

STEIN MART, INC.
COMPENSATION COMMITTEE REPORT TO SHAREHOLDERS

March 2006

Overall Review

The Compensation Committee (the "**Committee**") has determined to continue the compensation programs relating to: (i) annual base salaries paid by Stein Mart to its officers ("**Base Compensation**"); (ii) long-term incentives such as the Company's stock option plans ("**Long-Term Incentive Compensation**"); and (iii) the Company's annual bonus plans and formulas (the "**Annual Incentive Compensation**"). The Company's shareholders approved the Stein Mart Management Incentive Compensation Plan (the "**Management Compensation Plan**") in June 2005. As more fully described below (see "Plan Modifications") the Committee is recommending fine tuning of the Management Compensation Plan by paying a portion of the Long Term Incentive Compensation in "Performance Shares" and by adjusting the awards up or down based on the total shareholder return (the "**Total Shareholder Return**") compared to the Total Shareholder Return achieved by the Company's peer group of public companies.

The Committee continued to apply the Company's philosophy that the Company's Base Compensation should be conservative compared to the Company's peer group and that the overall Company compensation plans should reward performance within the Company and seek to align the interests of the Company's officers with those of the Company's shareholders.

Base Compensation

The Committee's compensation strategy calls for conservative Base Compensation coupled with market-competitive, performance-based annual and long-term incentive opportunities, which seek the use of the compensation programs to encourage business success through meeting or exceeding earnings per share goals and attaining a long-term superior shareholder return, combined with the need to attract, retain and motivate key talent to support the Company's success. The Committee is continuing to apply a general target for its senior officers of establishing Base Compensation at slightly below the 50th percentile of the Company's peer group.

Performance Based on Agreed Annual Plan

The Management Compensation Plan is designed to align the interest of management with those of our shareholders. Accordingly, that plan bases all incentive compensation on performance as a direct function of the Company's actual earning per share ("**EPS**") performance compared with the EPS budget and plan adopted by the Company's Board of Directors for the year in question (the "**Agreed Annual Plan**"). The Compensation Committee sets three target levels for each fiscal year in advance based on that year's Agreed Annual Plan: (i) The minimum or threshold level (the "**Threshold**"); (ii) the target level (the "**Target**"); and (iii) the superior level (the "**Superior**"). Incentive compensation under the Management Compensation Plan is then based on the range of EPS performance actually achieved between the Threshold and the Superior levels and is formula driven without discretion in the Committee. As applied to the Annual Incentive Compensation, Threshold is 85% of Target and Superior is 120% of Target. As applied to the Long-Term Incentive Compensation, Threshold is 85% of Target and the Superior target is reduced to 115% of Target.

Annual Incentive Compensation

The Management Compensation Plan provides for Annual Incentive Compensation (bonuses) paid to the Company's officers designed to create a potential bonus for each officer equal to a pre-established percentage of the officer's Base Compensation. For example, at the corporate director level, Annual Incentive Compensation set by the Committee for 2005 would be 5% of Base Compensation if the Threshold level of performance were achieved, 10% if the Target level were achieved, and 20% if the Superior level were achieved. At the Chief Executive level, Annual Incentive Compensation set by the Committee for 2005 would be 35% of Base Compensation if the Threshold level of performance were achieved, 70% if the Target level were achieved, and 140% if the Superior level were achieved.

The Annual Incentive Compensation mix is based on performance in three areas: (i) the Company's performance overall compared to the Agreed Annual Plan, (ii) the performance compared to plan of the individual business unit in which the employee in question was employed, and (iii) individual performance criteria established annually in advance for each employee subject to such analysis. The weight given to each area depends on the employee's position. For example, the CEO and other executive officers' Annual Incentive Compensation is based solely on the Company's overall performance compared to plan based on EPS targets. At other positions, the Company's overall performance counts for a low of 25% to a high of 88% of the total possible Annual Incentive Compensation. Individual performance goals count for no more than 33% of the total possible Annual Incentive Compensation.

Long-Term Compensation

The Management Compensation Plan currently provides that the Long-Term Incentive Compensation is awarded to the Company's officers through a combination of stock options and restricted share grants, with 50% of that value provided in options and 50% provided in restricted shares. The actual award pool is a direct function of the Company's performance compared with the Agreed Annual Plan. Long-term incentive grants are made only if the Company achieves the minimum Threshold level of EPS compared to the Agreed Annual Plan. Each officer level is awarded aggregate Long Term Incentive Compensation only if the Threshold is met, and then the aggregate value is based on such officer's position. By way of example, at the Chief Executive Level, Long-Term Incentive Compensation set by the Committee for 2005 would be 175% of Base Compensation if the Threshold level of performance were achieved, payable 50% in options and 50% in restricted shares. The total of all Long-Term Incentive Compensation (both options and restricted shares) in any one year will not exceed 1.8% of the Company's total outstanding shares ("COS") if the Threshold is met, 2% of COS if the Target is met, and 2.2% of COS if the Superior level is achieved. If the aggregate grants would exceed those levels, then each of those grants would be ratably scaled back.

The option component of each officer's Long-Term Compensation vests over five years, with 1/3 vesting in each of the third, fourth and fifth years. The restricted stock grants cliff vest at the end of seven years except that the vesting accelerates to the end of the third year of each performance period if the Company achieves its EPS Target level in the third year which had been established at the time of the grant.

The combination of annual grants and long term vesting is designed to balance the focus of management on both short term (one year) EPS goals and longer term (three years) EPS goals and be most likely to create the maximum increase in shareholder value. Moreover, the Committee determined that annual grants would be more successful in tying officers' incentives to shareholder interests by creating a "price-averaging" strategy into the incentive grants to officers. The Management Compensation Plan would provide the Committee the ability to implement that strategy and preserve the tax deduction for all of the incentive compensation under that Plan.

Proposed Changes in Long-Term Compensation. For 2006 and thereafter, the Committee proposes to modify the Long-Term Compensation component of the Management Compensation Plan as follows:

- (i) Instead of a combination of restricted shares and options as currently exists, the proposed modification provides for awarding the Long-Term Compensation 60% in "Performance Shares" and 40% in options.
- (ii) Instead of tying the Long-Term Compensation calculation solely to retroactive performance measuring actual EPS against the Agreed Annual Plan, the proposed modification will:
 - a. base the issuance of Performance Shares on prospective performance goals, and
 - b. increase or decrease the aggregate value of the Long-Term Compensation Performance Share awards by 20% in either direction based on how the Total Shareholder Return for the Company over a three year rolling period compares to the Total Shareholder Return achieved by the Company's peer group as calculated in the Dow Jones U.S. Apparel Retail Index. This up or down adjuster based on Total Shareholder Return comparisons would apply only to the top five executive officers of the Company.

- (iii) Limit the aggregate of all Long-Term Incentive Compensation grants (both Options and Performance Shares) made annually to no more than 2.2% of all outstanding shares of the Company's common stock.

Performance Shares are issued only when the performance goals are achieved unlike Restricted Shares which are issued currently, subject to later forfeiture if the officer leaves the Company prior to vesting. Under the proposed modifications of the Long-Term Compensation component of the Management Compensation Plan, the Performance Shares would be earned (and issued) only if the aggregate EPS goals for a three year rolling period are achieved. 50% of the Performance Shares will be earned if the aggregate three year EPS equals the Threshold (85% of plan), 100% of the Performance Shares will be earned if the aggregate three year EPS equals the Target (100% of plan) and, 150% of the Performance Shares will be earned if the aggregate three year EPS equals Superior (115% of plan). Moreover, the Performance Shares which are otherwise earned by the top five executive officers would be further subject to up or down adjustments based on the average Total Shareholder Return for the Company compared to the Total Shareholder Return for the Company's peer group as measured by the Dow Jones Apparel Retail Index for the same period. The Stock Option component of Long-Term Compensation would continue to be subject to the same vesting requirements of five years, with 1/3 vesting in each of the third, fourth and fifth years.

Current Executive Officer Compensation

In General

Base Compensation. The Committee caused surveys of the Company's peer group of retail companies to be taken and concluded that the existing Base Compensation of a number of the Company's officers remained below the Committee's goal of establishing Base Compensation at the mid-range of a percentile slightly below the 50th percentile of the Company's peer group. The adjustments in Base Compensation for all senior officers for fiscal 2006 were based on that determination and intended to narrow the gap between the Company's officers and those of the peer group.

Incentive Compensation. The Committee noted that the Company had achieved excellent, record earnings for fiscal 2005 and the Company's EPS would exceed the Target performance level previously set for fiscal 2005. As a result, the Committee approved the application of the Annual Incentive Compensation formula and the Long-Term Incentive Compensation formula discussed above and determined that management would receive the appropriate levels of non-discretionary compensation resulting from the application of those formulas for fiscal 2005.

Specific Officers. The Committee applied the strategies and philosophies described above to specific officers as follows:

Jay Stein, the Company's Chairman, received Base Compensation for fiscal 2005 of \$300,000. The Committee determined that his compensation should remain at the \$300,000 level without increase and that no bonus would be paid to Jay Stein. No Annual or Long-Term Incentive Compensation would be paid to Mr. Stein.

Michael D. Fisher, the Company's President and Chief Executive Officer received Base Compensation for fiscal 2005 of \$700,000. The survey of peer companies indicated that his target Base Compensation level as described above should be approximately \$932,400-974,238 for the current year. The Committee granted a \$126,000 increase in Base Compensation to Mr. Fisher resulting in a Base Compensation for fiscal 2006 of \$826,000. That amount was intended to continue the gradual increase in his Base Compensation towards the targeted level relative to his peer group. The Annual Incentive Compensation formula described above as a result of the Company's having achieved an EPS above its Target resulted in a bonus to Mr. Fisher of 78% of his 2005 Base Compensation, or a bonus of \$544,488. Under the Long Term Incentive Plan, for fiscal 2005, Mr. Fisher also received \$612,500 in stock options and \$612,500 in restricted shares, all subject to the vesting requirement described in this Report. The number of options is based on an option value fixed for 2004 and 2005 at \$4.00 per share. All options were issued at an exercise price equal to the closing price of the Company's shares on the public market on the date of grant. Thus, Mr. Fisher's total direct compensation (cash) was \$1,244,488 and his total indirect compensation (options and restricted shares) was \$1,225,000 with respect to 2005.

Other officers received Base Compensation adjustments consistent with the compensation philosophy described above to reach targeted salaries at approximately the mid-range of a percentile slightly below the 50th

percentile of the Company's peer group. Annual Incentive Bonuses were awarded based on the application of the Annual Incentive Compensation formula described above. The Committee determined that the formula appropriately recognized the outstanding performance by management during 2005 and determined that no discretionary bonuses were needed.

Long-Term Incentive Compensation. Stock options and restricted shares were also awarded to the executive officers by the Committee based on applying the formula for Long-Term Incentive Compensation described above.

CEO Compensation

The Compensation Committee's policies with respect to the compensation of the Company's Chief Executive Officer, Michael D. Fisher, were the same as the policies applied with respect to the Company's other executive officers. In applying the compensation philosophy described above, and as indicated above, the Chief Executive Officer will be entitled to receive Annual Incentive Compensation of 35% of his Base Compensation, if the Company achieves its minimum Threshold, of 70% of his Base Salary if the Company achieves its Agreed Annual Plan and of 140% of his Base Compensation if the Company achieves superior performance as a function of its Agreed Annual Plan.

In addition, the Company's Chief Executive Officer will be entitled to Long-Term Incentive Compensation awards under the modified Long-Term Compensation component, if approved by the Company's shareholders, in the form of stock options and Performance Share grants of up to 180% of the CEO's Base Compensation at the top end of performance. The number of options is based on an option value fixed for 2006, 2007 and 2008 by the Committee upon completion of the appropriate value analysis for options. Each option will be issued with an exercise price equal to the closing price of the Company's shares on the public markets on the day of grant, and the number of performance shares will also be based on the closing price of the Company's shares on the public markets on the day of grant. All options and restricted shares will be subject to the vesting requirements described above under "Long-Term Compensation."

Certain Tax Matters

Section 162(m) of the Internal Revenue Code, enacted in 1993, precludes a public corporation from deducting compensation of more than \$1 million each for its chief executive officer or for any of its four other highest paid officers. Certain performance-based compensation is exempt from this limitation. Currently, it is possible that if the higher levels of the Annual Incentive Compensation and the Long-Term Incentive Compensation outlined above are reached, a portion of such amounts might not be deductible.

The Compensation Committee has reviewed the impact of 162(m) of the Internal Revenue Code, and it is the general policy of the Company to have its executive compensation plan qualified to be treated as deductible compensation whenever, in the judgment of the Compensation Committee, to do so would be consistent with the objectives of that Compensation Plan in the best interests of the Company. Accordingly, the Committee has adopted and proposed for adoption by the Company's shareholders a formal Management Incentive Compensation Plan to maximize the Company's ability to obtain federal income tax deductions for compensation paid under that plan.

STEIN MART, INC. COMPENSATION COMMITTEE

Alvin R. Carpenter, Chairman
Michael D. Rose
Martin E. Stein, Jr.