FOOTSTAR INC
Form 10-K
March 13, 2008

Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 29, 2007
Commission File Number 1-11681
FOOTSTAR, INC.
(Exact name of registrant as specified in its charter)

Delaware	**22-3439443**
(State of incorporation)	(IRS Employer Identification No.)

933 MacArthur Blvd., Mahwah, New Jersey 07430
(Address of principal executive offices)
Registrant s telephone number, including area code: **(201) 934-2000**
Securities registered pursuant to Section 12(b) of the Act:
None
Securities registered pursuant to Section 12(g) of the Act:
Common Stock (par value $.01 per share)
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act o Yes þ No

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

Indicate by check mark 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 the definitive proxy statement incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. o

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

Large Accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. (The registrant did not distribute new securities under the plan confirmed by the court; there was no change to the holders of securities as a result of the registrant s reorganization.)
Yes þ No o

For the purpose of reporting the following market value of the registrant s common stock held by non-affiliates, the common stock held by the directors and executive officers of the registrant have been excluded. The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2007, was approximately $81.5 million based on the closing price on June 29, 2007 of $4.20 per share.

Number of shares outstanding of common stock, par value $.01 per share, as of March 1, 2008: 21,126,647.

Documents Incorporated by Reference

Portions of Footstar, Inc. s Proxy Statement for the 2008 Annual Meeting of Shareholders, the information from which is expected to be filed within 120 days after the end of the Company s fiscal year, are incorporated by reference into Part III.

FOOTSTAR, INC.
ANNUAL REPORT ON FORM 10-K
TABLE OF CONTENTS

Footstar, the Footstar logo, Just For Feet, Thom McAn, Cobbie Cuddlers, Texas Steer and Cara Mia are, or were as of December 29, 2007, trademarks and/or service marks of Footstar, Inc. s subsidiaries or affiliates. All other trademarks mentioned in this report are the property of their respective owners.

Table of Contents

PART I

INTRODUCTORY NOTE

Footstar, Inc., which may be referred to as Footstar , the Company , we , us or our , is today filing this Annual Rep
Form 10-K for its fiscal year ended December 29, 2007.

On February 7, 2006, Footstar emerged from bankruptcy and have since made payments to creditors totaling $127.5 million, including applicable interest, pursuant to our Plan of Reorganization (the Plan). These payments exclude approximately $0.5 million in claims which we expect will be paid upon final resolution. Creditors were or will be paid in full, plus interest where applicable, from existing cash balances.

Pursuant to the guidance provided by the American Institute of Certified Public Accountants in Statement of Position 90-7, Financial Reporting by Entities in Reorganization Under the Bankruptcy Code (SOP 90-7), the Company has not adopted fresh-start reporting because there was no change to the holders of existing voting shares and the reorganization value of the Company s assets was greater than its post petition liabilities and allowed claims.

The Company has operated licensed footwear departments in discount chains since 1961, and is the only major operator of licensed footwear departments in the United States today. As of December 29, 2007, the Company operated licensed footwear departments in 1,388 Kmart Corporation (Kmart) stores and in 859 Rite Aid Corporation (Rite Aid) stores located on the West Coast. The Company also supplies certain retail stores, including Rite Aid, with family footwear on a wholesale basis.

The business relationship between the Company and Kmart is extremely important to us. The licensed footwear departments in Kmart comprise substantially all of our sales and profits. On August 24, 2005, the Company and Kmart entered into an agreement (the Kmart Settlement or Kmart Agreement) with respect to the assumption, interpretation and amendment of the Master Agreement, which formerly governed our arrangement with Kmart.

The Kmart Agreement, pursuant to which we operate these footwear departments, is currently scheduled to expire at the end of 2008 (subject to any earlier termination by mutual agreement of Kmart and the Company or, in certain particular circumstances provided for in the Kmart Agreement, unilaterally by a party pursuant to the existing early termination or default terms of the Kmart Agreement), at which time Kmart has agreed to purchase the inventory in our Kmart footwear departments (excluding worn, damaged and seasonal inventory, as defined). Because we have not to date identified, and we do not believe we will identify, a course of action to offset this Kmart business, we are currently planning to wind-down our Kmart business and all our other businesses by not later than December 31, 2008. This would likely include a liquidation and wind-up of the Company s business, including proposing a plan of dissolution to our shareholders.

See Item 7, Management s Discussion and Analysis Factors to Consider , beginning at page 30, concerning:

Table of Contents

Our Board s continued review and consideration of courses of action to resolve the Company s future, including a liquidation and dissolution of our business following the termination of our Kmart business;

The terms of the existing Kmart Agreement which unless the parties agree otherwise will govern the rights and obligations of Footstar and Kmart on the termination of the Kmart Agreement at the scheduled December 31, 2008 expiration date; and

Certain other matters in connection with future events, circumstances and uncertainties impacting the Company.

ITEM 1. BUSINESS

GENERAL

The Company sells family footwear through licensed footwear departments and wholesale arrangements.

The Company has operated licensed footwear departments since 1961 and is the only major operator of licensed footwear departments in the United States today.

The following chart represents a summary of stores in which the Company operated licensed footwear departments for fiscal 2007, 2006 and 2005:

	Beginning of Year	Opened	Closed	End of Year
Fiscal 2007				
Kmart	1,392		(4)	1,388
Rite Aid	854	16	(11)	859
Fiscal 2006				
Kmart	1,421		(29)	1,392
Rite Aid	859	9	(14)	854
Fiscal 2005				
Kmart	1,482		(61)	1,421
Rite Aid	858	8	(7)	859

The Company s licensed footwear operation sells family footwear and lower-priced basic and seasonal footwear in Kmart and Rite Aid stores. Our net sales from Kmart and Rite-Aid for fiscal 2007 were $614.2 million and $15.8 million, respectively. In its licensed footwear departments, the Company generally sells a wide variety of family footwear, including men s, women s and children s dress, casual, athletic and seasonal footwear, work shoes and slippers. As of December 31, 2005, we had been supplying Thom McAn family footwear on a wholesale basis to 1,500 Wal-Mart stores in the United States and 13 stores in Puerto Rico. Beginning in January 2006, Wal-Mart stopped purchasing Thom McAn product for its stores in the United States. Beginning in April 2007, Wal-Mart no longer sourced footwear from us for Wal-Mart stores under Wal-Mart s proprietary brands, and, beginning August 2007, Wal-Mart no longer purchased Thom McAn footwear for Wal-Mart stores in Puerto Rico. Our total sales to Wal-Mart were approximately $2.0 million in fiscal 2007, approximately $8.9 million in fiscal 2006 and approximately $29.6 million in fiscal 2005.

Table of Contents

COMPETITIVE ENVIRONMENT

The family footwear business, where the majority of the Company s business is generated, is highly competitive. Competition is concentrated among a limited number of value-priced retailers and discount department stores, including Kmart, Wal-Mart, Payless ShoeSource, Kohl s, Target and Sears, with a number of traditional off-price and value retailers such as Shoe Carnival, Famous Footwear, DSW and Shoe Show also selling lower-priced footwear.

MERCHANDISING

The Company s merchandising strategy historically has been to continue to build upon its position in family footwear. The essence of this strategy has been to satisfy the Company s customers with high in-stock availability of its footwear products and by offering a wide selection of well-known national brands such as Thom McAn and Cobbie Cuddlers (which are Company-owned). We offer a wide range of quality, value-priced footwear. Key strengths have included style development, sourcing, quality control, competitive pricing, planning and inventory management.

In its licensed footwear operations, the Company seeks to attract non-footwear shoppers into the footwear departments from other areas of the stores. Its branded products are also intended to differentiate the Company s merchandise from that of its competitors. Brands currently available at the Company s operations include Thom McAn, Cobbie Cuddlers and Texas Steer (which are Company-owned) and Route 66 and Basic Editions.

The Company s traditional strength has been in quality leather footwear which it currently offers under the Thom McAn brand, as well as seasonal, work, value-priced athletic, women s casual and children s shoes. The Company has traditionally built on its strength in these areas by focusing on customer satisfaction. The Company s narrow and deep merchandising strategy and its merchandise planning systems have been designed to ensure that each store is well stocked in product lines that are particularly popular with the Company s core customers. The Company s demand-driven merchandise replenishment system has been designed to permit inventory management at the store, style and size levels. In addition, in order to ensure sufficient quantities of footwear in the desired size, style and color for each season, we are required to maintain substantial levels of inventory, especially prior to peak selling seasons when we build up our inventory levels. We must provide consumers with seasonally appropriate merchandise, making our sales highly dependent on seasonal weather conditions.

MARKETING

The Company believes that the typical footwear customer in its licensed footwear departments in Kmart generally resembles the average Kmart softlines shopper, which consists of shoppers from three distinct segments: families with moderate income, mature shoppers with average income and younger/middle-aged Hispanic and African-American families. The Company s marketing initiatives have been designed to support its overall business strategy of increasing purchases among traditional footwear shoppers, as well as appealing to the growing customer segments that include African Americans and Hispanics.

Table of Contents

The Company s marketing strategy in its Kmart footwear departments has been designed to convey to prospective customers that Kmart carries the right value combination of brands, product selection, quality, comfort and price to make Kmart footwear departments their footwear destination of choice. This message is communicated primarily through weekly advertising in newspaper inserts and in-store presentations. Kmart s weekly newspaper inserts had a weekly circulation of approximately 43 million as of December 29, 2007.

TRADEMARKS AND SERVICE MARKS

Footstar or its subsidiaries own all rights in the United States to the marks Thom McAn, Cobbie Cuddlers and Cara Mia for use in connection with footwear and/or related products and services. The Company or its subsidiaries have registered or have common law rights in the United States to over 100 trademarks and/or service marks under which we have marketed merchandise or services. Where it has been deemed important, the Company has registered its trademarks and service marks in foreign countries. We protect our trademarks and service marks. We do not believe, however, that any material portion of our business is substantially dependent on any of our trademarks.

In connection with the wind-down of our current business we will consider the sale or other transfer of our trademarks, tradenames and brands, including Thom McAn. We would anticipate that the terms of any such sale or transfer would continue to allow us to utilize our trademarks, tradenames and brands through the scheduled termination of the Kmart Agreement.

EMPLOYEES

As of December 29, 2007, we had 3,948 employees, of which 1,084 were full-time and 2,864 were part-time employees. Approximately 3,617 of the total employees are located in our licensed footwear departments.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following information sets forth the name, age and business experience during the past five years of the current executive officers of the Company:

Jeffrey A. Shepard, age 57, was appointed Chief Executive Officer and President of Footstar on February 6, 2006. He has been a member of the Board of Directors since January 2005. He formerly served as the Executive Vice President of Footstar and President and Chief Executive Officer of Meldisco. Mr. Shepard was an executive officer of Footstar at the time it filed for reorganization under Chapter 11 in March 2004.

William Lenich, age 59, has been Executive Vice President of Footstar since February 7, 2006. Prior to that, he was the Executive Vice President of Meldisco since joining Meldisco in 2002.

Dennis M. Lee, age 58, has been Senior Vice President, Human Resources of Footstar since February 7, 2006. Prior to that, he served as Senior Vice President, Human Resources of Meldisco since joining Meldisco in July 2004. Prior to joining Footstar, he served as an Assistant Professor in Residence for Human Resource Management, College of Continuing Studies and School of Business at the University of Connecticut and was Senior Vice President Human Resources and Logistics for the Venator Group.

Michael J. Lynch, age 41, has been the Chief Financial Officer Senior Vice President of Footstar since February 7, 2006. Prior to that, he served as Senior Vice President of Finance of Meldisco. Since joining the Company in August 1995, he also served as the Division Vice President Finance at both Footstar s former Athletic and Meldisco divisions.

Table of Contents

Randall Proffitt, age 62, has been Senior Vice President, Store Operations of Footstar since February 7, 2006 and prior thereto he held such position at Meldisco.

Maureen Richards, age 51, has been the Senior Vice President, General Counsel and Corporate Secretary of Footstar since March 2001 and was an executive officer of Footstar at the time it filed for reorganization under Chapter 11 in March 2004 and prior to March 2001, was Vice President, General Counsel and Corporate Secretary of Footstar.

Craig M. Haines, age 35, has been Vice President and Controller, and Principal Accounting Officer of Footstar since March 31, 2006 and prior thereto he was the Company s Vice President and Controller since he joined the Company in June 2005. From November 2002 through May 2005, Mr. Haines served as Executive Vice President, Finance and Administration for National Vision Administrators, LLC.

AVAILABLE INFORMATION

We make available free of charge through our web site, *www.footstar.com*, all materials that we file electronically with the SEC, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. During the period covered by this Form 10-K, we made all such materials available through our web site as soon as reasonably practicable after filing such materials with the SEC.

You may also read and copy any materials filed by us with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549, and you may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet web site, *www.sec.gov*, which contains reports, proxy and information statements and other information which we file electronically with the SEC.

A copy of Footstar s Corporate Governance Guidelines and its Code of Conduct and Compliance Program are posted on the Corporate Governance section of the Company s website, www.footstar.com, and are available in print to any shareholder who requests copies by contacting Maureen Richards, Senior Vice President, General Counsel and Corporate Secretary, at the Company s principal executive office set forth above.

ITEM 1A. RISK FACTORS

The matters discussed in this Annual Report on Form 10-K include forward-looking statements that involve significant risks and uncertainties. These statements are neither promises nor guarantees. A number of important risks and uncertainties, including those identified below and those factors included in this Annual Report on Form 10-K under Item 7, Management s Discussion and Analysis Factors to Consider , beginning at page 30, each of which is a risk factor and is incorporated into this Item 1A by reference and Recent Events , beginning on page 18, each of which is a risk factor and is incorporated into this Item 1A by reference, as well as risks and uncertainties discussed elsewhere in this Form 10-K, could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. In addition to the above-referenced statements and factors which are set forth elsewhere in our Annual Report on

Table of Contents

Form 10-K and incorporated herein by reference, we set forth the following risks and uncertainties related to our business.

Anticipated wind-down of our current footwear business by not later than the end of 2008

Our operation of the footwear departments in Kmart stores accounts for substantially all of our net sales and net profits. Our agreement with Kmart provides for the termination of this business by no later than December 31, 2008 (subject to any earlier termination by mutual agreement of Kmart and the Company or, in certain particular circumstances provided for in the Kmart Agreement, unilaterally by a party pursuant to the existing early termination or default terms of the Kmart Agreement) at which time Kmart is obligated to purchase our inventory, as defined in that agreement. There can be no assurance that we will not have issues and disputes with Kmart in winding up our business with Kmart.

If we do not operate these footwear departments through the end of 2008 or receive timely payments from Kmart for our inventory after the Kmart Agreement terminates, it could have a material adverse effect on our operations and financial condition. In addition, because the Company has not to date identified, and we do not believe we will identify, a course of action to offset this business, we are currently planning to wind-down our Kmart business and all our other businesses by not later than December 31, 2008. This would likely include a liquidation and wind-up of the Company's business, including proposing a plan of dissolution to our shareholders. Such liquidation could cause the Company to incur significant costs. See Item 7, Management s Discussion and Analysis Factors to Consider , beginning at page 30, concerning our Board s review of courses of action to resolve the Company s future, including a liquidation and dissolution following the termination of our Kmart business.

Our April 30, 2007 declaration and payment of a special cash distribution may impact our future cash requirements and liquidity needs.

On March 27, 2007, we announced the declaration of a $5.00 per common share cash distribution, paid on April 30, 2007. The Board considered, among other factors, our cash position, our expected future operating results, our future cash needs and cash position, our liquidity needs and available capital resources, and our strategic options.

This special cash distribution reduced cash available for future operations, and for future cash needs and liquidity, by a total of $104.8 million. The Company may be required to periodically borrow under its Credit Facility to support normal operating needs. This Credit Facility expires the earlier of on November 30, 2008 or thirty days prior to the termination of the Kmart Agreement. If our future operating results or cash needs or obligations differ in any material respect from our expectations, or other changes occur in our business or operations, which we have not anticipated, our cash needs could be greater than our cash generated from operations and funds available under our Credit Facility, which would have a material adverse impact on our financial condition. There can be no assurance that we will have sufficient available cash and available cash resources (including funds available under our Credit Facility and credit available from our vendors) to satisfy all of our future cash needs.

We may be unable to retain talented personnel.

Our success is dependent upon our ability to retain qualified individuals. We have instituted several retention programs designed to retain key executives and employees and may seek to implement additional programs to retain key executives and employees if and when necessary. However, if we are unable to retain key executives and employees, including senior management, and qualified accounting and finance, marketing, and merchandising personnel, or put in place additional retention programs, it could adversely affect our businesses. This risk potentially is more acute given the anticipated wind-down of our current business.

We rely on key vendors and third parties to manufacture, warehouse and distribute our products.

Product sourcing in the family footwear business is driven by relationships with foreign manufacturers. Because of the anticipated expiration of the Kmart Agreement by no later than the end of 2008, beginning in the first quarter of 2008 we provided our vendors with more current payment terms. If the terms under which these vendors deal with us, including payment terms, change adversely, there could be a material adverse impact on our operations and financial condition. Also, if these foreign manufacturers are unable to secure sufficient supplies of raw materials or maintain adequate manufacturing capacity, they may be unable to provide us with timely delivery of products of acceptable quality. In addition, if manufacturing costs increase, our cost of acquiring merchandise could increase. Although we pay for finished goods in U.S. dollars, it is possible that higher costs could be passed on to us through higher product costs. If we cannot recover these cost increases with increased pricing to our customers, it could have a material adverse effect on our operations and financial condition. These risks become potentially more acute given the anticipated wind-down of our current business.

The Company manages against possible product cost increases by shifting manufacturing production to lower cost regions of China. It is possible that the Company could experience lower product quality and/or late shipments from these new factories which could unfavorably impact the Company s financial results.

We also depend on third parties to receive, warehouse, transport and deliver our products. If these third parties are unable to perform for any reason, or if they increase the price of their services, there could be a material adverse effect on our operations and financial performance.

We may be unable to adjust to constantly changing fashion trends.

Our level of current sales depends, in large part, upon our ability to gauge the evolving fashion tastes of our customers and potential customers and to provide merchandise that satisfies those fashion tastes in a timely manner. The retailing industry fluctuates according to changing fashion tastes and seasons, and merchandise usually must be ordered well in advance of the season, frequently before consumer fashion tastes are evidenced by consumer purchases. In addition, in order to ensure sufficient quantities of footwear in the desired size, style and color for each season, we are required to maintain substantial levels of inventory, especially prior to peak selling seasons when we build up our inventory levels.

As a result, if we fail to properly gauge the fashion tastes of consumers or to respond to changes in fashion tastes in a timely manner, this failure could adversely affect retail and consumer acceptance of our merchandise and leave us with substantial unsold inventory. If that occurs, we may be forced to rely on markdowns or promotional sales to dispose of excess, slow-moving inventory, which may harm our business and financial results.

Table of Contents

We must provide consumers with seasonally appropriate merchandise, making our sales highly dependent on seasonal weather conditions.

If the weather conditions for a particular period vary significantly from those typical for that period, such as an unusually cold spring or an unusually warm winter, consumer demand for seasonally appropriate merchandise that we have available in our footwear departments will be lower, and our net sales and margins will be adversely affected. Lower sales may leave us with excess inventory of our basic products and seasonally appropriate products, forcing us to sell both types of our products at significantly discounted prices and, thereby, adversely affecting our net sales and margins.

Declines in our sales will have a magnified impact on profitability because of our fixed costs.

A significant portion of our operating expenses are fixed costs that are not dependent on our sales performance, as opposed to variable costs, which vary proportionately with sales performance. These fixed costs include, among other things, the costs associated with operating as a public company and a substantial portion of our labor expenses. If our sales decline we may not be able to reduce our operating expenses proportionately. If our sales fall below certain minimums set forth in our agreement with Kmart, our right to operate in Kmart stores, which accounts for substantially all of our business, could potentially be terminated prior to the scheduled termination of the Kmart Agreement.

We operate in the highly competitive footwear retailing industry.

The family footwear industry, where our business is concentrated, is highly competitive. Competition is concentrated among a limited number of retailers and discount department stores, including Payless ShoeSource, Kmart, Wal-Mart, Kohl s, Sears and Target, with a number of traditional mid-tier and value-priced retailers such as Shoe Carnival, Famous Footwear and Rack Room also selling lower-priced footwear. The events that caused us to seek bankruptcy put us at a disadvantage with respect to our competitors. In addition, our agreement with Kmart which provides that we will no longer operate the footwear departments in Kmart stores beyond December 31, 2008 at the latest, puts us at a disadvantage with respect to our competitors, many of which are growing rapidly and have substantial financial and marketing resources which are unavailable to us. If we are unable to overcome these disadvantages and our sales fall below certain minimums set forth in our agreement with Kmart, our right to operate in Kmart stores, which accounts for substantially all of our business, could potentially be terminated prior to the scheduled termination of the Kmart Agreement.

There are risks associated with our importation of products.

Approximately 97% of the Company s products are directly imported by us and manufactured in China. Substantially all of this imported merchandise is subject to customs duties and tariffs imposed by the United States. Penalties may be imposed for violations of labor and wage standards by foreign contractors.

In addition, China and other countries in which our merchandise is manufactured may, from time to time, impose additional new quotas, tariffs, duties, taxes or other restrictions on its merchandise or adversely change existing quotas, tariffs, duties, taxes or other restrictions. Any such changes could

Table of Contents

adversely affect our ability to import our products and, therefore, our results of operations.

Any deterioration in the trade relationship between the United States and China or any other disruption in our ability to import products from China could adversely affect our business, financial condition or results of operations.

Other risks inherent in sourcing products from foreign countries include economic and political instability, social unrest and the threat of terrorism, each of which risks could adversely affect our business, financial condition or results of operations. In addition, we incur costs as a result of security programs designed to prevent acts of terrorism such as those imposed by government regulations and our participation in the Customs-Trade Partnership Against Terrorism implemented by the United States Bureau of Customs and Border Protection. Significant increases in such costs could adversely affect our business, financial condition or results of operations.

Our ability to successfully import merchandise into the United States from foreign sources is also dependent on stable labor conditions in the major ports of the United States. Any instability or deterioration of the domestic labor environment in these ports could result in increased costs, delays or disruption in merchandise deliveries that could cause loss of revenue, damage to customer relationships and have a material adverse effect on our business operations and financial condition.

The footwear retailing industry is heavily influenced by general economic cycles.

Footwear retailing is a cyclical industry that is heavily dependent upon the overall level of consumer spending. Purchases of footwear, apparel and related goods tend to be highly correlated with the cycles of the levels of disposable income of our customers. As a result, any substantial deterioration in general economic conditions could have a material adverse effect on our operations and financial condition.

See Forward-Looking Statements in Item 7 for additional risk factors to consider.

ITEM 1 B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 29, 2007, we operated licensed footwear departments in 2,247 stores. The licensed footwear departments are located in 49 states, Guam, Puerto Rico and the U.S. Virgin Islands. Of the licensed departments operated as of December 29, 2007, 1,388 were located in Kmart discount stores and 859 were in Rite Aid drugstores on the West Coast.

Kmart and Rite Aid provide us with store space to sell footwear in exchange for certain payments. The footwear departments we operate in Kmart stores range from 1,200 to 4,400 square feet.

Our corporate headquarters is located in 129,000 square feet of owned office space in Mahwah, New Jersey.

Table of Contents

In connection with the wind-down of our current business, we are actively pursuing the sale of our corporate headquarters. We currently anticipate that the terms of any such sale will allow us to continue to utilize our corporate headquarters for our required needs through December 2008. If we are successful in the sale of our corporate headquarters, we anticipate that after December 2008 we will have limited operating space and the Company currently would intend to lease operating space, if necessary, suitable at a minimum for our wind-down activities.

We also lease approximately 20,000 square feet of space in Mahwah, New Jersey for use by our footwear testing lab and for storage. Our corporate tax department is located in 3,500 square feet of leased office space in Worcester, Massachusetts. We also lease approximately 7,800 square feet in Hong Kong. The leases for these properties expire approximately at the end of 2008 and no renewals, other than for a short time as we wind-down the current businesses, are currently anticipated.

ITEM 3. LEGAL PROCEEDINGS

In addition to the matters described below, we are involved in other ordinary routine legal proceedings, lawsuits and claims incidental to the conduct of our business. Estimates of the probable costs for resolution of these claims are accrued to the extent that they can be reasonably estimated. These estimates are based on an analysis of potential outcomes, assuming a combination of litigation and settlement strategies. These estimates also take into account any claim relating to events that occurred prior to our bankruptcy filing, which were required to be reported in a proof of claim filed with the Bankruptcy Court. However, legal proceedings are subject to significant uncertainties, the outcomes of which are difficult to predict, and assumptions and strategies may change. Consequently, we are unable to ascertain the ultimate financial impact of any legal proceedings.

LITIGATION MATTERS

On or about March 3, 2005, a first amended complaint was filed against us in the U.S. District Court for the District of Oregon, captioned *Adidas America, Inc. and Adidas Salomon AG v. Kmart Corporation and Footstar, Inc.* The first amended complaint and subsequent amendments, seek injunctive relief and unspecified monetary damages for alleged trademark infringement, trademark dilution, unfair competition, deceptive trade practices and breach of contract arising out of our use of four stripes as a design element on footwear which Adidas claims infringes on its registered three stripe trademark. While it is not possible to predict the outcome of the litigation, we believe that we have meritorious defenses which we have asserted in the pleadings filed in the Oregon proceedings and in our bankruptcy proceedings. At each balance sheet date, or more frequently as conditions warrant, the Company reviews the status of this claim, as well as its potential insurance coverage for such claim with due consideration given to potentially applicable deductibles and reservations of rights under its insurance policies. While the ultimate outcome of any litigation cannot be

Table of Contents

predicted, management believes that adequate provision has been made with respect to such claim and does not believe that an amount of loss in excess of recorded amounts is reasonably possible. Based on the information presently available and the availability of insurance, the Company does not expect that the outcome of such claim will have a material adverse effect on the Company s financial condition, results of operations or liquidity. There can be no assurance, however, that future events will not require the Company to increase the amount it has accrued for this matter. It is currently anticipated that a trial in this matter will take place in July 2008.

We are involved in various other claims and legal actions arising in the ordinary course of business. We do not believe that any of them will have a material adverse effect on our financial position.

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

None

PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

After the delisting of our common stock from the NYSE on December 30, 2003, our common stock was traded on the over-the-counter bulletin board (OTCBB) under the symbol FTSTQ.PK. Effective March 13, 2006 our symbol changed to FTAR.OB. Our common stock is quoted on the OTCBB and on the Pink Sheets LLC. Prices shown below reflect the quarterly high and low bid quotations for the common stock as reported on the OTCBB System. The over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, may not necessarily reflect actual transactions and have not been adjusted for dividends. As of February 29, 2008, the closing bid quotation of our common stock was $4.25 and there were 1,535 shareholders of record (not including the number of persons or entities holding stock in nominee or street name through various banks and brokerage firms). Information concerning the high and low closing bid quotations of our common stock is set forth below:

	HIGH	LOW
2006		
First Quarter	$4.75	$3.35
Second Quarter	$5.95	$4.25
Third Quarter	$5.45	$4.15
Fourth Quarter	$6.60	$4.75
2007		
First Quarter	$8.50	$6.10
Second Quarter	$9.12	$4.10
Third Quarter	$4.72	$4.00
Fourth Quarter	$4.92	$4.20

On March 27, 2007, the Company announced that its Board of Directors declared a special cash distribution to shareholders in the amount of $5.00 per common share. The Company recorded this distribution effective the date the declaration was made by the Board of Directors.

Table of Contents

The Company has no plans to pay regular cash distribution(s) or dividends. However, the Company s Board of Directors has considered, and could determine in the future, in its discretion, to approve and declare further distribution(s) or dividend(s) to shareholders. There can be no assurance that any such distribution(s) or dividend(s) will be approved or, if paid, in what amount or amounts or the timing thereof.

Please refer to Introductory Note and Item 1A, Risk Factors, above, in connection with the anticipated wind-down of the Company s businesses in connection with the Kmart Agreement.

Stock Performance Graph

The graph set forth below shows the cumulative total return to stockholders over the five-year fiscal period ended December 29,2007, assuming an investment of $100 on December 27, 2002 in each of Footstar s common stock, the NASDAQ Composite Index and the S&P Footwear Index. The graph assumes all dividends have been reinvested. The stock price performance included in the graph is not necessarily indicative of future stock price performance.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN

Among Footstar, Inc., The NASDAQ Composite Index

And The S&P Footwear Index

The Performance Graph in this Item 5 is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA
FIVE-YEAR HISTORICAL FINANCIAL SUMMARY

(dollars in millions except per share data)	**2007**	2006	2005	2004	2003
Statement of Operations Data					
Net sales	**$ 637.0**	$ 666.7	$ 715.4	$ 800.2	$ 962.4
Cost of sales	**427.4**	452.1	490.4	535.8	650.3
Gross profit	**209.6**	214.6	225.0	264.4	312.1
Store operating, selling, general and administrative expenses	**148.6**	160.6	183.1	236.1	250.7
Depreciation and amortization	**8.1**	8.8	7.7	21.7	19.0
Restructuring, asset impairment and other charges, net					2.5
Loss on Kmart Settlement (1)				6.3	
Other income	**(0.6)**			(9.2)	(5.4)
Interest expense	**1.2**	1.6	4.6	11.0	23.4
Interest income	**(2.6)**	(3.8)			(1.1)
Income (loss) before reorganization items, income taxes, minority interests and discontinued operations	**54.9**	47.4	29.6	(1.5)	23.0
Reorganization items (2)			(14.6)	(37.1)	
Income (loss) before income taxes, minority interests and discontinued operations	**54.9**	47.4	15.0	(38.6)	23.0
(Provision) benefit for income taxes (3)	**(2.1)**	(1.4)	(4.2)	2.9	(10.0)
Income (loss) before minority interests and discontinued operations	**52.8**	46.0	10.8	(35.7)	13.0
Minority interests in net loss (income)				11.0	(17.3)
Income (loss) from continuing operations	**52.8**	46.0	10.8	(24.7)	(4.3)
(Loss) income from discontinued operations, net of tax (4)	**(0.8)**	(0.8)	4.7	(66.7)	(50.1)
Gain from disposal of discontinued operations, net of tax		0.1	8.9	21.4	
Net income (loss)	**$ 52.0**	$ 45.3	$ 24.4	$ (70.0)	$ (54.4)
Basic income (loss) per share from continuing operations	**$ 2.56**	$ 2.23	$ 0.53	$ (1.20)	$ (0.21)
Diluted income (loss) per share from continuing operations	**$ 2.52**	$ 2.21	$ 0.53	$ (1.20)	$ (0.21)

15

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA, cont.
FIVE-YEAR HISTORICAL FINANCIAL SUMMARY

(dollars in millions)	**2007**	2006	2005	2004	2003
Balance Sheet Data					
Current assets:					
Cash and cash equivalents	**$ 53.8**	$101.3	$196.1	$189.6	$ 1.1
Inventories	**86.7**	92.0	89.2	98.9	179.7
Other	**15.8**	18.5	30.3	50.5	39.7
Assets related to discontinued operations			0.1	6.2	284.5
Total current assets	**156.3**	211.8	315.7	345.2	505.0
Property and equipment, net	**20.7**	25.2	28.9	35.4	147.2
Other assets	**4.6**	8.3	12.1	13.5	12.5
Total assets	**$181.6**	$245.3	$356.7	$394.1	$664.7
Notes payable	**$**	$	$	$	$198.0
Amount due under Kmart Settlement (1)	**5.1**			45.0	
Other current liabilities	**69.9**	78.5	107.8	98.0	133.2
Liabilities related to discontinued operations	**0.9**	2.3	7.4	3.5	110.5
Liabilities subject to compromise	**0.5**	1.2	125.5	152.3	
Total current liabilities	**76.4**	82.0	240.7	298.8	441.7
Other long term liabilities	**26.1**	26.6	35.0	38.5	58.9
Amount due under Kmart Settlement (1)		5.2	5.5	5.5	
Minority interests in subsidiaries (1)					42.2
Total liabilities	**102.5**	113.8	281.2	342.8	542.8
Shareholders equity	**79.1**	131.5	75.5	51.3	121.9
Total liabilities and shareholders equity	**$181.6**	$245.3	$356.7	$394.1	$664.7

(1) Represents additional charge incurred on Kmart Settlement and the elimination of the minority interests as part of the cure payment and

amount due relating to future store closings.

(2) Represents income and expenses associated with our bankruptcy. See Note 17 Reorganization Items of Notes to Consolidated Financial Statements.

(3) We reviewed the valuation of our deferred tax assets based on objective positive evidence, such as projections of our future taxable earnings along with negative evidence, such as operational uncertainties, no taxable income in carryback period, and anticipated liquidation of our Kmart business in connection with the termination of the Kmart Agreement no later than the end of 2008. As a result, we could not conclude that it is more likely than not that the deferred tax assets will be realized and have recorded a (reduction) increase of the valuation allowance of $(20.3) million in fiscal 2007, $(22.1) million in fiscal 2006, $(6.4) million in fiscal 2005,

$21.4 million in fiscal 2004 and $24.7 million in fiscal 2003.

(4) Loss from discontinued operations includes the losses from the operations of our discontinued Athletic Segment and the losses from the operations of our discontinued Meldisco operations including Shoe Zone stores and the footwear departments of Gordmans and Federated (Meldisco). We discontinued the Athletic Segment in 2003 and Meldisco in 2004. Additionally, during 2007, the Company increased its liability for an environmental remediation project which relates to a landfill used by one of the Company s former manufacturing facilities that was closed over 20 years ago. As such, the accounting for the additional obligation has been recorded in Discontinued Operations. The (loss) income from discontinued operations includes the following (in millions):

	2007	2006	2005	2004	2003
Athletic Segment	**$**	$(0.9)	$ 5.1	$(38.9)	$(39.9)
Meldisco Businesses		0.1	(0.4)	(27.8)	(10.2)
Closed Manufacturing Facility	**$(0.8)**				
Total	**$(0.8)**	$(0.8)	$ 4.7	$(66.7)	$(50.1)

See Note 3 Discontinued Operations of Notes to Consolidated Financial Statements.

Table of Contents

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

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements made in reliance upon the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements may be identified by the use of words such as anticipate, estimates, should, expect, project, intend, believe and other words and terms of similar meaning, in connection with any discussion of our financial statements, business, results of operations, liquidity, future operating or financial performance and other future events and circumstances. Factors that could affect our forward-looking statements include, among other things:

- the Company s ability to manage the anticipated wind-down of its current businesses in connection with the termination of our Kmart business by the end of 2008 (subject to any earlier termination by mutual agreement of Kmart and the Company or, in certain particular circumstances provided for in the Kmart Agreement, unilaterally by a party pursuant to the existing early termination or default terms of the Kmart Agreement);
- whether the Company continues to operate the footwear departments in Kmart stores through December 2008;
- the impact of the payment of the $5.00 per share special distribution on April 30, 2007 on our future cash requirements and liquidity needs, both for our operating plans and any contingencies and obligations;
- the Company s ability to obtain and maintain adequate terms and service with vendors and service providers and to ensure timely delivery of goods through December 2008;
- the effect of making more current certain vendor payable terms effective February 2008;
- the ability to maintain contracts that are critical to the Company s operations;
- the Company s ability to successfully implement and maintain internal control and procedures that ensure timely, effective and accurate financial reporting;
- the Company s ability to reduce overhead costs commensurate with any decline in sales and in connection with the winding down of our business;
- any adverse developments in existing commercial disputes or legal proceedings;
- the Company s ability to manage and plan for the disposal of, closing or conversion of Kmart stores;
- intense competition in the markets in which the Company competes; and
- retention of employees.