

FOOTSTAR INC
Form 10-Q
August 17, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 3, 2010

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: 1-11681

FOOTSTAR, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

22-3439443
(I.R.S. Employer Identification No.)

933 MacArthur Blvd., Mahwah, New Jersey
(Address of principal executive offices)

07430
(Zip Code)

(201) 934-2000
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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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 ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☒

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

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 ☒ No ☐

Number of shares outstanding of common stock, par value \$.01 per share, as of August 2, 2010: 24,183,897

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PART 1. FINANCIAL INFORMATION

ITEM 1. Financial Statements.

FOOTSTAR, INC. and SUBSIDIARY COMPANIES

Consolidated Condensed Statements of Operations

For the period April 5, 2009 through May 5, 2009 and

the period January 4, 2009 to May 5, 2009 (Going Concern Basis)
(in millions, except per share amounts)

	For the period April 5, 2009 to May 5, 2009 (unaudited)	For the period January 4, 2009 to May 5, 2009 *
Revenue		
Net Sales	\$ -	\$ -
Liquidation of inventory	-	2.5
Total revenue	-	2.5
Cost of revenue	-	-
Gross Profit	-	2.5
Store operating, selling, general and administrative expenses	1.7	6.5
Other Expense	(0.2)	(0.3)
Loss before income taxes and discontinued operations	(1.5)	(3.7)
Income tax provision	-	-
Net Loss	\$ (1.5)	\$ (3.7)
Net income (loss) per share:		
Basic & Diluted :		
Loss from continuing operations	\$ (0.07)	\$ (0.17)
Average common shares outstanding		
Basic & diluted:	21.4	21.3

* Derived from audited financial information

See accompanying notes to unaudited consolidated condensed financial statements.

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FOOTSTAR, INC. and SUBSIDIARY COMPANIES

Consolidated Condensed Statements of Net Assets

July 3, 2010 and January 2, 2010 (Liquidation Basis)
(\$ in millions)

	July 3, 2010 (Unaudited)	January 2, 2010 *
Current assets:		
Cash and cash equivalents	\$9.1	\$9.8
Prepaid expenses	2.9	5.1
Real Estate	6.2	6.2
Total current assets	18.2	21.1
Other assets	-	0.2
Total assets	18.2	21.3
Current liabilities:		
Accounts Payable and Accrued Expenses	3.1	5.3
Total current liabilities	3.1	5.3
Other long term liabilities	3.8	6.0
Total liabilities	6.9	11.3
Net Assets in Liquidation	\$11.3	\$10.0

* Derived from audited financial information

See accompanying notes to unaudited consolidated condensed financial statements.

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FOOTSTAR, INC. and SUBSIDIARY COMPANIES

Consolidated Condensed Statement of Changes in Net Assets in Liquidation

For the Six Months Ended July 3, 2010

(Liquidation Basis – Unaudited)

(\$ in millions)

	Six Months Ended July 3, 2010
Net Assets in liquidation January 2, 2010	\$ 10.0
Other cash proceeds received	0.1
Changes in liquidation accruals	0.2
Stock issued in lieu of compensation	0.6
Cash distribution to shareholders	(2.2)
Net Assets in Liquidation – April 3, 2010	8.7
Other cash proceeds received	1.1
Changes in liquidation accruals	1.5
Net Assets in Liquidation – July 3, 2010	\$ 11.3

See accompanying notes to unaudited consolidated condensed financial statements.

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FOOTSTAR, INC. and SUBSIDIARY COMPANIES

Consolidated Condensed Statement of Cash Flows

For the Period January 4, 2009 through May 5, 2009 (Going Concern Basis)
(\$ in millions)

	For the period January 4, 2009 to May 5, 2009 *
Net cash provided by operating activities	\$ 43.9
Cash flows used in financing activities	
Special cash distribution paid	(21.6)
Payments on Mortgage Note	(0.7)
Net cash use in financing activities	(22.3)
Net increase in cash and cash equivalents	21.6
Cash and cash equivalents, beginning of period	56.6
Cash and cash equivalents, end of period	\$ 78.2

* Derived from audited financial information

See accompanying notes to unaudited consolidated condensed financial statements.

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FOOTSTAR, INC. and SUBSIDIARY COMPANIES

1. Nature of Company

Background

Footstar, Inc. (“Footstar”, the “Company”, “we”, “us”, or “our”) is a holding company, incorporated under the laws of the State of Delaware in 1996 and operated its businesses through its subsidiaries primarily as a retailer selling family footwear through licensed footwear departments in discount chains and wholesale arrangements since 1961. Until December 31, 2008, the Company was the only major operator of licensed footwear departments in the United States. The Company had operated licensed footwear departments in various Kmart Corporation (“Kmart”) stores. The Company also had supplied certain retail stores, including Rite Aid Corporation (“Rite Aid”), with family footwear on a wholesale basis.

Substantially all of the Company’s business operations consisted of running licensed footwear departments in Kmart stores pursuant to that certain Amended and Restated Master Agreement dated as of August 24, 2005 by and between Kmart, Sears Holding Corporation (“Sears”) and the Company (the “Kmart Master Agreement”), as amended by that certain Master Agreement Amendment, dated as of April 3, 2008, by and among the Company, Kmart, certain affiliates of Kmart and Sears (the “Kmart Master Agreement Amendment” and, collectively with the Kmart Master Agreement, the “Kmart Agreement”). The Kmart Agreement expired by its terms on December 31, 2008.

Dissolution and Liquidation of the Company’s Business

In May 2008 the Board of Directors determined that it was in the best interests of the Company and its shareholders to liquidate and ultimately dissolve after the expiration of the Kmart Agreement in December 2008 (and other miscellaneous contracts through the end of such term) and to sell and/or dispose of any of the Company’s other remaining assets, including its property in Mahwah, New Jersey, which contains its corporate headquarters building, improvements and 21 acres of underlying land (collectively, the “Mahwah Real Estate”). In May 2008, the Board of Directors approved a Plan of Complete Liquidation of Footstar, Inc. (the “Original Plan”), which provided for the complete liquidation and ultimate dissolution of the Company on expiration of the Kmart Agreement on December 31, 2008.

The Board amended the Original Plan on March 5, 2009. The Amended Plan of Complete Dissolution and Liquidation of Footstar, Inc. (the “Plan of Dissolution”) reflects technical and legal changes to the Original Plan consistent with Delaware corporate law and is intended to modify, supersede and replace the Original Plan in order to more efficiently facilitate the liquidation and dissolution of the Company in the best interests of shareholders. The Plan of Dissolution provides for the complete, voluntary liquidation of the Company by providing for the sale of its remaining assets and the wind-down of the Company’s business as described in the Plan of Dissolution and for distributions of available cash to shareholders as determined by the Board of Directors (the “Dissolution”).

The Plan of Dissolution was approved by shareholders at a special meeting on May 5, 2009. Also on May 5, 2009, the Company filed a certificate of dissolution with the Secretary of State of Delaware, which commenced a three-year statutory liquidation process. The Company began implementing the Plan of Dissolution immediately following its approval, and adopted the liquidation basis of accounting effective May 6, 2009.

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In connection with the anticipated liquidation, wind-down and ultimate dissolution of the Company, the Company will, when and as determined by the Board of Directors in its absolute discretion, pay, or make adequate provision for payment of, all known and uncontroverted liabilities of the Company (including indemnification obligations and expenses associated with the liquidation and dissolution of the Company and the satisfaction in full of the obligations of the Company) and will set aside from its cash-on-hand such additional amount as the Board of Directors in its absolute discretion determines to be appropriate from time to time in connection with other, unascertained or contingent, liabilities of the Company.

2. Basis of Presentation

Basis of Presentation

The consolidated financial statements have been prepared by the Company without audit in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”), and should be read in conjunction with the audited Consolidated Financial Statements previously filed on the Company’s Form 10-K for the fiscal year ended January 2, 2010. In the opinion of management, the statements reflect all adjustments necessary for a fair presentation of the results of interim periods.

Certain information and note disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, which are not required for interim purposes, have been condensed or omitted. The results for any interim period are not necessarily indicative of the results to be expected for a full year.

The consolidated financial statements for the period ended July 3, 2010 were prepared on the liquidation basis of accounting and for the period ended May 5, 2009 were prepared on the going concern basis of accounting, which contemplates realization of assets and satisfaction of liabilities in the normal course of business. As a result of the shareholder’ approval of the Plan of Dissolution, the Company adopted the liquidation basis of accounting effective May 6, 2009. This basis of accounting is considered appropriate when, among other things, liquidation of a company is probable and the net realizable values of assets are reasonably determinable. Under this basis of accounting, assets are valued at their net realizable values and liabilities are stated at their estimated settlement amounts.

The conversion from the going concern to liquidation basis of accounting required management to make significant estimates and judgments. In order to record assets at estimated net realizable value and liabilities at estimated settlement amounts under the liquidation basis of accounting, the Company recorded its assets and liabilities at fair value as of May 6, 2009, the date of adoption of the liquidation basis of accounting.

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Accrued Cost of Liquidation

The Company will continue to incur certain operating costs and receive income on its investments throughout the liquidation period. On a regular basis, we will evaluate our assumptions, judgments and estimates that can have a significant impact on our reported net assets in liquidation based on the most recent information available to us, and when necessary make changes accordingly. Actual costs and income may differ from our estimates, which might reduce or increase the net assets available in liquidation to be distributed to shareholders. During the period April 4, 2010 to July 3, 2010, the Company recorded a reduction in liquidating expense accrual of \$1.5 million, related to reduced Compensation, General and Administrative and Headquarters Building Costs and received cash proceeds of \$1.1 million from a class action lawsuit, tax refunds and miscellaneous cash receipts. The Company does not anticipate any further significant recoveries from the aforementioned class action lawsuit.

The company does not expect to make any further distributions until such time as it has monetized its Mahwah Real Estate, following which, the Company expects to make further distributions to its shareholders of its remaining cash, less any amount applied to or reserved for actual or contingent liabilities (which may be deposited in a liquidating trust). The amounts reserved will be based on a determination by the Board of Directors, derived from consultation with management and outside experts, if the Board of Directors determines that it is advisable to retain such experts, and a review of, among other things, our estimated contingent liabilities and our estimated ongoing expenses, including, but not limited to, payroll, legal expenses, regulatory filings and other miscellaneous expenses. Each shareholder will receive its pro rata share of each distribution based on the number of shares held on the record date for such distribution. If at the end of the statutory three-year dissolution period on May 5, 2012, the Company has unsettled liabilities as more fully discussed in Note 9, it may determine to transfer its remaining assets and liabilities to a liquidating trust.

3. Fair Value

Effective January 1, 2008, the Company adopted Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 820, “Fair Value Measurement and Disclosure,” which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosure about fair value measurements. The Company uses the following methods for determining fair value in accordance with FASB ASC Topic 820. For assets and liabilities that are measured using quoted prices in active markets for the identical asset or liability, the total fair value is the published market price per unit multiplied by the number of units held without consideration of transaction costs (Level 1). Assets and liabilities that are measured using significant other observable inputs are valued by reference to similar assets or liabilities, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data (Level 2). For all remaining assets and liabilities for which there are no significant observable inputs, fair value is derived using an assessment of various discount rates, default risk, credit quality and the overall capital market liquidity (Level 3).

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The following table summarizes the basis used to measure certain financial assets and liabilities at fair value on a recurring basis in the consolidated balance sheet:

Fair Value Measurements at July 3, 2010

(In millions)	Balance at	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description	July 3, 2010			
Money Market Funds	8.8	8.8	-	-
Mahwah Real Estate	6.2	-	-	6.2

Money Market Funds – money market funds are valued using quoted market prices. Accordingly, money market funds are categorized in Level 1 of the fair value hierarchy. See also Note 4 for further discussion of the Mahwah Real Estate.

4. Mahwah Real Estate

The Company has been marketing its Mahwah Real Estate since May 5, 2007. As of July 3, 2010, the Company estimates that the fair value of the real estate, less estimated closing costs, is approximately \$6.2 million. This estimate is based on unobservable inputs and as such the actual amount ultimately realized upon disposition of this real estate could be materially different. There was no change in this value from January 2, 2010 to July 3, 2010.

The Company's mortgage, assumed in connection with the purchase of the Mahwah Real Estate was paid in full on May 1, 2010.

5. Earnings Per Share

Basic earnings per share ("EPS") is computed by dividing net (loss) income available for common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed by dividing net (loss) income available to common shareholders by the weighted average shares outstanding, after giving effect to the potential dilution that could occur if outstanding options or other contract or obligations to issue common stock were exercised or converted.

The following table reflects average shares outstanding used to compute basic and diluted (loss) earnings per share (in millions):

	For the period April 5, 2009 to May 5, 2009	For the period January 4, 2009 to May 5, 2009
Average shares outstanding – basic and diluted	21.4	21.3

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The computation of diluted EPS does not assume conversion, exercise or issuance of shares that would have an anti-dilutive effect on EPS. During the period of April 5, 2009 – May 5, 2009 and January 4, 2009 – May 5, 2009 we had a net loss; as a result, any assumed conversions would result in reducing the loss per share and, therefore, are not included in the calculation. Shares that could potentially dilute EPS in the future, but which were not included in the calculation of diluted EPS because to do so would have been anti-dilutive, totaled 269,625 shares for the period of April 5, 2009 – May 5, 2009 and for the period of January 4, 2009 – May 5, 2009.

6. Income Taxes

As of July 3, 2010, all of the Company's deferred tax assets continue to be subject to a full valuation allowance, including the net operating losses available to offset future taxable income.

7. Commitments and Contingencies

Litigation Matters

The Company is involved in various and routine litigation matters, which arise through the normal course of business. Management believes that the resolution of these matters will not have a material adverse effect on the final liquidation of the Company. While it firmly maintains that all pending claims are meritless, the Company will, however, continue to expend costs as it vigorously defends against these claims.

In connection with the Company's discontinued operations in 1995, the Company entered into a sub-lease formerly occupied by its Thom McAn stores. The lease expires effective February 1, 2014. The obligation under the sublease is \$2.8 million, although the Company believes that there has been a novation of its obligations under such lease and may in the future bring litigation to have a court finally determine such issue. If we are unable to resolve this matter prior to the conclusion of our statutory dissolution period on May 6, 2012, we may be required to fund a Liquidating Trust with \$1.5 million (the obligation amount from May 2012 through February 2014) until such time as the matter is concluded. At this time, the Company has not recorded a liability relating to this commitment as the probability of an unfavorable outcome is remote.

8. Special Cash Distribution

On February 24, 2010, the Company announced that its Board of Directors declared a \$.10 per share liquidating cash distribution to shareholders of record as of March 8, 2010. The distribution totaled \$2.2 million and was paid on March 12, 2010 from current balances in cash and cash equivalents.

On February 24, 2010, the Company announced it anticipates it will not make any further distributions until the monetization of the Mahwah Real Estate.

The aggregate amount of any remaining liquidation distribution to our shareholders is expected to be in the range of \$.41 to \$.47 per common share. However, uncertainties as to the ultimate amount of our liabilities make it impossible to predict with certainty the actual aggregate net amounts that will ultimately be available for distribution to shareholders or the timing of any such distributions. Such amount and timing will depend on a number of factors, several of which cannot be determined at this time, including:

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- 1) the ultimate amount of our known, unknown and contingent debts and liabilities;
- 2) the fees and expenses incurred by us in the liquidation of our assets; and
- 3) the ultimate proceeds from the sale of the Mahwah Real Estate.

As a result, the amount of cash remaining following completion of our liquidation could vary significantly from our current estimates.

9. Letters of Credit

In the past, we entered into standby letters of credit to secure certain obligations, including insurance programs and duties related to the import of our merchandise. These standby letters of credit, before balances were drawn down by the beneficiaries, were cash collateralized at 103% of face value, plus a reserve for future fees (the “L/C Cash Collateral”) totaled \$1.9 million, with Bank of America as issuing bank. In connection therewith, Bank of America had been granted a first priority security interest and lien upon the L/C Cash Collateral. On May 24, 2010, The Bank of America N.A. LC Cash Collateral account terminated by its terms.

On May 10, 2010, \$1.8 million, representing 100% of the amounts for which letters of credit have been provided, were drawn by the beneficiaries. The Company does not anticipate recovery of \$1.75 million of this amount for its Workers Compensation insurance programs. The Company anticipates recovering \$0.05 million of this amount for customs duties prior to the completion of its dissolution.

On May 20, 2010, \$0.1 million, representing the L/C Cash Collateral was refunded to the Company.

10. Stock Options

The Company records stock based compensation in accordance with FASB ASC Topic 718 “Compensation – Stock Compensation,” which requires all companies to measure and recognize compensation expense at fair value for all stock-based payments to employees and directors. The Company uses the Black-Scholes option-pricing model to estimate fair value of grants of employee and director stock options.

The Company calculates expected volatility for a share-based grant based on historic daily stock price observations of our common stock during the period immediately preceding the grant that is equal in length to the expected term of the grant. FASB ASC Topic 718 also requires that estimated forfeitures be included as a part of the estimate of expense as of the grant date. The Company has used historical data to estimate expected employee behaviors related to option term, exercises and forfeitures. With respect to both grants of options and awards of restricted stock, the risk free rate of interest is based on the U.S. Treasury rates appropriate for the expected term of the grant or award. Stock option expense relating to stock options was \$0 for each of the periods of January 4, 2009 through May 5, 2009 and April 5, 2009 through May 5, 2009. A summary of option activity as of July 3, 2010 and changes during the six months ended is presented below.

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	Shares	Weighted Average Exercise Price
Balance: January 2, 2010	191,240	\$31.28
Granted	2,500,000	0.40
Exercised	-	-
Forfeited	(65,100)	\$(21.75)
Balance: July 3, 2010	2,626,140	\$2.12
Options Exercisable: July 3, 2010	2,626,140	\$2.12

On March 15, 2010, Mr. Couchman was awarded a stock option to purchase up to 2,500,000 shares of the Company's common stock at an exercise price of \$0.40 per share (after giving effect to the liquidating cash dividend of \$0.10 paid on March 12, 2010). On the date of the grant, the closing stock price of the Company's stock was \$0.23. The stock option was fully vested at the time of the grant. The stock option expires upon the earlier of the tenth anniversary of the grant date and the payment of the final liquidation distribution to the Company's shareholders. The Company believes that granting a stock option with an exercise price substantially above both the estimated liquidation value per share and market price per share at the time of the grant will further incentive Mr. Couchman to work to maximize distributions to shareholders.

ITEM 2. 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 (the "Exchange Act"). These statements may be identified by the use of words such as "anticipate," "estimates," "should," "expect," "project," "intend," "plan," "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 impact of any dividends or any other special distributions to shareholders on the Company's future cash requirements and liquidity needs, both in connection with the wind-down of the Company's operations and all contingencies;

- under the Plan of Dissolution, the Company's remaining assets will be disposed of, known liabilities will be paid or provided for and reserves will be established for contingent liabilities, with only any remaining assets available for ultimate distribution;

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uncertainties exist as to the disposition value of our remaining assets as well as the amount of our liabilities and obligations, and, in connection with the Plan of Dissolution and our Dissolution, there can be no assurance as to the amount of any cash or other property that may potentially be distributed to shareholders or the timing of any distributions;

- we do not expect to be able to fully realize the benefits of our net operating loss carry forwards; and

the difficulty of selling the Mahwah Real Estate on satisfactory terms, taking into account the current decline in economic conditions, the New Jersey real estate market and the current disruption in the capital and credit markets.

Because the information in this Quarterly Report on Form 10-Q is based solely on data currently available, it is subject to change and should not be viewed as providing any assurance regarding our future. Actual results, operations, performance, events, plans and expectations may differ materially from our current expectations and the differences may be material, individually or in the aggregate, to our business, financial condition, and results of operations, liquidity and prospects. Additionally, we do not plan to update any of our forward-looking statements based on changes in assumptions, changes in results or other events subsequent to the date of this Quarterly Report on Form 10-Q, other than as included in our future required SEC filings, or as may otherwise be legally required.

Liquidity and Capital Resources

The Company also has and continues to incur additional severance, liquidation costs and professional fees in connection with the wind-down of its business. The Company intends to fund such cash requirements through current balances in cash and cash equivalents. At July 3, 2010, we had cash and cash equivalents of approximately \$9.1 million.

On February 24, 2010, the Company announced that its Board of Directors declared a liquidating cash distribution to shareholders in the amount of \$.10 per common share. The Company recorded the distribution effective the date the declaration was made by the Board of Directors. The liquidating cash distribution totaled \$2.2 million and was paid on March 12, 2010 to the holders of record at the close of business on March 8, 2010.

On February 24, 2010, the Company announced it anticipates it will not make any further distributions until the monetization of the Mahwah Real Estate.

Factors that could affect our short and long term liquidity relate primarily to the final wind-down of the businesses and include, among other things, the payment of any further dividends or distributions, our ability to sell our Mahwah Real Estate on acceptable terms, and managing costs associated with the management, liquidation and dissolution of the Company.

We plan to sell or liquidate any remaining assets and pay all of our known and undisputed liabilities and obligations. We intend to establish a contingency reserve to cover any unknown, disputed or contingent liabilities and intend to distribute remaining amounts to shareholders as and when our Board of Directors deems appropriate. We also intend to distribute remaining liquidation proceeds as promptly as practicable following the sale or liquidation of our remaining assets, subject to payment or provisions for the payment of known obligations and, if necessary or appropriate, establishing a contingency reserve. It is possible that unanticipated lawsuits or other claims will be asserted against us, which could result in certain distributions to our shareholders being delayed until the resolution of any such lawsuit or other claim and such period could extend over multiple years.

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Letters of Credit

In the past, we entered into standby letters of credit to secure certain obligations, including insurance programs and duties related to the import of our merchandise. These standby letters of credit, before balances were drawn down by the beneficiaries, were cash collateralized at 103% of face value, plus a reserve for future fees (the “L/C Cash Collateral”) totaled \$1.9 million, with Bank of America as issuing bank. In connection therewith, Bank of America had been granted a first priority security interest and lien upon the L/C Cash Collateral. On May 24, 2010, The Bank of America N.A. LC Cash Collateral account terminated by its terms.

On May 10, 2010, \$1.8 million, representing 100% of the amounts for which letters of credit have been provided, were drawn by the beneficiaries. The Company does not anticipate recovery of \$1.75 million of this amount for its Workers Compensation insurance programs. The Company anticipates recovering \$0.05 million of this amount for customs duties prior to the completion of its dissolution.

On May 20, 2010, \$0.1 million, representing the L/C Cash Collateral was refunded to the Company.

Critical Accounting Estimates

Our discussion of results of operations and financial condition relies on our consolidated financial statements that are prepared based on certain critical accounting estimates that require management to make judgments and estimates that are subject to varying degrees of uncertainty. We believe that investors need to be aware of these estimates and how they impact our financial statements as a whole, as well as our related discussion and analysis presented herein. While we believe that these accounting estimates are based on sound measurement criteria, actual future events can and often do result in outcomes that can be materially different from these estimates or forecasts.

The critical accounting estimates and related risks described in the Company’s Annual Report on Form 10-K for fiscal year ended January 2, 2010 (the “2009 Annual Report”) are those that depend most heavily on these judgments and estimates. As of July 3, 2010, there have been no material changes to any of the critical accounting estimates contained in the 2009 Annual Report.

In connection with the expiration of the Kmart Agreement, the Company has been marketing its Mahwah Real Estate. As of July 3, 2010, the Company estimates that the fair value of the real estate, less estimated closing costs, is approximately \$6.2 million. This estimate is based on unobservable inputs and as such the actual amount ultimately realized upon disposition of this real estate could be materially different. There was no change in this value from January 2, 2010 to July 3, 2010.

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ITEM 3. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable.

ITEM 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (“the Exchange Act”)) that are designed to ensure that information required to be disclosed by us in the reports we file or submit under 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 our management, including our Chief executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management evaluated, with the participation of our Chief Executive and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings.

The information set forth under the caption “Litigation Matters” in Note 7 to the Condensed Consolidated Financial Statements is incorporated herein by reference.

ITEM 1A. Risk Factors.

There are many factors that our shareholders should consider when deciding whether to invest in our common stock. Such factors include the risk factors set out in our publicly filed reports, including our 2009 Annual Report, which report is incorporated herein by reference, as well as the factors set forth below.

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We stopped recording transfers of our common stock on our stock transfer books on April 23, 2010 and therefore it is no longer possible for shareholders to change record ownership of our stock.

As of April 23, 2010 (the "Amended Final Record Date") we stopped recording transfers of our common stock on our stock transfer books. Accordingly, from and after the Amended Final Record Date, certificates representing our common stock are not assignable or transferable on the books of the Company except by will, intestate succession or operation of law. However, until trading is halted through termination of registration of our shares of common stock with the SEC, we believe that any trades of shares of our common stock after the Final Record Date are being tracked and marked with a due bill by brokers.

We intend in the future to make liquidation distributions pursuant to the Plan of Dissolution. From and after the Amended Final Record Date, and subject to applicable law, each holder of our common stock will have the right to receive liquidation distributions pursuant to, and in accordance with, the Plan of Dissolution until the final liquidation distribution is made. The proportionate interests of all of the shareholders of the Company have been fixed in the books of the Company on the basis of their respective stock holdings at the close of business on the Amended Final Record Date. Therefore, any liquidation distributions we make in the future will be made solely to the shareholders of record at the close of business on the Amended Final Record Date, except as may be necessary to reflect subsequent transfers recorded on the books of the Company as a result of any assignments by will, intestate succession or operation of law. The final liquidation distribution under the Plan of Dissolution will be in complete cancellation of all of the outstanding shares of our common stock.

Although we intend to seek relief from the SEC of certain of our public company reporting requirements, we cannot assure you that we will be successful in obtaining such relief.

We intend to seek relief from the SEC of certain of our public company reporting requirements. If we are able to obtain such relief from the SEC, we will continue to file current reports on Form 8-K to disclose material events relating to our liquidation, along with any other reports that the SEC may require, though we will no longer file annual and quarterly reports with the SEC. If we are unable to obtain relief, we will continue to file annual and quarterly reports with the SEC which will require us to continue to incur significant accounting, legal and other administrative costs in connection with preparing, reviewing and filing with the SEC.

See "Forward-Looking Statements" in Part I, Item 2 for additional risk factors to consider.

ITEM 6.

Exhibits.

- 31.1 Certification of Chief Executive Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Footstar, Inc.

Date: August 17, 2010

By: /s/ Jonathan M. Couchman

Jonathan M. Couchman

President, Chief Executive Officer and Chief Financial Officer