MOVIE STAR INC /NY/
Form 10-Q
May 14, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Under Section 13 or 15(d) of the

X Securities Exchange Act of 1934

For the quarter ended March 31, 2001

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 1-5893

MOVIE STAR, INC.
(Exact name of Registrant as specified in its charter)

New York 13-5651322
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

1115 Broadway, New York, N.Y. 10010
(Address of principal executive offices) (Zip Code)

(212) 684-3400
(Registrant's telephone number, including area code)

(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 X No
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The number of common shares outstanding on April 30, 2001 was 14,896,977.

MOVIE STAR, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(In Thousands)

	March 31, 2001 (Unaudited)	June 30, 2000*
Assets		
Current Assets		
Cash	$ 396	$ 712
Receivables, net	10,535	7,960
Inventory	11,785	14,643
Prepaid expenses and other current assets	1,997	2,143
Total current assets	24,713	25,458
Property, plant and equipment, net	2,215	3,247
Other assets	2,571	2,922
Total assets	$29,499	$31,627
Liabilities and Shareholders' Equity		
Current Liabilities		
Notes payable	$ 3,372	$ 1,690
Current maturities of long-term debt and capital lease obligations	8,848	83
Accounts payable and accrued expenses	4,454	6,432
Total current liabilities	16,674	8,205
Long-term debt and capital lease obligations	85	12,130
Commitments and Contingencies	-	-
Shareholders' equity		
Common stock, $.01 par value - authorized 30,000,000 shares; issued 16,914,000 shares	169	169
Additional paid-in capital	4,078	4,078
Retained earnings	12,111	10,663
	16,358	14,910
Less: Treasury stock, at cost - 2,017,000 shares	3,618	3,618
Total shareholders' equity	12,740	11,292
Total liabilities and shareholders' equity	$29,499	$31,627

* Derived from audited financial statements.

See notes to consolidated condensed unaudited financial statements.

MOVIE STAR, INC.
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)
(In Thousands, Except Per Share Amounts)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2001	2000	2001	2000
Net sales	$ 13,908	$ 12,898	$ 51,039	$ 50,618
Cost of sales	9,715	8,916	35,535	36,120
Gross profit	4,193	3,982	15,504	14,498
Selling, general and administrative expenses	3,702	3,382	11,508	10,461
Loss on closing of distribution facility (Note 5)	136	-	1,144	-
Operating income from continuing operations	355	600	2,852	4,037
Gain on purchases of subordinated debentures	-	-	-	(164
Interest income	(2)	(33)	(5)	(53
Interest expense	301	384	1,181	1,481
Income from continuing operations before income taxes and extraordinary gain	56	249	1,676	2,773
Income taxes	2	9	34	60
Income from continuing operations before extraordinary gain	54	240	1,642	2,713
Discontinued operations (Note 6)				
Income from operations of discontinued retail stores, net of income taxes	-	-	189	217
Loss on disposal of discontinued retail stores, including provision for operating losses during phase-out period, net of income taxes	-	-	(731)	-
Income before extraordinary gain	54	240	1,100	2,930
Extraordinary gain on purchases of subordinated debentures and senior notes, net of income taxes	-	-	348	150
Net income	$ 54	$ 240	$ 1,448	$ 3,080
BASIC NET INCOME (LOSS) PER SHARE				
From continuing operations	$ -	$ .02	$ .11	$ .18
From discontinued operations	-	-	(.04)	.02
From extraordinary gain	-	-	.03	.01

Net income per share	$ -	$ .02	$ .10	$ .21
DILUTED NET INCOME (LOSS) PER SHARE				
From continuing operations	$ -	$ .02	$ .11	$ .17
From discontinued operations	-	-	(.04)	.01
From extraordinary gain	-	-	.02	.01
Net income per share	$ -	$ .02	$ .09	$ .19
Basic weighted average number of shares outstanding	14,897	14,892	14,897	14,884
Diluted weighted average number of shares outstanding	15,378	15,804	15,370	16,041

See notes to consolidated condensed unaudited financial statements.

MOVIE STAR, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

	Nine Months Ended March 31,	
	2001	2000
CASH FLOWS FROM CONTINUING OPERATING ACTIVITIES:		
Net income	$ 1,448	$ 3,080
Adjustments to reconcile net income to net cash provided by continuing operating activities:		
Extraordinary gain on purchases of subordinated debentures and senior notes	(348)	(150)
Depreciation and amortization	380	421
Provision for allowance for doubtful accounts	123	(18)
Gain on purchases of subordinated debentures	-	(164)
Non-cash impairment charge	915	-
Loss on sale of property, plant and equipment	--	5
Loss (gain) on discontinued operations	542	(217)
(Increase) decrease in operating assets:		
Receivables	(2,698)	(2,607)
Inventory	1,324	4,257
Prepaid expenses and other current assets	136	366
Other assets	271	(95)
Decrease in operating liabilities:		
Accounts payable and accrued expenses	(788)	(1,615)
Net cash provided by continuing operating activities	1,305	3,263
CASH FLOWS FROM CONTINUING INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(459)	(105)

Proceeds from sale of property, plant and equipment	105	-
Net cash used in continuing investing activities	(354)	(105)
CASH FLOWS FROM CONTINUING FINANCING ACTIVITIES:		
Repayments on and purchases of long-term debt and capital lease obligations	(2,905)	(5,316)
Proceeds from revolving line of credit, net	1,682	-
Net cash used in continuing financing activities	(1,223)	(5,316)
Cash (used in) provided by discontinued operations	(44)	52
NET DECREASE IN CASH	(316)	(2,106)
CASH, beginning of period	712	4.597
CASH, end of period	$ 396	$ 2,491

(Cont'd)

See notes to consolidated condensed unaudited financial statements.

MOVIE STAR, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

	Nine Months Ended March 31,	
	2001	2000
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during period for:		
Interest	$ 981	$ 1,241
Income taxes (net of refunds received)	$ 58	$ 26
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING ACTIVITIES:		
Acquisition of equipment through assumption of capital lease obligation	$ -	$ 18
SUPPLEMENTAL DISCLOSURES OF NONCASH FINANCING ACTIVITIES:		
Conversion of long-term debt for common stock	$ -	$ (6)
Issuance of common stock	-	6

	$ -	$ -

(Concluded)

See notes to consolidated condensed unaudited financial statements.

MOVIE STAR, INC.
NOTES TO CONSOLIDATED CONDENSED UNAUDITED FINANCIAL STATEMENTS

1. In the opinion of the Company, the accompanying consolidated condensed unaudited financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position as of March 31, 2001 and the results of operations for the interim periods presented and cash flows for the nine months ended March 31, 2001 and 2000, respectively.

   The condensed consolidated financial statements and notes are presented as required by Form 10-Q and do not contain certain information included in the Company's year-end consolidated financial statements. The year-end condensed consolidated balance sheet was derived from the Company's audited financial statements. The results of operations for the three and nine months ended March 31, 2001 are not necessarily indicative of the results to be expected for the full year. This Form 10-Q should be read in conjunction with the Company's consolidated financial statements and notes included in the 2000 Annual Report on Form 10-K.

2. The inventory consists of the following (in thousands):

	March 31, 2001	June 30, 2000
Raw materials	$ 2,133	$ 5,787
Work-in process	674	952
Finished goods	8,978	7,904
	$11,785	$14,643

3. During the second quarter ended December 31, 2000, the Company purchased $3,050,000 in principal amount of its 8% Senior Notes and $157,000 in principal amount of its 12.875% Subordinated Debentures. As a result of these purchases, the Company recorded an extraordinary gain of $348,000, net of related costs and income taxes of $20,000 and $7,000, respectively. The Company will apply the principal amount of the 8% Senior Notes against the final payment due on September 1, 2001 and the principal amount of the 12.875% Subordinated Debentures against the final payment due on October 1, 2001.

   During September 2000, the Company purchased $10,000 in principal amount of its 12.875% Subordinated Debentures. The Company will further reduce its final payment due in October 2001 by an amount equal to the face amount of the principal of these debentures.

During the second quarter ended December 31, 1999, the Company purchased $2,786,000 in principal amount of its 12.875% Subordinated Debentures. Using previously acquired debentures and $903,000 of these debentures, the Company satisfied its sinking fund requirement due October 1, 2000. As a result of the purchase of these $903,000 of debentures, the Company recorded a pre-tax gain of $50,000, net of related costs. The remaining $1,883,000 of repurchased debentures will be applied to the final payment due on October 1, 2001. As a result of the purchase of these $1,883,000 of debentures, the Company recorded an extraordinary gain of $150,000, net of related costs and income taxes of $7,000 and $3,000, respectively.

In the first quarter ended September 30, 1999, the Company purchased $2,834,000 in principal amount of its 12.875% Subordinated Debentures and recorded a pre-tax gain of $114,000, net of related costs. The Company used these debentures to reduce its mandatory sinking fund requirement due on October 1, 2000.

4. Net Income Per Share - The Company's calculation of Basic and Diluted Net Income Per Share are as follows (in thousands, except per share amounts):

	Three Months Ended March 31,		Nine Mo Mar
	2001	2000	2001
BASIC:			
Income from continuing operations to common shareholders	$ 54	$ 240	$ 1,642
Income (loss) from discontinued operations	-	-	(542)
Extraordinary gain	-	-	348
Net income attributable to common shareholders	$ 54	$ 240	$ 1,448
Basic weighted average number of shares outstanding	14,897	14,892	14,897
Basic net income (loss) per share:			
From continuing operations	$ -	$ .02	$ .11
From discontinued operations	-	-	(.04)
From extraordinary gain	-	-	.03
Basic net income per share	$ -	$ .02	$ .10
DILUTED:			
Income from continuing operations to common shareholders	$ 54	$ 240	$ 1,642
Income (loss) from discontinued operations	-	-	(542)
Extraordinary gain	-	-	348
Plus: Interest Expense on 8% Convertible Senior Notes	1	2	4
Adjusted net income attributable to common shareholders	$ 55	$ 242	$ 1,452
Weighted average number of shares outstanding	14,897	14,892	14,897
Plus: Shares Issuable Upon Conversion of 8% Convertible Senior Notes	191	196	191
Shares Issuable Upon Conversion of Stock Options	270	689	262
Shares Issuable Upon Conversion of Warrants	20	27	20

Total average number of equivalent shares outstanding	15,378	15,804	15,370
Diluted net income per share:			
From continuing operations	$ -	$ .02	$ .11
From discontinued operations	-	-	(.04)
From extraordinary gain	-	-	.02
Diluted net income per share	$ -	$ .02	$ .09

In the nine-month period ended March 31, 2001, no potential common shares have been included in the calculation of diluted net income per share from discontinued operations because of the loss reported. At March 31, 2001, an aggregate of 525,000 potential common shares related to stock options, convertible notes and warrants have been excluded from the computation of diluted net income per share.

5. LOSS ON CLOSING OF DISTRIBUTION FACILITY

During the second and third quarter of fiscal 2001, the Company recorded facility closing costs of $93,000 and $136,000, respectively, relating to a plan to close the distribution facility in Lebanon, Virginia. The action was taken by the Company to enhance the Company's competitiveness, to reduce expenses and to improve efficiencies. The charges and related remaining accruals consist of the following (in thousands):

	December 31, 2001	March 31, 2001	Accrual Remaining as of March 31, 2001
Impairment charge	$ 915	$ -	$ -
Severance and other employee benefits	12	76	68
Exit costs	81	60	21
	$1,008	$ 136	$ 89

The Company periodically reviews the recorded value of its long-lived assets to determine if the carrying amount of those assets may not be recoverable based upon the future operating cash flows expected to be generated by those assets. In accordance with Statement of Financial Accounting Standards No. 121, during the second quarter of fiscal 2001, based upon management's decision to close the distribution facility, the Company recorded a non-cash impairment charge of $915,000 related to the write-down of a portion of the recorded property, plant and equipment values. Since the sum of the undiscounted expected future cash flows was less than the carrying amount of the asset, the asset was considered impaired. An impairment loss was measured as the amount by which the carry amount of the asset exceeds the fair value of the asset, which was based upon quoted market price, less the cost to sell the property. The $630,000 value of the asset is included in property, plant and equipment as assets held for sale, based upon the expected sale price of the building. The Company has discontinued depreciating this asset.

In conjunction with the closing of the facility, the Company will eliminate sixty-three positions and will provide severance to certain employees. The Company recorded severance and related taxes of $12,000 and $76,000 in the second and third quarter of fiscal 2001, respectively.

The Company recorded exit costs of $81,000 and $60,000 associated with the shutdown of the distribution facility during the second and third quarter of fiscal 2001, respectively. Such costs include employee salaries and benefits and other costs to be incurred after operations cease. The Company will complete the closure in the fourth quarter of fiscal 2001.

6. DISCONTINUED OPERATIONS

In December 2000, management authorized the shutdown of the retail segment and ceased all operations in March 2001. Accordingly, operating results of this segment, for the three and nine months ended March 31, 2001 and 2000, have been reclassified as income from discontinued operations.

The estimated loss on disposal provides for the write-down of assets to the estimated market value of $102,000, the loss on fulfilling lease obligations of $94,000, the costs of disposal of $200,000 and future operating losses of $350,000. Accordingly, the Company has recorded an estimated loss on disposal of $731,000, net of a benefit from income taxes of $15,000, for the nine months ended March 31, 2001. The Company does not expect the final loss on disposal to materially differ from the estimated loss.

The Company also reclassified the income from operations of discontinued operations of $189,000 and $217,000, net of income taxes of $4,000 for the nine months ended March 31, 2001 and 2000, respectively, to income from operations of discontinued retail stores.

Operating results of discontinued operations are as follows (in thousands, unaudited):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2001	2000	2001	2000
Net sales	$ 709	$1,589	$4,342	$6,442
Costs and expenses	709	1,589	4,149	6,221
Income taxes	-	-	4	4
Net income from discontinued operations	$ -	$ -	$ 189	$ 217

The net assets and liabilities of discontinued operations included in the accompanying consolidated balance sheets are as follows (in thousands, unaudited):

	March 31, 2001	June 30, 2000

Cash	$ 56	$ 100
Inventory	-	1,534
Prepaid expenses and other current assets	11	21
Property, plant and equipment, net	116	266
Other assets	-	2
Total assets of discontinued operations	$ 183	$1,923
Accounts payable	$ 30	$ 185
Accrued liabilities	179	104
Total liabilities of discontinued operations	$209	$ 289

7. SUBSEQUENT EVENT

In May 2001, the Company purchased $2,233,000 in principal of its 8% Senior Notes and will record an extraordinary gain of $123,000, net of related costs and income taxes of $3,000. The Company will apply the principal amount of the 8% Senior Notes against the final payment due on September 1, 2001.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion contains certain forward-looking statements with respect to anticipated results, which are subject to a number of risks and uncertainties. Among the factors that could cause actual results to differ materially are: business conditions and growth in the Company's industry; general economic conditions; the addition or loss of significant customers; the loss of key personnel; product development; competition; foreign government regulations; fluctuations in foreign currency exchange rates; rising costs of raw materials and the unavailability of sources of supply; the timing of orders placed by the Company's customers; and the risk factors listed from time to time in the Company's SEC reports .

Results of Continuing Operations

Net sales for the three months ended March 31, 2001 increased by 8% to $13,908,000 from $12,898,000 in the comparable period in 2000.

Net sales for the nine months ended March 31, 2001 increased by 1% to $51,039,000 from $50,618,000 in the comparable period in 2000.

The gross profit percentage decreased to 30.1% for the three months ended March 31, 2001 from 30.9% in the similar period in 2000. The gross profit percentage increased to 30.4% for the nine months ended March 31, 2001 from 28.6% in the similar period in 2000. The reduction for the three months was due to a less favorable product mix in the current year. The higher margins for the nine months resulted primarily from the shift of production to offshore locations from the Company's last fully operational domestic manufacturing facility.

At the end of January 2000, the Company completed the elimination of the sewing operation at its manufacturing facility in Virginia. This action was taken to correct the operational inefficiencies the Company experienced in the six months ended December 31, 1999 and to lower overall manufacturing costs.

During the second quarter of fiscal 2001, the Company implemented a plan to close the distribution operation at its Virginia facility and to consolidate

these operations with the warehouse and distribution facility located in Mississippi. This decision was made to increase the overall efficiencies of the Mississippi facility and reduce overall shipping costs. The Company recorded a charge in the second quarter of fiscal 2001 of $1,008,000 in connection with this closure. The charge consisted of a non-cash charge for the impairment of assets of $915,000 and other charges totaling $93,000. The Company incurred additional costs in the third quarter of approximately $136,000 related to severance for certain employees not notified of the closure until the third quarter and to prepare the facility for closure. The Company will complete the closure in the fourth quarter.

Selling, general and administrative expenses increased to $3,702,000, or 26.6% of sales, for the three months ended March 31, 2001 as compared to $3,382,000, or 26.2% of sales, for the similar period in 2000. This increase of $320,000 resulted primarily from an increase in shipping expense of $228,000, and an increase in salary expense of $72,000 and a net increase in other selling, general and administrative expenses. The increase in shipping expense was

primarily due to the inefficiencies at the Company's Virginia facility during the shutdown of that facility, the duplication of personnel of Virginia and Mississippi during the transition period and the transfer of inventory from Virginia to the Company's facility in Mississippi. The salary increase reflects a general increase in overall salaries.

Selling, general and administrative expenses increased to $11,508,000 or 22.5% of sales, for the nine months ended March 31, 2001 as compared to $10,461,000, or 20.7% of sales, for the similar period in 2000. This increase of $1,047,000 resulted primarily from an increase in shipping expense of $658,000, an increase in salary expense of $239,000 and an increase in bad debt expense of $173,000, offset partially by a net decrease in other selling, general and administrative expenses. This increase resulted from the same factors discussed above and the increase in bad debt expense was primarily related to the bankruptcy of Montgomery Ward.

Income from operations decreased to $355,000 and $2,852,000 for the three and nine months ended March 31, 2001, from $600,000 and $4,037,000 for the similar periods in 2000. The decrease for the three months was due to a decrease in gross margins, an increase in selling, general and administrative expenses and a loss on the disposal of the Virginia distribution facility partially offset by an increase in sales. The decrease for the nine months was due to an increase in selling, general and administrative expenses and a loss on the disposal of the Virginia distribution facility partially offset by an increase in sales and gross margins.

During the second quarter ended December 31, 1999, the Company purchased $2,786,000 in principal amount of its 12.875% Subordinated Debentures. In conjunction with previously acquired debentures and with $903,000 of these debentures, the Company satisfied its sinking fund requirement due October 1, 2000. As a result of the purchase of $903,000 of these debentures, the Company recorded a pre-tax gain of $50,000, net of related costs. The remaining $1,883,000 will be applied to the final payment due on October 1, 2001. As a result of the purchase of $1,883,000 of these debentures, the Company recorded an extraordinary gain of $150,000, net of related costs and income taxes.

During the first quarter ended September 30, 1999, the Company purchased $2,834,000 in principal amount of its 12.875% Subordinated Debentures. As a result, the Company recorded a pre-tax gain of $114,000, net of related costs. The Company utilized these debentures to reduce its mandatory sinking fund requirement due on October 1, 2000.

Interest income for the three and nine months ended March 31, 2001 was $2,000 and $5,000, respectively, as compared to $33,000 and $53,000 for the similar periods in 2000.

Interest expense for the three and nine months ended March 31, 2001 was $301,000 and $1,181,000, respectively, as compared to $384,000 and $1,481,000 for the similar periods in 2000. These reductions were due to overall lower borrowing levels.

The Company provided for an alternative minimum tax of $2,000 and $34,000 for the three and nine months ended March 31, 2001, respectively, as compared to $9,000 and $60,000 for the similar periods in 2000.

The Company had income from continuing operations before extraordinary gains of $54,000 and $1,642,000 for the three and nine months ended March 31, 2001, respectively, as compared to $240,000 and $2,713,000 for the similar periods in 2000. The reduction for the three months was due to a lower gross margin, an increase in selling, general and administrative expenses, a loss on the disposal of the Virginia distribution facility and a gain, in the prior year, on the purchases of the Company's 12.875% Subordinated Debentures offset partially by an increase in sales, lower net interest costs and a lower provision for income taxes. The reduction for the nine months was due to an increase in selling, general and administrative expenses, a loss on the disposal of the Virginia distribution facility and a gain, in the prior year, on the purchases of the Company's 12.875% Subordinated Debentures offset partially by an increase in sales, an increase in gross margins, lower net interest costs and a lower provision for income taxes.

Results of Discontinued Operations

Due to the continued decline in performance of the Company's retail division, in December 2000, the Company determined to dispose of the majority of the assets of this division. Accordingly, the operating results of this division, for the three and nine months ended March 31, 2001 and 2000, have been reclassified as income from discontinued operations.

In the second quarter ended December 31, 2000, the Company recorded a loss on the disposal of the retail stores of $731,000, net of a benefit from income taxes of $15,000. The estimated loss on disposal provides for the write-down of assets to the estimated market value, the loss on fulfilling lease obligations, the costs of disposal and future operating losses. At the end of March 2001, the Company had closed all of its stores and had disposed of all of its inventory. The Company does not expect the final loss on disposal to materially differ from the estimated loss.

The retail division had income from discontinued operations of $189,000 for the nine months ended March 31, 2001 as compared to $217,000 for the similar period in 2000.

Extraordinary Gain

During the second quarter ended December 31, 2000, the Company purchased $3,050,000 in principal amount of its 8% Senior Notes and $157,000 in principal amount of its 12.875% Subordinated Debentures. The 8% Senior Notes acquired by the Company will be applied in the reduction of the outstanding balance due on September 1, 2001 and the principal amount of the 12.875% Subordinated Debentures against the final payment due on October 1, 2001. As a result of these purchases the Company recorded an extraordinary gain of $348,000, net of related costs and income taxes.

During the second quarter ended December 31, 1999, the Company recorded an extraordinary gain of $150,000, net of related costs and income taxes, on the purchase of its 12.875% Subordinated Debentures (see discussion above).

Net Income

The Company had net income of $54,000 and $1,448,000 for the three and nine months ended March 31, 2001, respectively, as compared to $240,000 and $3,080,000 for the similar periods in 2000. The reduction for the three months was due to a decrease in gross margins, an increase in selling, general and administrative expenses and a loss on the disposal of its Virginia distribution center offset partially by an increase in sales, lower net interest costs and a lower provision for income taxes. The reduction for the nine months was due to an increase in selling, general and administrative expenses, a loss on the disposal of the Virginia distribution facility, a loss on the disposal of its retail stores and a gain, in the prior year, on the purchases of the Company's 12.875% Subordinated Debentures offset partially by an increase in sales, an increase in gross margins, lower net interest costs, a lower provision for income taxes and a larger extraordinary gain in the current year.

Liquidity and Capital Resources

For the nine months ended March 31, 2001, the Company's working capital decreased by $9,214,000 to $8,039,000, primarily due to the transfer of the principal amount of the Company's 8% Senior Notes and 12.875% Subordinated Debentures from long-term debt to short-term debt, partially offset by operating profits.

During the nine months ended March 31, 2001, cash decreased by $316,000. The Company used cash of $459,000 for the purchase of fixed assets, $2,905,000 for the repayment and purchases of long-term debt and capital lease obligations and $44,000 on discontinued operations. These activities were funded from cash generated from continuing operations of $1,305,000, the proceeds from short-term borrowings of $1,682,000 and the proceeds from the sale of certain non-operating assets aggregating $105,000.

Receivables at March 31, 2001 increased by $2,575,000 to $10,535,000 from $7,960,000 at June 30, 2000. This increase is due to normal seasonal shipping fluctuations within the period.

Inventory at March 31, 2001 decreased by $2,858,000 to $11,785,000 from $14,643,000 at June 30, 2000. This decrease was reflected in both the intimate apparel and the discontinued retail division inventories. The decrease in the intimate apparel division was the result of normal fluctuations in sales. The inventory for the retail division decreased due to the discontinuance of this division.

During the second quarter ended December 31, 2000, the Company purchased $3,050,000 in principal amount of its 8% Senior Notes and $157,000 in principal amount of its 12.875% Subordinated Debentures. The Company will apply the principal amount of the 8% Senior Notes against the final payment due on September 1, 2001 and the principal amount of the 12.875% Subordinated Debentures against the final payment due on October 1, 2001.

During September 2000, the Company purchased $10,000 in principal amount of its 12.875% Subordinated Debentures. The Company will further reduce its final payment due in October 2001 by an amount equal to the face amount of the principal of these debentures.

During the second quarter ended December 31, 1999, the Company purchased $2,786,000 in principal amount of its 12.875% Subordinated Debentures. In conjunction with previously acquired debentures and with $903,000 of these debentures the Company satisfied its sinking fund requirement due October 1, 2000. The remaining $1,883,000 will be applied to the final payment due on October 1, 2001.

During the first quarter ended September 30, 1999, the Company purchased

$2,834,000 in principal amount of its 12.875% Subordinated Debentures. The Company reduced its mandatory sinking fund requirement due on October 1, 2000 with these debentures.

In May 2001, the Company purchased $2,233,000 in principal amount of its 8% Senior Notes. As a result of the transaction, the Company will record an extraordinary gain of $123,000, net of related costs and income taxes, in the fourth quarter of fiscal 2001. The Company will apply the principal amount of the 8% Senior Notes against the final payment due on September 1, 2001.

In August 2000, the Company sold a non-operating manufacturing facility located in Mississippi, for approximately $105,000. The Company did not recognize a gain or loss on this transaction.

As of March 31, 2001, included in current liabilities is $4,516,000 of 8% Senior Notes, $71,500 of 8% Convertible Senior Notes and $4,180,000 of 12.875% Subordinated Debentures. The 8% Senior Notes and the 8% Convertible Senior Notes mature on September 1, 2001 and the 12.875% Subordinated Debentures mature on October 1, 2001. The $71,500 of 8% Convertible Senior Notes are convertible into the Company's common stock, at any time prior to maturity, at a price of $0.375 per share.

The Company has a secured revolving line of credit of up to $18,000,000. The revolving line of credit expires July 1, 2001 and is sufficient for the Company's projected needs for operating capital and letters of credit to fund the purchase of imported goods through July 1, 2001. Direct borrowings under this line bear interest at the prime rate of Chase Manhattan Bank. Availability under the line of credit is subject to the Company's compliance with certain agreed upon financial formulas. Under the terms of this financing, the Company has agreed to pledge substantially all of its assets, except the Company's real property. Management has commenced discussions with its current lender regarding the terms and conditions for the renewal of the secured revolving line of credit. The Company is also evaluating the general market conditions for its borrowing needs by exploring the possibility of placing its secured revolving line of credit with other potential lending institutions.

Management believes the available borrowing under its secured revolving line of credit, along with anticipated internally generated funds, will be sufficient to cover its working capital requirements through July 1, 2001.

The Company does not anticipate making any purchases of its stock and anticipates that capital expenditures for fiscal 2001 will be less than $650,000.

Recently Issued Accounting Standard

In November 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting and Bulletin ("SAB") 101, "Revenue Recognition." This Bulletin sets forth The SEC Staff's position regarding the point at which it is appropriate for a Registrant to recognize revenue. The Staff believes that revenue is realizable and earned when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or service has been rendered; the seller's price to the buyer is fixed or determinable; and collectibility is reasonably assured. The Company uses the above criteria to determine whether revenue can be recognized, and therefore believes that the issuance of this Bulletin does not have a material impact on these financial statements.

Imports

The Company's transactions with its foreign manufacturers and suppliers are subject to the risks of doing business abroad. The Company's import and offshore operations are subject to constraints imposed by agreements between the United States and a number of foreign countries in which the Company does business.

These agreements impose quotas on the amount and type of goods that can be imported into the United States from these countries. Such agreements also allow the United States to impose, at any time, restraints on the importation of categories of merchandise that, under the terms of the agreements, are not subject to specified limits. The Company's imported products are also subject to United States customs duties and, in the ordinary course of business, the Company is from time to time subject to claims by the United States Customs Service for duties and other charges. The United States and other countries in which the Company's products are manufactured may, from time to time, impose new

quotas, duties, tariffs or other restrictions, or adversely adjust presently prevailing quotas, duty or tariff levels, which could adversely affect the Company's operations and its ability to continue to import products at current or increased levels. The Company cannot predict the likelihood or frequency of any such events occurring.

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS UNDER THE SECURITIES LITIGATION REFORM ACT OF 1995

Except for historical information contained herein, this Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which involve certain risks and uncertainties. The Company's actual results or outcomes may differ materially from those anticipated. Important factors that the Company believes might cause differences are discussed in the cautionary statement under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Form 10-Q. In assessing forward-looking statements contained herein, readers are urged to carefully read those statements.

PART II Other Information

Item 1 - Legal proceedings - Not Applicable

Item 2 - Changes in Securities - Not Applicable

Item 3 - Defaults Upon Senior Securities - Not Applicable

Item 4 - Submission of Matters to a Vote of Security Holders - None

Item 5 - Other Information - None

Item 6 - (a) Exhibits - None

(b) Form 8-K Report - None

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 hereunto duly authorized.

MOVIE STAR, INC.

By: /s/ MELVYN KNIGIN

MELVYN KNIGIN
President; Chief Executive Officer

By: /s/ THOMAS RENDE

THOMAS RENDE
Chief Financial Officer

May 14, 2001