2003 compared to 2002. On a dollar basis significant decreases were noted in payroll, advertising and bad debt expense. Payroll, advertising and bad debt expense declined \$37.0 million, \$8.6 million and \$9.5 million, respectively. The decrease in payroll was caused primarily by a reduction in incentive based sales payroll which is directly tied to the decrease in sales during 2003. The decline in advertising expense resulted primarily from a reduction in newspaper advertising as the Company considers which media more appropriately matches its customers' lifestyles. Improvement in the quality of accounts receivable through lower delinquencies as well as a reduction in outstanding accounts receivable contributed to the lower bad debt expense. SG&A expenses in fiscal 2003 include a \$12.3 million pretax credit recorded due to the resolution of certain liabilities originally recorded in conjunction with the purchase of Mercantile Stores Company, Inc. that were deemed not necessary based upon current information.

Depreciation and amortization as a percentage of sales remained flat during fiscal 2003 principally due to lower capital expenditures in fiscal 2003 combined with a lack of sales leverage from the 4% decline in comparable store sales during the year.

Interest and debt expense as a percentage of sales was unchanged from fiscal 2002 as a result of the Company's lack of sales leverage. Interest expense declined \$9.0 million due to the Company's continuing focus on reducing its outstanding debt levels. Average debt outstanding declined approximately \$226 million in fiscal 2003. Interest expense for fiscal 2003 includes a credit of \$4.1 million received from the Internal Revenue Service as a result of the Company's filing of an interest netting claim related to previously settled tax years. A call premium of \$15.6 million related to the early retirement of debt is included in interest expense for fiscal 2003 compared to a call premium of \$11.6 million related to the early retirement of debt for fiscal 2002. The Company has retired all the remaining debt associated with the call premiums in fiscal 2003 and 2002 and does not anticipate any similar call premiums in fiscal 2004. Also included in interest expense for the fiscal 2002 is a pretax gain of \$4.8 million related to the early extinguishment of debt. The Company retired \$272 million in long-term debt and issued \$50 million in new short-term borrowings during 2003.

During fiscal 2003, the Company recorded a pre tax charge of \$44 million for asset impairment and store closing costs. The charge includes a write down to fair value for certain under-performing properties. The charge consists of a write down for a joint venture in the amount of \$5.5 million, a write down of goodwill on two stores to be closed of \$2.5 million and a write down of property and equipment in the amount of \$35.7 million. The Company does not expect to incur significant additional exit costs upon the closing of these properties during fiscal 2004. A breakdown of the asset impairment and store closing charges for fiscal 2003 is as follows:

(in thousands of dollars)	Number of Locations	Impairment Amount
Stores closed during fiscal 2003	3	\$ 3,809
Stores to close during fiscal 2004	4	17,115
Store impaired based on cash flows	1	1,293
Non-operating facilities	7	16,030
Joint Venture	1	5,480
Total	16	\$43,727

## 2002 Compared to 2001

Advertising, selling, administrative and general (“SG&A”) expenses increased to 27.3% of sales for fiscal 2002 compared to 26.9% for fiscal 2001. The percentage increase is primarily due to a lack of sales leverage as SG&A expenses decreased \$27.4 million in 2002 compared to 2001. On a dollar basis significant decreases were noted in payroll, utilities and supplies partially offset by a \$23.8 million increase in bad debt expenses, which includes an increase in the allowance for doubtful accounts of \$12.4 million during 2002 compared to 2001.

Depreciation and amortization as a percentage of sales remained flat during fiscal 2002 principally due to lower amortization expenses during 2002 compared to 2001 as a result of the non-amortization provisions of SFAS No. 142 combined with a lack of sales leverage from the 3% decline in comparable store sales during the year.

Interest and debt expense as a percentage of sales remained flat during fiscal 2002 as a result of the Company’s continuing focus on reducing its outstanding debt levels and the reduction in variable short-term interest rates combined with a lack of sales leverage. The Company retired \$340 million in long-term debt and issued \$40 million in new mortgage loans and \$100 million in additional receivable financing during 2002.

The Company adopted the provisions of SFAS No. 145, “Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections” (“SFAS No. 145”) as of February 1, 2003. For the year ended February 1, 2003, as a result of adopting SFAS No. 145, the Company has reclassified \$6.8 million to interest and debt expense from extraordinary loss. This amount is comprised of a gain of \$4.8 million on debt repurchased, offset by a call premium of \$11.6 million. For the year ended February 2, 2002, the Company has reclassified \$9.4 million to interest and debt expense from extraordinary gain.

The Company has reclassified \$11.3 million in interest expense related to its receivable financing from other revenue to interest expense on its consolidated statements of operations for fiscal 2001.

During fiscal 2002, the Company recorded a pretax charge of \$52.2 million for asset impairment and store closing costs. The charge includes a write down to fair value for certain under-performing properties in the amount of \$55.8 million and exit costs to close four such properties in the amount of \$4.4 million, all of which were closed during fiscal 2003, partially offset by forgiveness of a lease obligation of \$8.0 million in connection with the sale of a closed owned store in Memphis, Tennessee in satisfaction of that obligation. During fiscal 2001, the Company recorded a pretax charge of \$3.8 million for asset impairment and store closing costs. The charge includes a write down to fair value for one under-performing store in the amount of \$1.8 million and lease commitments of \$2 million.

## **Service Charges, Interest and Other Income**

(in millions of dollars)				\$ Change		% Change	
	2003	2002	2001	03-02	02-01	03-02	02-01
Joint venture income	\$ 8.1	\$ 19.5	\$ 11.6	\$(11.4)	\$ 7.9	-58.5%	68.1%
Gain on sale of joint venture and property and equipment	24.3	65.4	2.1	(41.1)	63.3	-62.8	*
Service charge income	207.9	225.7	210.4	(17.8)	15.3	-7.9	7.3
Other	24.4	12.3	20.7	12.1	(8.4)	98.4	-40.6
Total	\$ 264.7	\$ 322.9	\$ 244.8	\$(58.2)	\$ 78.1	-18.0%	31.9%
Average accounts receivable	\$1,231.4	\$1,330.9	\$1,260.8	\$(99.5)	\$ 70.1	-7.5%	5.6%

\* percent change greater than 100%

### **2003 Compared to 2002**

Included in other income in fiscal 2003 is a gain of \$15.6 million relating the sale of the Company's interest in Sunrise Mall and its associated center in Brownsville, Texas. Included in other income in fiscal 2002 is a \$64.3 million gain pertaining to the Company's sale of its interest in the FlatIron Crossing joint venture located in Broomfield, Colorado. Service charge income decreased due to a \$99 million decrease in the average amount of outstanding accounts receivable during 2003 compared to 2002. The decrease in accounts receivable was due to a 140 basis point decline in sales penetration on the Company's proprietary credit card coupled with a 4% decline in overall retail sales during fiscal 2003 compared to the prior year. Sales on the Company's proprietary credit cards as a percent of total sales were 26.8%, 28.2% and 28.8% for fiscal 2003, 2002 and 2001, respectively. Also included in other income are realized gains on the sale of property and equipment of \$8.7 million and \$1.1 million for fiscal 2003 and fiscal 2002, respectively. Earnings from joint ventures declined due to the Company's sale of FlatIron Crossing in fiscal 2002 and the sale of Sunrise Mall in the first quarter of fiscal 2003.

### **2002 Compared to 2001**

Service charge income was \$226 million in 2002 compared to \$210 million in 2001. This increase is due to a \$70 million increase in the average amount of outstanding accounts receivable during 2002 compared to 2001. Earnings from FlatIron Crossing for fiscal 2002 were \$13.6 million.

### **Income Taxes**

The Company's actual federal and state income tax rate (exclusive of the effect of nondeductible goodwill amortization) was 36% in fiscal 2003, 2002 and 2001.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Financial Position Summary**

(in thousands of dollars)	2003	2002	\$ Change	% Change
Cash and cash equivalents	\$ 160,873	\$ 142,356	18,517	13.0
Short-term debt	50,000	-	50,000	-
Current portion of long-term debt	166,041	138,814	27,227	19.6
Current portion of Guaranteed Beneficial Interests	331,579	-	331,579	-
Long-term debt	1,855,065	2,193,006	(337,941)	-15.4
Guaranteed Beneficial Interests	200,000	531,579	(331,579)	-62.4
Stockholders' equity	2,237,097	2,264,196	(27,099)	-1.2
Current ratio	2.26%	3.53%		
Debt to capitalization	53.8%	55.8%		

The Company's current priorities for its use of cash are:

- Investment in high-return capital projects, in particular investments in technology to improve merchandising and distribution, reduce costs, improve efficiencies or help the Company better serve its customers;
- Strategic investments to enhance the value of existing properties;

- Construction of new stores;
- Dividend payments to shareholders;
- Debt reduction; and
- Stock repurchase plan.

Cash flows for the three fiscal years ended were as follows:

(in thousands of dollars)	% Change				
	2003	2002	2001	03-02	02-01
Operating Activities	\$ 432,106	\$ 356,942	\$ 616,981	21.1	(42.1)
Investing Activities	(161,076)	(164,973)	(270,595)	2.4	39.0
Financing Activities	(252,513)	(202,573)	(387,406)	(24.7)	47.7
Total Cash Provided (Used)	\$ 18,517	\$ (10,604)	\$ (41,020)		

### **Operating Activities**

The primary source of the Company's liquidity is cash flows from operations. Retail sales are the key operating cash component providing 96.6% and 96.1% of total revenues over the past two years. Operating cash inflows also include finance charges paid on Company receivables and cash distributions from joint ventures. Operating cash outflows include payments to vendors for inventory, services and supplies, payments to employees, and payments of interest and taxes.

Net cash flows from operations were \$432 million for 2003 and were adequate to fund the Company's operations for the year. Cash flows from operations increased from 2002 levels due primarily to a \$111 million decrease in accounts receivable in the current year. The decrease in accounts receivable was due to a 140 basis point decline in sales penetration on the Company's proprietary credit card coupled with a 4% decline in overall retail sales during fiscal 2003 compared to the prior year. Accounts payable and accrued expenses increased \$5 million in fiscal 2003 compared to a \$104 million decrease in accounts payable and accrued expenses in the prior year. Net cash flow from operations was negatively impacted by lower income before accounting change during fiscal 2003.

### **Investing Activities**

Cash inflows from investing activities generally include proceeds from sales of property and equipment and joint ventures. Investment cash outflows generally include payments for capital expenditures such as property and equipment.

Capital expenditures were \$227 million for 2003. These expenditures consist primarily of the construction of new stores, remodeling of existing stores and investments in technology. During 2003, the Company opened four new stores, Great Northern Mall in Olmstead, Ohio; NorthPark Mall in Davenport, Iowa; Stoney Point Fashion Park and Short Pump Town Center in Richmond, Virginia and one replacement store, Memorial City Mall in Houston, Texas. These five stores totaled approximately 996,000 square feet of retail space. In addition, the Company completed major expansions on two stores totaling 56,000 square feet of retail space. The Company closed ten store locations, including the one replacement store, during the year totaling approximately 1.6 million square feet of retail space. Capital expenditures for 2004 are expected to be approximately \$240 million. The Company plans to open eight new stores in fiscal 2004 totaling 821,000 square feet, net of replaced square footage. Historically, the Company has financed such capital expenditures with cash flow from operations. The Company believes that it will continue to finance capital expenditures in this manner during fiscal 2004.

During 2003, the Company recorded a gain of \$15.6 million and received proceeds of \$34.6 million from the sale of its interest in Sunrise Mall and its associated center in Brownsville, Texas. During 2003, the company recorded a gain on the sale of property and equipment of \$8.7 million and received proceeds of \$31.8 million. During 2002, the Company recorded a gain of \$64.3 million and received proceeds of \$68.3 million from the sale of its interest in FlatIron Crossing, a regional mall in Broomfield, Colorado.

### **Financing Activities**

Cash inflows from financing activities generally include borrowing under the Company's accounts receivable conduit facilities, the issuance of new mortgage notes or long-term debt and funds from stock option exercises. Financing cash outflows generally include the repayment of borrowings under the Company's accounts receivable conduit facilities, the repayment of mortgage notes or long-term debt, the payment of dividends and the purchase of treasury stock.

At January 31, 2004, the Company has \$50 million of variable rate (currently 1.08%) short-term borrowings under its accounts receivable conduit facilities. The Company repurchased \$6.0 million of its outstanding unsecured notes prior to their related maturity dates. The Company also retired the remaining \$125.9 million of its 6.39% Reset Put Securities (“REPS”) due August 1, 2013 prior to their maturity dates. Interest rates on the repurchased securities ranged from 6.39% to 6.88%. Maturity dates ranged from 2004 to 2013.

During 2003, the Company reduced its net level of outstanding debt and capital leases by \$221 million through scheduled debt maturities and repurchases of notes prior to their related maturity dates. Maturities of long-term debt over the next five years are \$166 million, \$292 million, \$298 million, \$201 million and \$201 million, respectively.

### Third-Party Financing

The Company has the following financing sources available to supplement cash flows from operations:

- Accounts receivable conduit,
- Revolving credit agreement, and
- Shelf registration statement.

### Accounts Receivable Conduit

The Company utilizes credit card securitizations as part of its overall funding strategy. The Company had \$400 million of long-term debt outstanding under this agreement on the consolidated balance sheet as of January 31, 2004 and February 1, 2003.

At January 31, 2004 and February 1, 2003, the Company had \$50.0 million and \$0 outstanding, respectively, in short-term borrowings under its accounts receivable conduit facilities related to seasonal financing needs. Remaining available short-term borrowings under these conduit facilities at January 31, 2004 were \$450.0 million. These facilities were subsequently reduced to an availability of \$400 million and extended to a maturity date of September 30, 2004.

### Revolving Credit Agreement

During fiscal 2003, the Company amended and extended its revolving credit agreement (“credit agreement”) to increase the amount available under this facility from \$400 million to \$1 billion (\$835 million of the facility was available upon closing on December 12, 2003, with an additional \$165 million becoming available immediately upon the Preferred Security redemption discussed below). Borrowings under the credit agreement accrue interest at JPMorgan’s Base Rate or LIBOR plus 1.50% (currently 2.60%) subject to certain availability thresholds as defined in the credit agreement. Availability for borrowings and letter of credit obligations under the credit agreement is limited to 75% of the inventory of certain Company subsidiaries (approximately \$1.2 billion at January 31, 2004). There are no financial covenant requirements under the credit agreement provided availability exceeds \$100 million. The credit agreement expires on December 12, 2008. At January 31, 2004, letters of credit totaling \$75.5 million were issued under this facility. There was no funded debt outstanding under the revolving credit agreement at January 31, 2004.

### Shelf Registration Statement

At the end of fiscal 2003, the Company had an outstanding shelf registration statement for securities in the amount of \$750 million.

### Long-term Debt

At January 31, 2004, the Company had \$1.6 billion of unsecured notes and mortgage notes outstanding. The unsecured notes bear interest at rates ranging from 6.30% to 9.50% with due dates from 2003 through 2028. The mortgage notes bear interest at rates ranging from 7.25% to 13.25% with due dates through 2013.

### Stock Repurchase

In May 2000, the Company announced that the Board of Directors authorized the repurchase of up to \$200 million of its Class A Common Stock. During fiscal 2003, the Company repurchased approximately \$18.9 million of Class A Common Stock, representing 1.5 million shares at an average price of \$12.99 per share. Approximately \$56 million in share repurchase authorization remained under this open-ended plan at January 31, 2004.

### Guaranteed Beneficial Interests In the Company’s Subordinated Debentures

The Company entered into an agreement to redeem the \$331.6 million liquidation amount of Preferred Securities of Horatio Finance V.O.F., a wholly owned subsidiary of the Company, effective February 2, 2004. The Company redeemed the \$331.6 million Preferred Securities on February 2, 2004 as planned, with \$100 million borrowed under its amended revolving credit agreement and the balance borrowed under the Company’s accounts receivable securitization conduit facilities. Short-term borrowings under both the credit facility and accounts receivable securitization conduit



facilities were \$376.5 million at February 2, 2004. Subsequently, the Company has paid down substantially all of these borrowings from cash from operations during the first quarter of fiscal 2004.

#### Fiscal 2004

During fiscal 2004, the Company expects to finance its capital expenditures and its working capital requirements including required debt repayments and stock repurchases, if any, from cash flows generated from operations. As part of its overall funding strategy and for peak working capital requirements, the Company expects to obtain funds through its credit card receivable financing facilities and its revolving credit agreement. The Company's available receivable financing facilities provide for borrowings of up to \$400 million and mature on September 30, 2004. The Company intends to renew maturing receivable financing facilities as they become due. The peak borrowings incurred under the facilities were \$381.5 million during 2003. The Company expects peak funding requirements of approximately \$600 million during fiscal 2004. This peak demand will be met through a combination of accounts receivable financing and the \$1 billion credit agreement. At January 31, 2004, letters of credit totaling \$75.5 million were issued under this line of credit facility. Other than peak working capital requirements, management believes that cash generated from operations will be sufficient to cover its reasonably foreseeable working capital, capital expenditure, debt service requirements and stock repurchase. Depending on conditions in the capital markets and other factors, the Company will from time to time consider the issuance of debt or other securities, or other possible capital market transactions, the proceeds of which could be used to refinance current indebtedness or other corporate purposes.

#### Contractual Obligations and Commercial Commitments

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

(in thousands of dollars)	Total	<u>PAYMENTS DUE BY PERIOD</u>			
		Within 1 year	2-3 years	4-5 years	After 5 years
Contractual obligations					
Long-term debt	\$1,621,106	\$166,041	\$190,116	\$401,341	\$863,608
Guaranteed beneficial interests in the Company's subordinated debentures	531,579	331,579	-	-	200,000
Receivable financing facility	400,000	-	400,000	-	-
Short-term receivable financing facility	50,000	50,000	-	-	-
Capital lease obligations	19,837	2,126	3,849	2,370	11,492
Operating leases	266,073	51,309	80,535	53,339	80,890
Total contractual cash obligations	\$2,888,595	\$601,055	\$674,500	\$457,050	\$1,155,990

(in thousands of dollars)	<u>AMOUNT OF COMMITMENT EXPIRATION PER PERIOD</u>				
	Total	Within 1 year	2-3 years	4-5 years	After 5 years
	Amounts Committed				
Other commercial commitments					
\$760 million line of credit, none outstanding (1)	\$-	\$-	\$-	\$-	\$-
\$450 million receivables financing facility, none outstanding	-	-	-	-	-
Standby letters of credit	59,325	59,325	-	-	-
Import letters of credit	16,153	16,153	-	-	-
Total commercial commitments	\$75,478	\$75,478	\$-	\$-	\$-

(1) Available amount of \$835 million has been reduced by outstanding letters of credit of \$75 million.

Other long-term commitments consist of liabilities incurred relating to the Company's defined benefit plans. The Company expects pension expense to be approximately \$8.5 million in fiscal 2004 with a liability of \$83 million. The Company expects to make a contribution to the pension plan of approximately \$3.4 million in fiscal 2004.

## **New Accounting Pronouncements**

In April 2002, SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS No. 145") was issued. SFAS No. 145 rescinds SFAS No. 4 and 64, which required gains and losses from extinguishments of debt to be classified as extraordinary items. SFAS No. 145 also amends SFAS No. 13, eliminating inconsistencies in certain sale-leaseback transactions. The Company adopted the provisions of SFAS No. 145 as of February 2, 2003. For the year ended February 1, 2003, as a result of adopting SFAS No. 145, the Company has reclassified \$6.8 million (\$4.4 million after tax) to interest and debt expense from extraordinary loss and for the year ended February 2, 2002, the Company has reclassified \$9.4 million (\$6.0 million after-tax), respectively, to interest and debt expense from extraordinary gain.

In December 2003, the FASB issued SFAS No. 132 (Revised) ("SFAS No. 132-R"), Employer's Disclosure about Pensions and Other Postretirement Benefits. SFAS No. 132-R retains disclosure requirements of the original SFAS No. 132 and requires additional disclosures relating to assets, obligations, cash flows, and net periodic benefit cost. SFAS No. 132-R is effective for fiscal years ending after December 15, 2003, except that certain disclosures are effective for fiscal years ending after June 15, 2004. Interim period disclosures are effective for interim periods beginning after December 15, 2003. The adoption of the disclosure provisions of SFAS No. 132-R did not have a material effect on the Company's financial position or results of operations.

In March 2003, the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force ("EITF") issued final transition guidance regarding accounting for vendor allowances in its Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Cash Consideration Received from a Vendor". EITF Issue No. 02-16 addresses the accounting treatment for vendor allowances and stipulates that cash consideration received from a vendor should be presumed to be a reduction of the prices of the vendors' product and should therefore be shown as a reduction in the purchase price of the merchandise. Further, these allowances should be recognized as a reduction in cost of sales when the related product is sold. To the extent that the cash consideration represents a reimbursement of a specific, incremental and identifiable cost, then those vendor allowances should offset such costs. The Company receives concessions from its vendors through a variety of programs and arrangements, including co-operative advertising and markdown reimbursement programs. Co-operative advertising allowances are reported as a reduction of advertising expense in the period in which the advertising occurred. All other vendor allowances are recognized as a reduction of cost purchases. Accordingly, a reduction or increase in vendor concessions has an inverse impact on cost of sales and/or selling and administrative expenses. Payroll reimbursements are reported as a reduction of payroll expense in the period in which the reimbursement occurred.

The adoption of EITF Issue No. 02-16 in 2003 did not have a material impact on the Company's financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS No. 150"). This statement establishes standards for how a company classifies and measures certain financial instruments with characteristics of both liabilities and equity. The FASB Staff Position defers the effective date of SFAS No. 150 for certain mandatorily redeemable noncontrolling interests. We do not expect SFAS No. 150 to have a material impact on the Company's financial position or results of operations.

FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of APB No. 50" ("FIN 46"), was issued in January 2003, as amended by FIN 46-R. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The Company does not currently participate in any variable interest entities.

## **Forward-Looking Information**

The foregoing contains certain "forward-looking statements" within the definition of federal securities laws. Statements in the Management's Discussion and Analysis of Financial Condition and Results of Operations include certain "forward-looking statements," including (without limitation) statements with respect to anticipated future operating and financial performance, growth and acquisition opportunities, financing requirements and other similar forecasts and statements of expectation. Words such as "expects," "anticipates," "plans" and "believes," and variations of these words and similar expressions, are intended to identify these forward-looking statements. Statements made regarding the Company's merchandise strategies, funding of cyclical working capital needs, store opening schedule and estimates of depreciation and amortization, rental expense, interest and debt expense and capital expenditures for fiscal year 2004 are

forward-looking statements. The Company cautions that forward-looking statements, as such term is defined in the Private Securities Litigation Reform Act of 1995, contained in this report are based on estimates, projections, beliefs and assumptions of management at the time of such statements and are not guarantees of future performance. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise. Forward-looking statements of the Company involve risks and uncertainties and are subject to change based on various important factors. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties and assumptions. Representative examples of those factors (without limitation) include general retail industry conditions and macro-economic conditions; economic and weather conditions for regions in which the Company's stores are located and the effect of these factors on the buying patterns of the Company's customers; the impact of competitive pressures in the department store industry and other retail channels including specialty, off-price, discount, internet, and mail-order retailers; trends in personal bankruptcies and charge-off trends in the credit card receivables portfolio; changes in consumer spending patterns and debt levels; adequate and stable availability of materials and production facilities from which the Company sources its merchandise; changes in operating expenses, including employee wages, commission structures and related benefits; possible future acquisitions of store properties from other department store operators and the continued availability of financing in amounts and at the terms necessary to support the Company's future business; fluctuations in LIBOR and other base borrowing rates; potential disruption from terrorist activity and the effect on ongoing consumer confidence; potential disruption of international trade and supply chain efficiencies; world conflict and the possible impact on consumer spending patterns and other economic and demographic changes of similar or dissimilar nature.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The table below provides information about the Company's obligations that are sensitive to changes in interest rates. The table presents maturities of the Company's long-term debt and Guaranteed Beneficial Interests in the Company's Subordinated Debentures along with the related weighted-average interest rates by expected maturity dates.

(in thousands of dollars)

Expected Maturity Date (fiscal year)	2004	2005	2006	2007	2008	Thereafter	Total	Fair Value
Long-term debt (including receivables financing facilities)	\$166,041	\$291,633	\$298,483	\$200,640	\$200,701	\$863,608	\$2,021,106	\$2,059,118
Average interest rate	6.5%	3.1%	5.0%	6.9%	6.5%	7.5%	6.3%	
Guaranteed Beneficial Interests in the Company's Subordinated Debentures	\$331,579	\$-	\$-	\$-	\$-	\$200,000	\$ 531,579	\$ 525,579
Average interest rate	2.7%	-%	-%	-%	-%	7.5%	4.5%	

During the year ended January 31, 2004, the Company repurchased \$6.0 million of its outstanding unsecured notes prior to their related maturity dates. During the year ended January 31, 2004, the Company also retired \$125.9 million of its 6.39% Reset Put Securities ("REPS") due August 1, 2013 prior to their maturity dates. Interest rates on the repurchased securities ranged from 6.39% to 6.88%. Maturity dates ranged from 2004 to 2013.

The Company is exposed to market risk from changes in the interest rates on certain receivable financing facilities and \$331.6 million of the Guaranteed Beneficial Interests in the Company's Subordinated Debentures. Outstanding balances under these facilities bear interest at a variable rate based on a spread over LIBOR. Based on the amount outstanding as of January 31, 2004, a 100 basis point change in interest rates would result in an approximate \$5.8 million annual change to interest expense.

In fiscal 2003, the Company announced its intention to redeem its \$331.6 million Preferred Securities included in Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures anticipating that such redemption would occur on February 2, 2004. Accordingly, \$331.6 million of Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures is included in current liabilities on the Company's consolidated balance sheet at January 31, 2004. The Company redeemed the \$331.6 million Preferred Securities on February 2, 2004 as planned.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

The consolidated financial statements of the Company and notes thereto are included in this report beginning on page F-1.

## **ITEM 9. CHANGES IN AND DISGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

## **ITEM 9A. CONTROLS AND PROCEDURES.**

The Company maintains “disclosure controls and procedures,” as such term is defined in Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that are designed to ensure that information required to be disclosed in the Company’s reports, pursuant to the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding the required disclosures. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well-designed and operated, can provide only reasonable assurances of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

The Company’s management, including William Dillard, II, Chairman of the Board of Directors and Chief Executive Officer (principal executive officer), and James I. Freeman, Senior Vice-President and Chief Financial Officer (principal financial officer), have evaluated the effectiveness of the Company’s “disclosure controls and procedures,” as of January 31, 2004. Based on their evaluation, the principal executive officer and principal financial officer concluded that the Company’s disclosure controls and procedures are effective to ensure that the material information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported with the time periods specified in the rules and forms of the SEC. There were no changes in the Company’s internal controls over financial reporting during the period covered by this report that have materially affected or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

## **PART III**

## **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.**

### **A. Directors of the Registrant**

Information regarding directors of the Registrant is incorporated herein by reference under the heading “Nominees for Election as Directors” and under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement.

### **B. Executive Officers of the Registrant**

Information regarding executive officers of the Registrant is incorporated herein by reference to Item 1 of this report under the heading “Executive Officers of the Registrant.” Reference additionally is made to the information under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement, which information is incorporated herein by reference.

The Company’s Board of Directors has adopted a Company Code of Conduct that applies to all Company employees including the Company’s Directors, CEO and senior financial officers. The current version of such Code of Conduct is available free of charge on Dillard’s, Inc. Web site, [www.dillards.com](http://www.dillards.com), and are available in print to any shareholder who requests copies by contacting Julie J. Bull, Director of Investor Relations, at the Company’s principal executive offices set forth above.

## **ITEM 11. EXECUTIVE COMPENSATION.**

Information regarding executive compensation and compensation of directors is incorporated herein by reference to the information beginning under the heading "Compensation of Directors and Executive Officers" and concluding under the heading "Compensation of Directors" in the Proxy Statement.

## **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference to the information under the heading "Principal Holders of Voting Securities" and under the heading "Nominees for Election as Directors" and continuing through footnote 12 in the Proxy Statement.

## **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.**

Information regarding certain relationships and related transactions is incorporated herein by reference to the information under the heading "Certain Relationships and Transactions" in the Proxy Statement.

## **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

Information regarding principal accountant fees and services is incorporated herein by reference to the information on under the heading "Independent Accountant Fees" in the Proxy Statement.

## **PART IV**

## **ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.**

### **(a)(1) and (2) Financial Statements and Financial Statement Schedules**

An "Index to Financial Statements" and "Financial Statement Schedules" has been filed as a part of this Report beginning on page F-1 hereof.

### **(a)(3) Exhibits and Management Compensatory Plans**

An "Exhibit Index" has been filed as a part of this Report beginning on page E-1 hereof and is herein incorporated by reference.

### **(b) Reports on Form 8-K filed during the fourth quarter**

A current report on Form 8-K dated November 20, 2003 was filed with the Securities and Exchange Commission on November 21, 2003 to report, under Item 5, that the registrant issued its third quarter earnings release (attached as Exhibit 99 thereto).

## **SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dillard's, Inc.  
Registrant

Date: April 8, 2004

/s/ James I. Freeman  
James I. Freeman, Senior Vice President and  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacity and on the date indicated.

/s/ Robert C. Connor  
Robert C. Connor  
Director

/s/ Drue Corbusier  
Drue Corbusier  
Executive Vice President and Director

/s/ Will D. Davis  
Will D. Davis  
Director

/s/ William Dillard, II  
William Dillard, II  
Chairman of the Board and  
Chief Executive Officer  
(Principal Executive Officer)

/s/ Alex Dillard  
Alex Dillard  
President and Director

/s/ Mike Dillard  
Mike Dillard  
Executive Vice President  
and Director

/s/ James I. Freeman  
James I. Freeman  
Senior Vice President and Chief  
Financial Officer and Director

/s/ John Paul Hammerschmidt  
John Paul Hammerschmidt  
Director

/s/ Bob L. Martin  
Bob L. Martin  
Director

/s/ Warren A. Stephens  
Warren A. Stephens  
Director

/s/ William H. Sutton  
William H. Sutton  
Director

/s/ J.C. Watts, Jr.  
J.C. Watts, Jr.  
Director

Date: April 8, 2004

## CERTIFICATIONS

I, William Dillard, II, certify that:

1. I have reviewed this annual report on Form 10-K of Dillard's, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report based on such evaluation; and
  - (c) disclosed in this annual report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 8, 2004

/s/ William Dillard, II  
William Dillard, II  
Chairman of the Board and Chief Executive Officer

I, James I. Freeman, certify that:

1. I have reviewed this annual report on Form 10-K of Dillard's, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report based on such evaluation; and
  - (c) disclosed in this annual report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 8, 2004

/s/ James I. Freeman  
James I. Freeman  
Senior Vice-President and Chief Financial Officer



**INDEX OF FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES**  
**DILLARD'S, INC. AND SUBSIDIARIES**  
**Year Ended January 31, 2004**

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# Independent Auditors' Report

Independent Auditors' Report  
To the Stockholders and Board of Directors of Dillard's, Inc.  
Little Rock, Arkansas

We have audited the accompanying consolidated balance sheets of Dillard's, Inc. and subsidiaries as of January 31, 2004 and February 1, 2003, and the related consolidated statements of operations, stockholders' equity and comprehensive loss and cash flows for each of the three fiscal years in the period ended January 31, 2004. Our audits also included the financial statement schedule of Dillard's, Inc. and subsidiaries, listed in item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of Dillard's, Inc. and subsidiaries as of January 31, 2004 and February 1, 2003, and the results of their operations and their cash flows for each of the three fiscal years in the period ended January 31, 2004 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Notes 1 and 2 to the consolidated financial statements, the Company changed its method of accounting for goodwill and other intangible assets in 2002 to conform to Statement of Financial Standards No. 142.

Deloitte & Touche LLP

Dallas, Texas  
April 8, 2004

Consolidated Balance Sheets  
Dollars in Thousands

Assets	January 31, 2004	February 1, 2003
<b>Current Assets:</b>		
Cash and cash equivalents	\$160,873	\$142,356
Accounts receivable (net of allowance for doubtful accounts of \$40,967 and \$49,755)	1,191,489	1,338,080
Merchandise inventories	1,632,377	1,594,308
Other current assets	38,952	55,507
<b>Total current assets</b>	<b>3,023,691</b>	<b>3,130,251</b>
<b>Property and Equipment:</b>		
Land and land improvements	100,726	104,848
Buildings and leasehold improvements	2,685,628	2,748,225
Furniture, fixtures and equipment	2,192,029	2,202,811
Buildings under construction	40,636	28,602
Buildings under capital leases	51,493	50,123
Less accumulated depreciation and amortization	(1,873,043)	(1,764,107)
	<b>3,197,469</b>	<b>3,370,502</b>
Goodwill	36,731	39,214
Other Assets	153,206	135,965
<b>Total Assets</b>	<b>\$6,411,097</b>	<b>\$6,675,932</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities:</b>		
Trade accounts payable and accrued expenses	\$679,854	\$675,962
Other short-term borrowings	50,000	-
Current portion of long-term debt	166,041	138,814
Current portion of Guaranteed Beneficial Interest In the Company's Subordinated Debentures	331,579	-
Current portion of capital lease obligations	2,126	1,856
Federal and state income taxes	106,487	69,829
<b>Total current liabilities</b>	<b>1,336,087</b>	<b>886,461</b>
Long-term Debt	1,855,065	2,193,006
Capital Lease Obligations	17,711	18,600
Other Liabilities	147,901	137,070
Deferred Income Taxes	617,236	645,020
<b>Operating Leases and Commitments</b>		
<b>Guaranteed Preferred Beneficial Interests in the</b>		
Company's Subordinated Debentures	200,000	531,579
<b>Stockholders' Equity:</b>		
Common stock, Class A – 112,866,918 and 112,677,505 shares issued; 79,480,069 and 80,746,732 shares outstanding	1,129	1,127
Common stock, Class B (convertible) — 4,010,929 shares issued and outstanding	40	40
Additional paid-in capital	713,974	711,324
Accumulated other comprehensive loss	(11,281)	(4,496)
Retained earnings	2,201,623	2,205,674
Less treasury stock, at cost, Class A — 33,386,849 and 31,930,773 shares	(668,388)	(649,473)
<b>Total stockholders' equity</b>	<b>2,237,097</b>	<b>2,264,196</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$6,411,097</b>	<b>\$6,675,932</b>

See notes to consolidated financial statements.

Consolidated Statements of Operations  
Dollars in Thousands, Except Per Share Data

	Years Ended		
	January 31, 2004	February 1, 2003	February 2, 2002
Net Sales	\$7,598,934	\$7,910,996	\$8,154,911
Service Charges, Interest and Other Income	264,734	322,943	244,776
	7,863,668	8,233,939	8,399,687
Costs and Expenses:			
Cost of sales	5,170,173	5,254,134	5,507,702
Advertising, selling, administrative and general expenses	2,097,947	2,164,033	2,191,389
Depreciation and amortization	290,661	301,407	310,754
Rentals	64,101	68,101	72,783
Interest and debt expense	181,065	189,779	192,344
Asset impairment and store closing charges	43,727	52,224	3,752
Total costs and expenses	7,847,674	8,029,678	8,278,724
Income Before Income Taxes	15,994	204,261	120,963
Income Taxes	6,650	72,335	49,165
Income before cumulative effect of accounting change	9,344	131,926	71,798
Cumulative effect of accounting change, net of tax benefit of \$0	—	(530,331)	—
Net Income (Loss)	\$9,344	\$(398,405)	\$71,798
Basic Earnings Per Common Share:			
Income before cumulative effect of accounting change	\$0.11	\$ 1.56	\$0.85
Cumulative effect of accounting change	—	(6.27)	—
Net Income (Loss)	\$0.11	\$(4.71)	\$0.85
Diluted Earnings Per Common Share:			
Income before cumulative effect of accounting change	\$0.11	\$ 1.55	\$0.85
Cumulative effect of accounting change	—	(6.22)	—
Net Income (Loss)	\$0.11	\$(4.67)	\$0.85

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity and Comprehensive Loss  
Dollars in Thousands, Except Per Share Data

	Common Stock Class A	Common Stock Class B	Additional Paid-in Capital	Accumulated Other Comprehen- sive Loss	Retained Earnings	Treasury Stock	Total
Balance, February 3, 2001	\$ 1,116	\$40	\$696,879	\$ —	\$2,558,933	\$(627,148)	\$2,629,820
Net income	—	—	—	—	71,798	—	71,798
Issuance of 221,635 shares under stock option, employee savings and stock bonus plans	2	—	2,225	—	—	—	2,227
Purchase of 1,333,959 shares of treasury stock	—	—	—	—	—	(22,325)	(22,325)
Cash dividends declared: Common stock, \$.16 per share	—	—	—	—	(13,123)	—	(13,123)
Balance, February 2, 2002	1,118	40	699,104	—	2,617,608	(649,473)	2,668,397
Net loss	—	—	—	—	(398,405)	—	(398,405)
Minimum pension liability adjustment, net	—	—	—	(4,496)	—	—	(4,496)
Total comprehensive loss	—	—	—	—	—	—	(402,901)
Issuance of 869,985 shares under stock option, employee savings and stock bonus plans	9	—	12,220	—	—	—	12,229
Cash dividends declared: Common stock, \$.16 per share	—	—	—	—	(13,529)	—	(13,529)
Balance, February 1, 2003	1,127	40	711,324	(4,496)	2,205,674	(649,473)	2,264,196
Net income	—	—	—	—	9,344	—	9,344
Minimum pension liability adjustment, net	—	—	—	(6,785)	—	—	(6,785)
Total comprehensive income	—	—	—	—	—	—	2,559
Issuance of 189,413 shares under stock option, employee savings and stock bonus plans	2	—	2,650	—	—	—	2,652
Purchase of 1,456,076 shares of treasury stock	—	—	—	—	—	(18,915)	(18,915)
Cash dividends declared: Common stock, \$.16 per share	—	—	—	—	(13,395)	—	(13,395)
Balance, January 31, 2004	\$1,129	\$40	\$713,974	\$(11,281)	\$2,201,623	\$(668,388)	\$2,237,097

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows  
Dollars in Thousands

	Years Ended		
	January 31, 2004	February 1, 2003	February 2, 2002
<b>Operating Activities:</b>			
Net income (loss)	\$9,344	\$(398,405)	\$71,798
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	297,201	305,545	313,711
Deferred income taxes	13,623	24,878	2,043
Loss (gain) on early extinguishments of debt	-	6,834	(9,394)
Impairment charges	43,727	52,224	3,752
Gain on sale of joint venture	(15,624)	(64,295)	—
Gain on sale of property and equipment	(8,699)	(1,103)	(2,060)
Provision for loan losses	35,244	36,574	21,286
Cumulative effect of accounting change, net of taxes	—	530,331	—
Changes in operating assets and liabilities:			
Decrease (increase) in accounts receivable	110,936	286	(116,985)
(Increase) decrease in merchandise inventories	(38,069)	(32,445)	54,323
Decrease (increase) in other current assets	16,121	(30,760)	28,794
(Increase) decrease in other assets	(37,048)	31,559	53,504
(Decrease) increase in trade accounts payable and accrued expenses, other liabilities and income taxes	5,350	(104,281)	196,209
<b>Net cash provided by operating activities</b>	<b>432,106</b>	<b>356,942</b>	<b>616,981</b>
<b>Investing Activities:</b>			
Purchase of property and equipment	(227,421)	(233,268)	(270,595)
Proceeds from sale of property and equipment	31,766	—	—
Proceeds from sale of joint venture	34,579	68,295	—
<b>Net cash used in investing activities</b>	<b>(161,076)</b>	<b>(164,973)</b>	<b>(270,595)</b>
<b>Financing Activities:</b>			
Principal payments on long-term debt and capital lease obligations	(272,702)	(340,081)	(402,941)
Increase in short-term borrowings and capital lease obligations	51,369	—	—
Cash dividends paid	(13,395)	(13,529)	(13,123)
Proceeds from issuance of common stock	1,130	11,037	983
Purchase of treasury stock	(18,915)	—	(22,325)
Proceeds from receivable financing, net	—	100,000	—
Proceeds from long-term borrowings	—	40,000	50,000
<b>Net cash used in financing activities</b>	<b>(252,513)</b>	<b>(202,573)</b>	<b>(387,406)</b>
Increase (decrease) in Cash and Cash Equivalents	18,517	(10,604)	(41,020)
Cash and Cash Equivalents, Beginning of Year	142,356	152,960	193,980
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$160,873</b>	<b>\$142,356</b>	<b>\$152,960</b>

See notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

### 1. Description of Business and Summary of Significant Accounting Policies

**Description of Business** – Dillard’s, Inc. (the “Company”) operates retail department stores located primarily in the Southeastern, Southwestern and Midwestern areas of the United States. The Company’s fiscal year ends on the Saturday nearest January 31 of each year. Fiscal years 2003, 2002 and 2001 ended on January 31, 2004, February 1, 2003 and February 2, 2002, respectively. Fiscal years 2003, 2002 and 2001 included 52 weeks.

**Consolidation** – The accompanying consolidated financial statements include the accounts of Dillard’s, Inc. and its wholly owned subsidiaries. Intercompany accounts and transactions are eliminated in consolidation. Investments in and advances to joint ventures in which the Company has a 50% ownership interest are accounted for by the equity method.

**Use of Estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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. Significant estimates include inventories, sales return, allowance for doubtful accounts, self-insured accruals and lives of long-lived assets. Actual results could differ from those estimates.

**Cash Equivalents** – The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

**Accounts Receivable** – Customer accounts receivable are classified as current assets and include some which are due after one year, consistent with industry practice. Credit card receivables are shown net of an allowance for uncollectible accounts. The Company calculates the allowance for uncollectible accounts using a model that analyzes factors such as bankruptcy filings, delinquency rates, historical charge-off patterns, recovery rates and other portfolio data. The calculation is then reviewed by management to assess whether, based on recent economic events, additional analyses are required to appropriately estimate losses inherent in the portfolio. The Company’s current credit processing system charges off an account automatically when a customer has failed to make a required payment in each of the six billing cycles following a missed payment. The Company also provides for the estimated uncollectible portion of the finance charge revenue based upon our historical collection experience as part of the allowance for doubtful accounts. This allowance represents amounts of credit card receivable balances (including billed but uncollected finance charges) which management estimates will ultimately not be collected. Finance charge revenue is recorded until an account is charged off, at which time uncollected finance charge revenue is recorded as a reduction of credit revenues.

The Company utilizes credit card securitizations as part of its overall funding strategy. The transfers were subject to the grandfathering provisions of Statement of Financial Accounting Standards (“SFAS”) No. 140, “Accounting for Transfer and Servicing of Financial Assets and Liabilities” until May 2002 and thus continued to be accounted for under the previous accounting standards that existed under FAS 125. In May 2002, the Company amended its conduit financing agreement in a manner that prevented future transfers of accounts receivable to its master trust from qualifying as a sale and thus receiving off-balance-sheet treatment. As a result of this decision, the Company does not have any off-balance-sheet financing as it relates to new transfers to the Trust. All financing through this facility is recorded on the balance sheet. (see Note 15).

**Significant Group Concentrations of Credit Risk** – The Company grants credit to customers throughout North America. There were no Metropolitan Statistical Areas that comprised 10% of the Company’s managed credit card receivables at January 31, 2004 and February 1, 2003.

**Merchandise Inventories** – The retail last-in, first-out (“LIFO”) inventory method is used to value merchandise inventories. At January 31, 2004 and February 1, 2003, the LIFO cost of merchandise was approximately equal to the first-in, first-out (“FIFO”) cost of merchandise.

**Property and Equipment** – Property and equipment owned by the Company is stated at cost, which includes related interest costs incurred during periods of construction, less accumulated depreciation and amortization. Capitalized interest was \$2.6 million, \$2.5 million and \$5.4 million in fiscal 2003, 2002 and 2001, respectively. For tax reporting purposes, accelerated depreciation or cost recovery methods are used and the related deferred income taxes are included in noncurrent deferred income taxes in the Consolidated Balance Sheets. For financial reporting purposes, depreciation is computed by the straight-line method over estimated useful lives:

Buildings and leasehold improvements	20 - 40 years
Furniture, fixtures and equipment	3 - 10 years

Properties leased by the Company under lease agreements which are determined to be capital leases are stated at an amount equal to the present value of the minimum lease payments during the lease term, less accumulated amortization. The properties under capital leases and leasehold improvements under operating leases are amortized on the straight-line method over the shorter of their useful lives or the related lease terms. The provision for amortization of leased properties is included in depreciation and amortization expense.

Included in property and equipment as of January 31, 2004 are assets held for sale in the amount of \$31.9 million. During fiscal 2003, 2002 and 2001, the Company realized gains on the sale of property and equipment of \$8.7 million, \$1.1 million and \$2.1 million, respectively.

Depreciation expense on property and equipment was \$291 million, \$301 million and \$295 million for fiscal 2003, 2002 and 2001, respectively.

**Long-Lived Assets Excluding Goodwill** – The Company follows 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 when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets’ carrying amount. In the evaluation of the fair value and future benefits of long-lived assets, the Company performs an analysis of the anticipated undiscounted future net cash flows of the related long-lived assets. This analysis is performed at the store unit level. If the carrying value of the related asset exceeds the undiscounted cash flows, the carrying value is reduced to its fair value. Various factors including future sales growth and profit margins are included in this analysis. Management believes at this time that the carrying value and useful lives continue to be appropriate, after recognizing the impairment charge recorded in 2003 and 2002, as disclosed in Note 13.

**Goodwill** – The Company adopted SFAS No. 142, “Goodwill and Other Intangible Assets,” effective February 3, 2002. It changes the accounting for goodwill from an amortization method to an “impairment only” approach. Under SFAS No. 142, goodwill is no longer amortized but reviewed for impairment annually or more frequently if certain indicators arise. The Company tested goodwill for impairment as of the adoption date using the two-step process prescribed in SFAS No. 142. The Company identified its reporting units under SFAS No. 142 at the store unit level. The fair value of these reporting units was estimated using the expected discounted future cash flows and market values of related businesses, where appropriate. Prior to the adoption of SFAS No. 142, goodwill, which represents the cost in excess of fair value of net assets acquired, was amortized on the straight-line basis over 40 years. Accumulated goodwill amortization was \$55.6 million at February 2, 2002. Management believes at this time that the carrying value continues to be appropriate, recognizing the impairment charge recorded in fiscal 2003 and 2002, as disclosed in Note 2.

**Other Assets** – Other assets include investments in joint ventures accounted for by the equity method. These joint ventures, which consist of malls and a general contracting company that constructs Dillard’s stores and other commercial buildings, had carrying values of \$97 million and \$97 million at January 31, 2004 and February 1, 2003, respectively. The malls are located in Crestview Hills, Kentucky; Toledo, Ohio; Denver, Colorado and two currently under construction in Bonita Springs, Florida and Yuma, Arizona. Earnings from joint ventures were \$8.1 million, \$19.5 million and \$11.6 million for fiscal 2003, 2002 and 2001, respectively. The Company also recorded a \$15.6 million pretax gain for the year ended January 31, 2004 from the sale of its interest in Sunrise Mall and its associated center in Brownsville, Texas for \$80.7 million including the assumption of the \$40.0 million mortgage note. The Company recorded a pretax gain of \$64.3 million pertaining to the Company’s sale of its interest in FlatIron Crossing, a Broomfield, Colorado shopping center, for the year ended February 1, 2003. The gains on the sale were recorded in Service Charges, Interest and Other Income.

**Vendor Allowances** – The Company receives concessions from its vendors through a variety of programs and arrangements, including co-operative advertising and markdown reimbursement programs. Co-operative advertising allowances are reported as a reduction of advertising expense in the period in which the advertising occurred. Payroll reimbursements are reported as a reduction of payroll expense in the period in which the reimbursement occurred. All other vendor allowances are recognized as a reduction of cost purchases. Accordingly, a reduction or increase in vendor concessions has an inverse impact on cost of sales and/or selling and administrative expenses.



**Insurance accruals.** The Company's consolidated balance sheets include liabilities with respect to self-insured workers' compensation and general liability claims. The Company estimates the required liability of such claims on a discounted basis, utilizing an actuarial method, based upon various assumptions, which include, but are not limited to, our historical loss experience, projected loss development factors, actual payroll and other data. The required liability is also subject to adjustment in the future based upon the changes in claims experience, including changes in the number of incidents (frequency) and changes in the ultimate cost per incident (severity).

**Revenue Recognition** – The Company recognizes revenue at the “point of sale.” Finance charge revenue earned on customer accounts, serviced by the Company under its proprietary credit card program, is recognized in the period in which it is earned. Allowance for sales returns are recorded as a component of net sales in the period in which the related sales are recorded.

**Advertising** – Advertising and promotional costs, which include newspaper, television, radio and other media advertising, are expensed as incurred and were \$245 million, \$253 million and \$245 million for fiscal years 2003, 2002 and 2001, respectively.

**Income Taxes** – In accordance with SFAS No. 109, “Accounting for Income Taxes,” deferred income taxes reflect the future tax consequences of differences between the tax bases of assets and liabilities and their financial reporting amounts at year-end.

**Shipping and Handling** – In accordance with Emerging Issues Task Force (“EITF”) 00-10, “Accounting for Shipping and Handling Fees and Costs,” the Company records shipping and handling reimbursements in Other Income. The Company records shipping and handling costs in Advertising, Selling, Administrative and General Expenses.

**Comprehensive Income** – Comprehensive income is equivalent to the Company's net income for fiscal year 2001.

**Stock-Based Compensation** – The Company periodically grants stock options to employees. Pursuant to Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” the Company accounts for stock-based employee compensation arrangements using the intrinsic value method. No compensation expense has been recorded in the Consolidated Financial Statements with respect to option grants. The Company has adopted the disclosure only provisions of Financial Accounting Standards Board Statement No. 123, “Accounting for Stock Based Compensation,” as amended by Financial Accounting Standards Board Statement No. 148, “Accounting for Stock Based Compensation – Transition and Disclosure, an Amendment of FASB Statement No. 123”. See Note 11 to the Company's Consolidated Financial Statements. If compensation cost for the Company's stock option plans had been determined in accordance with the fair value method prescribed by SFAS No. 123, the Company's income before extraordinary item and accounting change would have been:

(in thousands of dollars, except per share data)	Fiscal 2003	Fiscal 2002	Fiscal 2001
Income before cumulative effect of accounting change			
As reported	\$9,344	\$131,926	\$71,798
Deduct: Total stock based employee compensation expense determined under fair value based method, net of taxes	(2,732)	(9,261)	(5,667)
Pro forma	\$6,612	\$122,665	\$66,131
Basic earnings per share:			
As reported	\$0.11	\$1.56	\$0.85
Pro forma	0.08	1.45	0.78
Diluted earnings per share:			
As reported	\$0.11	\$1.55	\$0.85
Pro forma	0.08	1.44	0.79

**Segment Reporting** – The Company operates in a single operating segment — the operation of retail department stores. Revenues from external customers are derived from merchandise sales and service charges and interest on the Company's proprietary credit card.

The Company does not rely on any major customers as a source of revenue.

## **New Accounting Pronouncements**

In April 2002, SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS No. 145") was issued. SFAS No. 145 rescinds SFAS No. 4 and 64, which required gains and losses from extinguishments of debt to be classified as extraordinary items. SFAS No. 145 also amends SFAS No. 13, eliminating inconsistencies in certain sale-leaseback transactions. The Company adopted the provisions of SFAS No. 145 as of February 2, 2003. For the year ended February 1, 2003, as a result of adopting SFAS No. 145, the Company has reclassified \$6.8 million (\$4.4 million after tax) to interest and debt expense from extraordinary loss and for the year ended February 2, 2002, the Company has reclassified \$9.4 million (\$6.0 million after-tax), respectively, to interest and debt expense from extraordinary gain.

In December 2003, the FASB issued SFAS No. 132 (Revised) ("SFAS No. 132-R"), "Employer's Disclosure about Pensions and Other Postretirement Benefits." SFAS No. 132-R retains disclosure requirements of the original SFAS No. 132 and requires additional disclosures relating to assets, obligations, cash flows, and net periodic benefit cost. SFAS No. 132-R is effective for fiscal years ending after December 15, 2003, except that certain disclosures are effective for fiscal years ending after June 15, 2004. Interim period disclosures are effective for interim periods beginning after December 15, 2003. The adoption of the disclosure provisions of SFAS No. 132-R did not have a material effect on the Company's financial position or results of operations.

In March 2003, the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force ("EITF") issued final transition guidance regarding accounting for vendor allowances in its Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Cash Consideration Received from a Vendor". EITF Issue No. 02-16 addresses the accounting treatment for vendor allowances and stipulates that cash consideration received from a vendor should be presumed to be a reduction of the prices of the vendors' product and should therefore be shown as a reduction in the purchase price of the merchandise. Further, these allowances should be recognized as a reduction in cost of sales when the related product is sold. To the extent that the cash consideration represents a reimbursement of a specific, incremental and identifiable cost, then those vendor allowances should offset such costs. The Company receives concessions from its vendors through a variety of programs and arrangements, including co-operative advertising and markdown reimbursement programs. Co-operative advertising allowances are reported as a reduction of advertising expense in the period in which the advertising occurred. All other vendor allowances are recognized as a reduction of cost purchases. Accordingly, a reduction or increase in vendor concessions has an inverse impact on cost of sales and/or selling and administrative expenses. Payroll reimbursements are reported as a reduction of payroll expense in the period in which the reimbursement occurred. The adoption of EITF Issue No. 02-16 in 2003 did not have a material impact on the Company's financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS No. 150"). This statement establishes standards for how a company classifies and measures certain financial instruments with characteristics of both liabilities and equity. The FASB Staff Position defers the effective date of Statement No. 150 for certain mandatorily redeemable noncontrolling interests. We do not expect SFAS 150 to have a material impact on the Company's financial position or results of operations.

FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of APB No. 50" ("FIN 46"), was issued in January 2003, as amended by FIN 46-R. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The Company does not currently participate in any variable interest entities.

**Reclassifications** – Certain reclassifications have been made to prior year financial statements to conform with fiscal 2003 presentations.

## **2. Goodwill**

The Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," effective February 3, 2002. It changes the accounting for goodwill from an amortization method to an "impairment only" approach. Under SFAS No. 142, goodwill is no longer amortized but reviewed for impairment annually or more frequently if certain indicators arise. The Company tested goodwill for impairment as of the adoption date using the two-step process prescribed in SFAS No. 142. The Company identified its reporting units under SFAS

No. 142 at the store unit level. The fair value of these reporting units was estimated using the expected discounted future cash flows and market values of related businesses, where appropriate.

Related to the 1998 acquisition of Mercantile Stores Company Inc., the Company had \$570 million in goodwill recorded in its consolidated balance sheet at the beginning of 2002. The Company completed the required impairment tests of goodwill in the second quarter of 2002 and determined that \$530 million of goodwill was impaired under the fair value test. This impairment was the result of sequential periods of declining profits in certain of these reporting units. In accordance with SFAS No. 142, the impairment loss for goodwill was reflected as a cumulative effect of a change in accounting principle in the first quarter of 2002.

The changes in the carrying amount of goodwill for the years ended January 31, 2004 and February 1, 2003 are as follows (in thousands):

Goodwill balance at February 2, 2002	\$569,545
Cumulative effect of adopting SFAS No. 142	(530,331)
Goodwill balance at February 1, 2003	39,214
Goodwill written off in fiscal 2003	(2,483)
Goodwill balance at January 31, 2004	\$ 36,731

The following pro forma financial information is presented as if the statement was adopted at January 30, 2000 (in thousands, except per share amounts):

	Fiscal 2003	Fiscal 2002	Fiscal 2001
Reported net income (loss)	\$ 9,344	\$(398,405)	\$71,798
Cumulative effect of accounting change	-	530,331	-
Net income before the cumulative effect of accounting change	9,344	131,926	71,798
Add back:			
Goodwill amortization	-	-	15,604
Pro forma	\$ 9,344	\$ 131,926	\$87,402
Net income (loss) per share reported – basic	\$0.11	\$(4.71)	\$0.85
Cumulative effect of accounting change	-	6.27	-
Goodwill amortization	-	-	0.19
Pro forma net income per share – basic	\$0.11	\$ 1.56	\$1.04
Net income (loss) per share reported – diluted	\$0.11	\$(4.67)	\$0.85
Cumulative effect of accounting change	-	6.22	-
Goodwill amortization	-	-	0.18
Pro forma net income per share – diluted	\$0.11	\$ 1.55	\$1.03

### 3. Revolving Credit Agreement

At January 31, 2004, the Company maintained an \$835 million revolving credit facility with JPMorgan Chase Bank (“JPMorgan”) with an additional \$165 million becoming available immediately upon the Preferred Security redemption discussed in Note 7. Borrowings under the credit agreement accrue interest at JPMorgan’s Base Rate or LIBOR plus 1.50% (currently 2.60%) subject to certain availability thresholds as defined in the credit agreement. Availability for borrowings and letter of credit obligations under the credit agreement is limited to 75% of the inventory of certain Company subsidiaries (approximately \$1.2 billion at January 31, 2004). There are no financial covenant requirements under the credit agreement provided availability exceeds \$100 million. The credit agreement expires on December 12, 2008. The Company pays an annual commitment fee of 0.375% of the committed amount to the banks. There were no funds borrowed under the revolving credit facility during fiscal 2003.

#### 4. Long-term Debt

Long-term debt consists of the following:

(in thousands of dollars)	January 31, 2004	February 1, 2003
Unsecured notes at rates ranging from 6.30% to 9.50%, due 2003 through 2028	\$1,561,353	\$1,823,429
Receivable financing facilities at rates ranging from 1.4% to 3.8% due 2005 through 2006	400,000	400,000
Mortgage notes, payable monthly or quarterly (some with balloon payments) through 2013 and bearing interest at rates ranging from 7.25% to 13.25%	59,753	108,391
	2,021,106	2,331,820
Current portion	(166,041)	(138,814)
	\$1,855,065	\$2,193,006

Building, land, and land improvements with a carrying value of \$39.6 million at January 31, 2004 were pledged as collateral on the mortgage notes. Maturities of long-term debt over the next five years are \$166 million, \$292 million, \$298 million, \$201 million and \$201 million. Outstanding letters of credit aggregated \$75.5 million at January 31, 2004.

Interest and debt expense consists of the following:

(in thousands of dollars)	Fiscal 2003	Fiscal 2002	Fiscal 2001
Long-term debt:			
Interest	\$159,844	\$166,093	\$180,918
(Gain) loss on early retirement of long-term debt	-	6,839	(9,392)
Amortization of debt expense	6,985	4,088	4,204
	166,829	177,020	175,730
Interest on capital lease obligations	2,202	2,354	2,560
Interest on receivable financing	12,034	10,405	14,054
	\$181,065	\$189,779	\$192,344

Interest paid during fiscal 2003, 2002 and 2001 was approximately \$186.9 million, \$158.6 million and \$208.9 million, respectively. The interest paid during fiscal 2002 does not include a \$28.4 million interest payment made on February 3, 2003 that would have been due on the last day of the Company's fiscal year had the date fallen on a business day.

The Company has reclassified \$11.3 million in interest expense related to its receivable financing from other revenue to interest expense on its consolidated statements of operations for the fiscal year ended February 2, 2002.

The Company has reclassified \$6.8 million to interest and debt expense from extraordinary loss for the year ended February 1, 2003, and the Company has reclassified \$9.4 million to interest and debt expense from extraordinary gain for the year ended February 2, 2002.

## 5. Trade Accounts Payable and Accrued Expenses

Trade accounts payable and accrued expenses consist of the following:

(in thousands of dollars)	January 31, 2004	February 1, 2003
Trade accounts payable	\$457,485	\$431,752
Accrued expenses:		
Taxes, other than income	76,263	66,894
Salaries, wages, and employee benefits	44,661	53,560
Liability to customers	47,340	46,900
Interest	39,789	46,138
Rent	9,949	11,704
Other	4,367	19,014
	\$679,854	\$675,962

## 6. Income Taxes

The provision for federal and state income taxes is summarized as follows:

(in thousands of dollars)	Fiscal 2003	Fiscal 2002	Fiscal 2001
Current:			
Federal	\$(5,293)	\$45,428	\$45,107
State	(1,680)	2,029	2,015
	(6,973)	47,457	47,122
Deferred:			
Federal	12,046	23,570	1,692
State	1,577	1,308	351
	13,623	24,878	2,043
	\$6,650	\$72,335	\$49,165

A reconciliation between the Company's income tax provision and income taxes using the federal statutory income tax rate is presented below:

(in thousands of dollars)	Fiscal 2003	Fiscal 2002	Fiscal 2001
Income tax at the statutory federal rate	\$5,598	\$71,493	\$42,338
State income taxes, net of federal benefit	122	2,008	1,320
Nondeductible goodwill amortization and write off	869	-	5,461
Impact of reduced effective income tax rate on deferred taxes	-	-	-
Other	61	(1,166)	46
	\$6,650	\$72,335	\$49,165

At January 31, 2004, the Company incurred a net operating loss of approximately \$18.9 million. For federal income tax purposes, the loss will be carried back to the year ended February 1, 2003 to reduce the income tax liability for that year. For state income tax purposes, the loss will be carried back to the extent allowed by each states' law, otherwise the loss will be carried forward to reduce future years' state income tax liability. The Company also has a charitable contribution carryforward of approximately \$1.3 million that will expire on January 31, 2009. 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. The Company's actual federal and state income tax rate (exclusive of the effect of non-deductible goodwill amortization) was 36% in fiscal 2003, 2002 and 2001. Significant components of the Company's deferred tax assets and liabilities as of January 31, 2004 and February 1, 2003 are as follows:

(in thousands of dollars)	January 31, 2004	February 1, 2003
Property and equipment bases and depreciation differences	\$505,581	\$524,090
State income taxes	25,787	25,612
Joint venture basis differences	24,849	14,119
Differences between book and tax bases of inventory	49,095	36,872
Other	112,550	121,303
<b>Total deferred tax liabilities</b>	<b>717,862</b>	<b>721,996</b>
Accruals not currently deductible	(45,813)	(59,156)
State income taxes	(2,045)	(2,641)
<b>Total deferred tax assets</b>	<b>(47,858)</b>	<b>(61,797)</b>
<b>Net deferred tax liabilities</b>	<b>\$670,004</b>	<b>\$660,199</b>

Deferred tax assets and liabilities are presented as follows in the accompanying consolidated balance sheets:

(in thousands of dollars)	January 31, 2004	February 1, 2003
Net deferred tax liabilities-noncurrent	\$617,236	\$645,020
Net deferred tax liabilities-current	52,768	15,179
<b>Net deferred tax liabilities</b>	<b>\$670,004</b>	<b>\$660,199</b>

Income taxes paid during fiscal 2003, 2002 and 2001 were approximately \$0, \$0 and \$22.9 million, respectively.

#### **7. Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures**

Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures are comprised of \$200 million liquidation amount of 7.5% Capital Securities, due August 1, 2038 (the "Capital Securities") representing beneficial ownership interest in the assets of Dillard's Capital Trust I, a wholly owned subsidiary of the Company, and \$331.6 million liquidation amount of LIBOR plus 1.56% Preferred Securities, due January 29, 2009 (the "Preferred Securities") by Horatio Finance V.O.F., a wholly owned subsidiary of the Company.

Holders of the Capital Securities are entitled to receive cumulative cash distributions, payable quarterly, at the annual rate of 7.5% of the liquidation amount of \$25 per Capital Security. The subordinated debentures are the sole assets of the Trust, and the Capital Securities are subject to mandatory redemption upon repayment of the subordinated debentures. Holders of the Preferred Securities are entitled to receive quarterly dividends at LIBOR plus 1.56%. The Company's obligations under the debentures and related agreements, taken together, provide a full and unconditional guarantee of payments due on the Capital and Preferred Securities. The Company has entered into an agreement to redeem the \$331.6 million liquidation amount of Preferred Securities of Horatio Finance V.O.F., effective February 2, 2004. The Company redeemed the \$331.6 million Preferred Securities on February 2, 2004 as planned.

#### **8. Benefit Plans**

The Company has a retirement plan with a 401(k)-salary deferral feature for eligible employees. Under the terms of the plan, eligible employees may contribute up to 20% of eligible pay. Eligible employees with one year of service may elect to make a Basic Contribution of up to 5% of eligible pay which will be matched 100% only if invested in the Company's common stock. The Company contributions are used to purchase Class A Common Stock of the Company for the account of the employee. The terms of the plan provide a six-year graduated-vesting schedule for the Company contribution portion of the plan. The Company incurred expense of \$18 million, \$18 million and \$19 million for fiscal 2003, 2002 and 2001, respectively, for the plan.

The Company has a nonqualified defined benefit plan for certain officers. The plan is noncontributory and provides benefits based on years of service and compensation during employment. Pension expense is determined using various actuarial cost methods to estimate the total benefits ultimately payable to officers and allocates this cost to service periods. The pension plan is unfunded. The actuarial assumptions used to calculate pension costs are reviewed annually. The Company expects to make a contribution to the pension plan of approximately \$3.4 million in fiscal 2004.

The accumulated benefit obligations (“ABO”), change in projected benefit obligation (“PBO”), change in plan assets, funded status, and reconciliation to amounts recognized in the consolidated balance sheets are as follows:

(in thousands of dollars)	January 31, 2004	February 1, 2003
Change in projected benefit obligation:		
PBO at beginning of year	\$64,360	\$45,163
Service cost	993	1,416
Interest cost	4,235	3,592
Plan amendments	-	6,360
Actuarial loss (gain)	14,244	10,988
Benefits paid	(3,279)	(3,159)
PBO at end of year	\$80,553	\$64,360
ABO at end of year	\$77,856	\$64,126
	January 31, 2004	February 1, 2003
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contribution	3,279	3,159
Benefits paid	(3,279)	(3,159)
Fair value of plan assets at end of year	\$ -	\$ -
Funded status (PBO less plan assets)	\$80,553	\$64,360
Unamortized prior service costs	(5,734)	(6,360)
Unrecognized net actuarial loss	(19,829)	(5,715)
Intangible asset	5,734	6,360
Unrecognized net loss	17,627	7,025
Accrued benefit cost	\$78,351	\$65,670
ABO in excess of plan assets	\$77,856	\$64,126
Amounts recognized in the balance sheets:		
Accrued benefit liability	\$54,990	\$52,285
Intangible asset	5,734	6,360
Accumulated other comprehensive loss	17,627	7,025
Net amount recognized	\$78,351	\$65,670

Accrued benefit liability is included in other liabilities. Intangible asset is included in other assets. Accumulated other comprehensive loss, net of tax benefit, is included in stockholders’ equity.

The discount rate that the Company utilizes for determining future pension obligations is based on the Moody’s AA corporate bond index. The indices selected reflect the weighted average remaining period of benefit payments. The discount rate determined on this basis had decreased to 6.0% as of January 31, 2004 from 6.75% as of February 1, 2003. Weighted average assumptions are as follows:

	Fiscal 2003	Fiscal 2002	Fiscal 2001
Discount rate-net periodic pension cost	6.75%	7.25%	7.25%
Discount rate-benefit obligations	6.00%	6.75%	7.25%
Rate of compensation increases	2.50%	2.50%	2.50%

The components of net periodic benefit costs are as follows:

(in thousands of dollars)	Fiscal 2003	Fiscal 2002	Fiscal 2001
Components of net periodic benefit costs:			
Service cost	\$ 993	\$1,416	\$1,255
Interest cost	4,235	3,592	3,287
Net actuarial gain (loss)	130	(156)	(103)
Amortization of prior service cost	627	-	-
Amortization of transition obligation	-	-	2,688
Net periodic benefit costs	\$5,985	\$4,852	\$7,127

## 9. Stockholders' Equity

Capital stock is comprised of the following:

Type	Par Value	Shares Authorized
Preferred (5% cumulative)	\$100	5,000
Additional preferred	\$ .01	10,000,000
Class A, common	\$ .01	289,000,000
Class B, common	\$ .01	11,000,000

Holders of Class A are empowered as a class to elect one-third of the members of the Board of Directors and the holders of Class B are empowered as a class to elect two-thirds of the members of the Board of Directors. Shares of Class B are convertible at the option of any holder thereof into shares of Class A at the rate of one share of Class B for one share of Class A.

On March 2, 2002, the Company adopted a shareholder rights plan under which the Board of Directors declared a dividend of one preferred share purchase right for each outstanding share of the Company's Common Stock, which includes both the Company's Class A and Class B Common Stock, payable on March 18, 2002 to the shareholders of record on that date. Each right, which is not presently exercisable, entitles the holder to purchase one one-thousandth of a share of Series A Junior Participating Preferred Stock for \$70 per one one-thousandth of a share of Preferred Stock, subject to adjustment. In the event that any person acquires 15% or more of the outstanding shares of common stock, each holder of a right (other than the acquiring person or group) will be entitled to receive, upon payment of the exercise price, shares of Class A common stock having a market value of two times the exercise price. The rights will expire, unless extended, redeemed or exchanged by the Company, on March 2, 2012.

In May 2000, the Company announced that the Board of Directors authorized the repurchase of up to \$200 million of its Class A Common Stock. During fiscal 2003, the Company repurchased approximately \$18.9 million of Class A Common Stock, representing 1.5 million shares at an average price of \$12.99 per share. Approximately \$56 million in share repurchase authorization remained under this open-ended plan at January 31, 2004.

## 10. Earnings per Share

In accordance with SFAS No. 128, "Earnings Per Share," basic earnings per share has been computed based upon the weighted average of Class A and Class B common shares outstanding. Diluted earnings per share gives effect to outstanding stock options. Earnings per common share has been computed as follows:

(in thousands of dollars, except per share data)	Fiscal 2003		Fiscal 2002		Fiscal 2001	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
Earnings before cumulative effect of accounting change	\$9,344	\$9,344	\$ 131,926	\$ 131,926	\$71,798	\$71,798
Cumulative effect of accounting change	-	-	(530,331)	(530,331)	-	-
Net earnings (loss) available for per-share calculation	\$9,344	\$9,344	\$(398,405)	\$(398,405)	\$71,798	\$71,798
Average shares of common stock outstanding	83,643	83,643	84,513	84,513	84,020	84,020
Stock options	-	257	-	803	-	467
Total average equivalent shares	83,643	83,900	84,513	85,316	84,020	84,487



Per Share of Common Stock:						
Earnings before cumulative effect of accounting change	\$0.11	\$0.11	\$ 1.56	\$ 1.55	\$0.85	\$0.85
Cumulative effect of accounting change	-	-	(6.27)	(6.22)	-	-
Net income (loss)	\$0.11	\$0.11	\$(4.71)	\$(4.67)	\$0.85	\$0.85

Total stock options outstanding were 7,870,739, 9,669,755 and 10,708,646 at January 31, 2004, February 1, 2003 and February 2, 2002, respectively. Of these, options to purchase 7,343,073, 8,974,174 and 9,298,695 shares of Class A Common Stock at prices ranging from \$18.13 to \$40.22, \$18.13 to \$40.22, \$15.74 to \$40.22 per share were outstanding in fiscal 2003, 2002 and 2001, respectively, but were not included in the computation of diluted earnings per share because the exercise price of the options exceeds the average market price and would have been antidilutive.

### 11. Stock Options

The Company has various stock option plans that provide for the granting of options to purchase shares of Class A Common Stock to certain key employees of the Company. Exercise and vesting terms for options granted under the plans are determined at each grant date. All options were granted at not less than fair market value at dates of grant. At the end of fiscal 2003, 9,773,141 shares were available for grant under the plans and 17,643,880 shares of Class A Common Stock were reserved for issuance under the stock option plans. Stock option transactions are summarized as follows:

	Fiscal 2003		Fiscal 2002		Fiscal 2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Fixed Options						
Outstanding, beginning of year	9,669,755	\$24.72	10,708,646	\$ 24.58	11,270,261	\$ 25.30
Granted	-	-	2,312,375	24.02	654,000	15.74
Exercised	(122,375)	10.44	(2,150,111)	20.62	(345,675)	12.93
Forfeited	(1,676,641)	35.27	(1,201,155)	31.53	(869,940)	31.98
Outstanding, end of year	7,870,739	\$22.45	9,669,755	\$ 24.72	10,708,646	\$ 24.58
Options exercisable at year-end	5,823,459	\$23.56	6,793,960	\$ 26.63	7,834,601	\$ 26.73
Weighted-average fair value of options granted during the year	\$-		\$6.91		\$3.91	

The following table summarizes information about stock options outstanding at January 31, 2004:

Range of Exercise Prices	Options Outstanding		Options Exercisable	
	Options Outstanding	Weighted-Average Remaining Contractual Life (Yrs.)	Options Exercisable	Weighted-Average Exercise Price
\$10.44 - \$15.74	1,742,141	3.68	1,188,866	\$12.42
\$18.13 - \$25.13	4,767,598	2.67	3,273,593	22.18
\$28.19 - \$40.22	1,361,000	0.85	1,361,000	36.62
	7,870,739	2.58	5,823,459	\$23.56

SFAS No. 123, "Accounting for Stock Based Compensation," permits compensation expense to be measured based on the fair value of the equity instrument awarded. In accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," the Company uses the intrinsic value method of accounting for stock options. No compensation cost has been recognized in the consolidated statements of operations for the Company's stock option plans.

The fair value of each option grant is estimated on the date of each grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Fiscal 2003	Fiscal 2002	Fiscal 2001
Risk-free interest rate	-	1.96%	2.27%
Expected option life (years)	-	3.1	2.0
Expected volatility	-	41.6%	44.0%
Expected dividend yield	-	0.67%	1.02%

The fair values generated by the Black-Scholes model may not be indicative of the future benefit, if any, that may be received by the option holder.

## 12. Leases and Commitments

Rental expense consists of the following:

(in thousands of dollars)	Fiscal 2003	Fiscal 2002	Fiscal 2001
Operating leases:			
Buildings:			
Minimum rentals	\$38,087	\$40,862	\$45,066
Contingent rentals	8,732	10,433	10,310
Equipment	17,282	16,806	16,757
	64,101	68,101	72,133
Contingent rentals on capital leases	-	-	650
	\$64,101	\$68,101	\$72,783

Contingent rentals on certain leases are based on a percentage of annual sales in excess of specified amounts. Other contingent rentals are based entirely on a percentage of sales.

The future minimum rental commitments as of January 31, 2004 for all noncancelable leases for buildings and equipment are as follows:

(in thousands of dollars) Fiscal Year	Operating Leases	Capital Leases
2004	\$51,309	\$4,095
2005	41,948	3,813
2006	38,587	3,429
2007	29,904	2,578
2008	23,435	2,342
After 2008	80,890	19,251
Total minimum lease payments	<u>\$266,073</u>	35,508
Less amount representing interest		<u>(15,671)</u>
Present value of net minimum lease payments (of which \$2,126 is currently payable)		\$19,837

Renewal options from three to 25 years exist on the majority of leased properties. At January 31, 2004, the Company is committed to incur costs of approximately \$167 million to acquire, complete and furnish certain stores and equipment.

Various legal proceedings, in the form of lawsuits and claims, which occur in the normal course of business are pending against the Company and its subsidiaries. In the opinion of management, disposition of these matters is not expected to materially affect the Company's financial position, cash flows or results of operations.

### **13. Asset Impairment and Store Closing Charges**

In the evaluation of the fair value and future benefits of long-lived assets, the Company performs an analysis of the anticipated undiscounted future net cash flows of the related long-lived assets. If the carrying value of the related asset exceeds the undiscounted cash flows, the Company reduces the carrying value to its fair value, which is generally calculated using discounted cash flows. During fiscal 2003, the Company recorded a pre-tax charge of \$43.7 million for asset impairment and store closing costs. The charge includes a write-down to fair value for certain under-performing properties. The charge consists of a write down to a joint venture in the amount of \$5.5 million, a write down of goodwill on two stores to be closed of \$2.5 million and a write down of property and equipment in the amount of \$35.7 million. The Company does not expect to incur significant additional exit costs upon the closing of these properties during fiscal 2004. During fiscal 2002, the Company recorded a pre-tax charge of \$52.2 million for asset impairment and store closing costs. The charge includes a write down to fair value for certain under-performing properties in the amount of \$55.8 million and exit costs to close four such properties in the amount of \$4.4 million, all of which were closed during fiscal 2003, partially offset by the forgiveness of a lease obligation of \$8.0 million in connection with the sale of a closed owned store in Memphis, Tennessee in satisfaction of that obligation. During fiscal 2001, the Company recorded a pre-tax charge of \$3.8 million for asset impairment and store closing costs. The charge includes a write down to fair value for one under-performing store in the amount of \$1.8 million and lease commitments of \$2 million.

### **14. Fair Value Disclosures**

The estimated fair values of financial instruments which are presented herein have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of amounts the Company could realize in a current market exchange.

The fair value of trade accounts receivable is determined by discounting the estimated future cash flows at current market rates, after consideration of credit risks and servicing costs using historical rates. The fair value of the Company's long-term debt and Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures is based on market prices or dealer quotes (for publicly traded unsecured notes) and on discounted future cash flows using current interest rates for financial instruments with similar characteristics and maturity (for bank notes and mortgage notes).

The fair value of the Company's cash and cash equivalents and trade accounts receivable approximates their carrying values at January 31, 2004 and February 1, 2003 due to the short-term maturities of these instruments. The fair value of the Company's long-term debt at January 31, 2004 and February 1, 2003 was \$2.06 billion and \$2.24 billion, respectively. The carrying value of the Company's long-term debt at January 31, 2004 and February 1, 2003 was \$2.02 billion and \$2.33 billion, respectively. The fair value of the Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures at January 31, 2004 and February 1, 2003 was \$526 million and \$473 million, respectively. The carrying value of the Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures at January 31, 2004 and February 1, 2003 was \$532 million.

### **15. Securitizations of Assets**

As part of its credit card securitizations, the Company transfers credit card receivable balances to a Trust in exchange for certificates representing undivided interests in such receivables. The Trust securitizes balances by issuing certificates representing undivided interests in the Trust's receivables to outside investors. In each securitization, the Company retains certain subordinated interests that serve as a credit enhancement to outside investors and expose the Trust assets to possible credit losses on receivables sold to outside investors. The investors and the Trust have no recourse against the Company beyond Trust assets. In order to maintain the committed level of securitized assets, the Trust reinvests cash collections on securitized accounts in additional balances. The Company also receives annual servicing fees as compensation for servicing the outstanding balances.

Currently, all borrowings under the Company's receivable financing conduit are recorded on balance sheet. The Company had \$400 million of long-term debt outstanding under this agreement on the consolidated balance sheet as of January 31, 2004 and February 1, 2003. Prior to May 2002, the Company accounted for securitizations of credit card receivables as sales of receivables, thus off balance sheet. Since May 2002, future transfers no longer meet sale treatment, and interest paid to outside investors is recorded in interest expense instead of other revenue. The Company reclassified \$11.3 million for the twelve months ended February 2, 2002 to conform to current period classification. Accordingly, as a result of this decision, the Company recorded an income statement charge of \$5.4 million related to the amortization of the beneficial interests recognized up front on the off-balance-sheet financing for the twelve months ended February 1, 2003. This charge was included in Service Charges, Interest and Other Income.

At January 31, 2004 and February 1, 2003, the Company had \$50.0 million and \$0 outstanding, respectively, in short-term borrowings under its accounts receivable conduit facilities related to seasonal financing needs. Remaining available short-term borrowings under these conduit facilities at January 31, 2004 were \$450.0 million.

#### 16. Quarterly Results of Operations (unaudited)

During the second quarter of 2002, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets.” The cumulative effect of the accounting change as of February 3, 2002 was to decrease net income for fiscal year 2002 by \$530 million or \$6.22 per diluted share.

Fiscal 2003, Three Months Ended				
(in thousands of dollars, except per share data)	May 3	August 2	November 1	January 31
Net sales	\$1,813,911	\$1,721,485	\$1,764,484	\$2,299,054
Gross profit	601,939	535,067	564,431	727,324
Net income (loss)	24,349	(50,346)	(15,835)	51,176
Diluted earnings per share:				
Net income (loss)	0.29	(0.60)	(0.19)	0.61

Fiscal 2002, Three Months Ended				
(in thousands of dollars, except per share data)	May 4	August 3	November 2	February 1
Net sales	\$1,910,879	\$1,817,976	\$1,794,250	\$2,387,891
Gross profit	684,451	620,677	602,813	748,921
Income (loss) before cumulative effect of accounting change	58,112	6,666	(5,102)	72,250
Net income (loss)	(472,219)	6,666	(5,102)	72,250
Diluted earnings per share:				
Income (loss) before cumulative effect of accounting change	0.68	0.08	(0.06)	0.85
Net income (loss)	(5.56)	0.08	(0.06)	0.85

Total of quarterly earnings per common share may not equal the annual amount because net income per common share is calculated independently for each quarter.

Quarterly information for fiscal 2003 and fiscal 2002 include the following items:

#### First Quarter 2003

- a pretax gain of \$15.6 million (\$10.0 million after tax or \$0.12 per diluted share) pertaining to the Company’s sale of its interest in Sunrise Mall and its associated center in Brownsville, Texas.
- a pretax gain of \$12.3 million (\$7.9 million after tax or \$0.09 per diluted share) recorded due to the resolution of certain liabilities originally recorded in conjunction with the purchase of Mercantile Stores Company, Inc.

#### Second Quarter 2003

- a call premium resulting in additional interest expense of \$15.6 million (\$10.0 million after tax or \$0.12 per diluted share) associated with a \$125.9 million call of debt.
- a \$17.1 million pretax charge (\$10.9 million after tax, or \$0.13 per diluted share) for asset impairment and store closing charges related to certain stores.

## 2002

- a call premium resulting in additional interest expense of \$11.6 million (\$7.4 million after tax \$0.09 per diluted share) associated with a \$143.0 million call of debt.
- a charge of \$3.2 million (\$2.0 million after tax or \$0.02 per diluted share) on the amortization of off-balance-sheet accounts receivable securitization.
- a pretax gain of \$3.1 million (\$2.0 million after tax or \$0.02 per diluted share) from an investee partnership of the Company who received an unusual distribution in the settlement of a receivable.
- a pretax gain of \$2.5 million (\$1.6 million after tax or \$0.02 per diluted share) on the early extinguishment of debt.
- \$862,000 in pre-tax net income (\$552,000 after tax, or \$0.01 per diluted share) for asset impairment and store closing charges related to certain stores.

## Third Quarter 2003

- a \$1.7 million charge (\$1.1 million after tax or \$0.01 per diluted share) for asset impairment and store closing charges related to certain stores.
- \$4.1 million (\$2.6 million after tax or \$0.03 per diluted share) received from the Internal Revenue Service as a result of the Company's filing of an interest-netting claim related to previously settled tax years.

## 2002

- a charge of \$2.2 million (\$1.4 million after tax or \$0.02 per diluted share) on the amortization of off-balance-sheet accounts receivable securitization.
- a pretax gain of \$1.7 million (\$1.1 million after tax or \$0.01 per diluted share) on the early extinguishment of debt.

## Fourth Quarter 2003

- a pretax asset impairment and store closing charge of \$25.0 million (\$16.8 million after tax or \$0.20 per diluted share) related to certain stores.
- an \$8.5 million gain (\$5.5 million after tax or \$0.07 per diluted share) related to the sale of three store properties.

## 2002

- a pretax gain of \$64.3 million (\$41.1 million after tax or \$0.48 per diluted share) pertaining to the Company's sale of its interest in FlatIron Crossing, a Broomfield, Colorado shopping center (see Note 1 of the Notes to the Consolidated Financial Statements).
- a pretax asset impairment and store closing charge of \$53.1 million (\$34.0 million after tax or \$0.40 per fully diluted share) related to certain stores.

**SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS**  
**DILLARD'S, INC. AND SUBSIDIARIES**  
**(DOLLAR AMOUNTS IN THOUSANDS)**

Column A	Column B	Column C	Column D	Column E	Column F
Description	Balance at Beginning of Period	Additions		Deductions (1)	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
Allowance for losses on accounts receivable:					
Year Ended January 31, 2004	\$49,755	\$83,030	\$ -	\$91,818	\$40,967
Year Ended February 1, 2003	37,385	98,787	-	86,417	49,755
Year Ended February 2, 2002	32,240	78,121	-	72,976	37,385

(1) Accounts written off and charged to allowance for losses on accounts receivable (net of recoveries).

## Exhibit Index

<u>Number</u>	<u>Description</u>
*3(a)	Restated Certificate of Incorporation (Exhibit 3 to Form 10-Q for the quarter ended August 1, 1992 in 1-6140).
*3(b)	By-Laws as currently in effect (Exhibit 3.1 to Form 8-K dated as of March 2, 2002 in 1-6140).
*4(a)	Indenture between the Registrant and Chemical Bank, Trustee, dated as of October 1, 1985 (Exhibit (4) in 2-85556).
*4(b)	Indenture between the Registrant and Chemical Bank, Trustee, dated as of October 1, 1986 (Exhibit (4) in 33-8859).
*4(c)	Indenture between Registrant and Chemical bank, dated as of April 15, 1987 (Exhibit 4.3 in 33-13534).
*4(d)	Indenture between Registrant and Chemical bank, Trustee, dated as of May 15, 1988, as supplemented (Exhibit 4 in 33-21671, Exhibit 4.2 in 33-25114 and Exhibit 4(c) to Current Report on Form 8-K dated September 26, 1990 in 1-6140).
*4(e)	Rights Agreement between Dillard's, Inc. and Registrar and Transfer Company, as Rights Agent (Exhibit 4.1 to Form 8-K dated as of March 2, 2002 in 1-6140).
**10(a)	Retirement Contract of William Dillard dated March 8, 1997 (Exhibit 10(a) to Form 10-K for the fiscal year ended February 1, 1997 in 1-6140).
**10(b)	1998 Incentive and Nonqualified Stock Option Plan (Exhibit 10 (b) to Form 10-K for the fiscal year ended January 30, 1999 in 1-6140).
**10(c)	Amended and Restated Corporate Officers Non-Qualified Pension Plan (Exhibit 10 to Form 10-Q for the quarter ended May 2, 2003 in 1-6140).
**10(d)	Senior Management Cash Bonus Plan (Exhibit 10(d) to Form 10-K for the fiscal year ended January 28, 1995 in 1-6140).
**10(e)	2000 Incentive and Nonqualified Stock Option Plan (Exhibit 10(e) to Form 10-K for the fiscal year ended February 3, 2001 in 1-6140).
*10(f)	Amended and Restated Credit Agreement among Dillard's, Inc. and JPMorgan Chase Bank and Fleet Retail Group, Inc. (Exhibit 10 to Form 10-Q for the quarter ended November 1, 2003 in 1-6140).
12	Statement re: Computation of Ratio of Earnings to Fixed Charges.
*18	Letter re: Change in Accounting Principles (Exhibit 18 to Form 10-K for the fiscal year ended February 3, 2001 in 1-6140).
21	Subsidiaries of Registrant.
23	Consent of Independent Auditors.

- 31(a) Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a) (17 CFR 240.13a-14(a) or Rule 15d-14(a) (17 CFR 240.15d-14(a)).
- 31(b) Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a) (17 CFR 240.13a-14(a) or Rule 15d-14(a) (17 CFR 240.15d-14(a)).
- 32(a) Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32(b) Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

\* Incorporated by reference as indicated.

\*\* A management contract or compensatory plan or arrangement required to be filed as an exhibit to this report pursuant to Item 14(c) of Form 10-K.





### Annual Meeting

Saturday, May 15, 2004, at 9:30 a.m.,  
Dillard's Corporate Office  
1600 Cantrell Road,  
Little Rock, Arkansas 72201

### Financial and Other Information

Copies of financial documents and other company information such as Dillard's, Inc. reports on Form 10-K and 10-Q and other reports filed with the Securities and Exchange Commission are available by contacting:

Dillard's, Inc.  
Investor Relations  
1600 Cantrell Road,  
Little Rock, Arkansas 72201  
501-376-5522

E-mail: [investor.relations@dillards.com](mailto:investor.relations@dillards.com)

Financial reports, press releases and other Company information are available on the Dillard's, Inc. Web site: [www.dillards.com](http://www.dillards.com)

Individuals or securities analysts with questions regarding Dillard's, Inc. may contact:

Julie J. Bull  
Director of Investor Relations  
1600 Cantrell Road  
Little Rock, Arkansas 72201  
Telephone: 501-376-5965  
Fax: 501-376-5917  
E-mail: [julie.bull@dillards.com](mailto:julie.bull@dillards.com)

### Transfer Agent and Registrar

Registered shareholders should address communications regarding address changes, lost certificates and other administrative matters to the Company's Transfer Agent and Registrar.

Registrar and Transfer Company  
10 Commerce Drive  
Cranford, New Jersey 07016-3572  
Telephone: 800-368-5948  
E-Mail: [info@rtco.com](mailto:info@rtco.com)  
Web page: [www.rtco.com](http://www.rtco.com)

Please refer to Dillard's, Inc. on all correspondence and have available your name as printed on your stock certificate, your Social Security number, your address and phone number.

### Corporate Headquarters

1600 Cantrell Road  
Little Rock, Arkansas 72201

### Mailing Address

Post Office Box 486  
Little Rock, Arkansas 72203  
Telephone: 501-376-5200  
Fax: 501-376-5917

### Listing

New York Stock Exchange, Ticker Symbol "DDS"

### Store Openings - 2003

Store Name	Location	Open Month	Sq. Foot
Great Northern Mall	Olmstead, Ohio	March	220,000
NorthPark Mall	Davenport, Iowa	July	126,000
Stony Point Fashion Park	Richmond, Virginia	September	200,000
Short Pump Town Center	Richmond, Virginia	September	200,000
Memorial City Mall**	Houston, Texas	October	250,000

\*\*Replacing 223,000 sf



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[www.dillards.com](http://www.dillards.com)