

bebe stores, inc.
Form 10-Q
May 14, 2015

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

FORM 10-Q

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

For the quarterly period ended April 4, 2015

OR

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

Commission File Number 0-24395

bebe stores, inc.
(Exact name of registrant as specified in its charter)

California
(State or Jurisdiction of
Incorporation or Organization)

94-2450490
(IRS Employer
Identification Number)

400 Valley Drive
Brisbane, California 94005
(Address of principal executive offices)
Telephone: (415) 715-3900

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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 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

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The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of May 7, 2015 was 79,632,714.

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PART I. FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements

bebe stores, inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(unaudited)

	As of April 4, 2015	As of July 5, 2014	As of April 5, 2014
Assets:			
Current assets:			
Cash and equivalents	\$51,865	\$94,345	\$115,940
Available for sale securities	19,681	18,665	11,504
Receivables	6,206	4,814	4,620
Inventories, net	32,589	31,683	31,919
Deferred income taxes, net	48	88	171
Prepaid and other	10,801	10,704	14,260
Total current assets	121,190	160,299	178,414
Available for sale securities	5,343	11,941	11,506
Property and equipment, net	93,924	93,640	96,146
Intangible asset	917	917	917
Other assets	3,802	3,558	5,118
Total assets	\$225,176	\$270,355	\$292,101
Liabilities and Shareholders' Equity:			
Current liabilities:			
Accounts payable	\$15,531	\$20,022	\$14,096
Accrued liabilities and other	28,428	39,277	27,656
Total current liabilities	43,959	59,299	41,752
Deferred rent and other lease incentives	25,071	25,847	30,791
Uncertain tax positions	80	78	230
Total liabilities	69,110	85,224	72,773
Commitments and contingencies			
Shareholders' equity:			
Preferred stock-authorized 1,000,000 shares at \$0.001 par value per share; no shares issued and outstanding	—	—	—
Common stock-authorized 135,000,000 shares at \$0.001 par value per share; issued and outstanding 79,609,749, 79,555,064 and 79,062,470 shares	80	80	79
Additional paid-in capital	144,759	142,868	142,196
Accumulated other comprehensive (loss) income	(1,762	) 3,161	1,559
Retained earnings	12,989	39,022	75,494
Total shareholders' equity	156,066	185,131	219,328
Total liabilities and shareholders' equity	\$225,176	\$270,355	\$292,101
See accompanying notes to condensed consolidated financial statements.			

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except per share data)

(unaudited)

	Three Months Ended		Nine Months Ended	
	April 4, 2015	April 5, 2014	April 4, 2015	April 5, 2014
Net sales	\$92,668	\$89,019	\$323,738	\$321,548
Cost of sales, including production and occupancy	64,481	64,519	214,873	215,426
Gross margin	28,187	24,500	108,865	106,122
Selling, general and administrative expenses	39,047	47,365	128,991	141,703
Operating income (loss)	(10,860)	(22,865)	(20,126)	(35,581)
Interest and other income, net	43	18	478	262
Loss from continuing operations, before income taxes	(10,817)	(22,847)	(19,648)	(35,319)
Income tax provision (benefit)	75	(93)	250	(298)
Loss from continuing operations, net of tax	(10,892)	(22,754)	(19,898)	(35,021)
Loss from discontinued operations, net of tax	(354)	(1,522)	(2,548)	(3,875)
Net loss	\$(11,246)	\$(24,276)	\$(22,446)	\$(38,896)
Basic per share amounts:				
Net loss from continuing operations, net of tax	\$(0.14)	\$(0.29)	\$(0.25)	\$(0.44)
Net loss from discontinued operations, net of tax	—	(0.02)	(0.03)	(0.05)
Net loss	\$(0.14)	\$(0.31)	\$(0.28)	\$(0.49)
Diluted per share amounts:				
Net loss from continuing operations, net of tax	\$(0.14)	\$(0.29)	\$(0.25)	\$(0.44)
Net loss from discontinued operations, net of tax	—	(0.02)	(0.03)	(0.05)
Net loss	\$(0.14)	\$(0.31)	\$(0.28)	\$(0.49)
Basic weighted average shares outstanding	79,630	79,303	79,607	79,159
Diluted weighted average shares outstanding	79,630	79,303	79,607	79,159
Dividends declared per share	\$0.015	\$0.025	\$0.045	\$0.075
Other comprehensive income (loss)				
Gain (loss) on available for sale securities	\$(112)	\$382	\$(23)	\$2,175
Foreign currency translation adjustments	(1,894)	(1,080)	(4,900)	(1,400)
Other comprehensive income (loss)	(2,006)	(698)	(4,923)	775
Comprehensive loss	\$(13,252)	\$(24,974)	\$(27,369)	\$(38,121)

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Nine Months Ended	
	April 4, 2015	April 5, 2014
Cash flows from operating activities:		
Net loss	\$(22,446	) \$(38,896
Adjustments to reconcile net loss to cash used by operating activities:		
Non-cash compensation expense	1,846	3,152
Depreciation and amortization	12,175	15,189
Non-cash charge for asset impairment	224	3,805
Deferred income taxes	107	(935
Other	(111	) (430
Changes in operating assets and liabilities:		
Receivables	(1,700	) 2,424
Inventories	(895	) 1,943
Prepaid expenses and other	1,445	(1,111
Accounts payable	(1,718	) (2,930
Deferred rent and other lease incentives	(775	) (3,429
Accrued liabilities	(9,755	) (3,875
Net cash used by operating activities	(21,603	) (25,093
Cash flows from investing activities:		
Purchase of property and equipment and store construction deposits	(18,779	) (11,761
Purchase of marketable securities	(14,490) —
Proceeds from sales of investment securities	18,373	71,270
Net cash (used) provided by investing activities	(14,896	) 59,509
Cash flows from financing activities:		
Proceeds from issuance of common stock	16	737
Excess tax benefit from exercise of stock options and awards	—	223
Cash dividends paid	(3,582	) (5,941
Net cash used by financing activities	(3,566	) (4,981
Net decrease in cash and equivalents	(40,065	) 29,435
Effect of exchange rate changes on cash	(2,415	) (460
Cash and equivalents:		
Beginning of period	94,345	86,965
End of period	\$51,865	\$115,940
See accompanying notes to condensed consolidated financial statements.		

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
INTERIM FINANCIAL STATEMENTS

The accompanying condensed consolidated balance sheets of bebe stores, inc. (the "Company") as of April 4, 2015 and April 5, 2014, the condensed consolidated statements of operations and comprehensive loss for the three and nine months ended April 4, 2015 and April 5, 2014 and the condensed consolidated statements of cash flows for the three and nine months ended April 4, 2015 and April 5, 2014 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, without audit. Accordingly, they do not include all of the information required by accounting principles generally accepted in the United States of America for annual financial statements. Therefore, these condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended July 5, 2014.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to present fairly the financial position at the balance sheet dates and the results of operations for the periods presented have been included. The condensed consolidated balance sheet at July 5, 2014, presented herein, was derived from the audited balance sheet included in the Company's Annual Report on Form 10-K for the fiscal year ended July 5, 2014. The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. The results for the periods presented are not necessarily indicative of future financial results.

FISCAL YEAR

The Company's fiscal year is a 52 or 53 week period, each period ending on the first Saturday on or after June 30. Fiscal years 2015 and 2014 both include 52 weeks.

The three month periods ended April 4, 2015 and April 5, 2014 each include 13 weeks. The nine month periods ended April 4, 2015 and April 5, 2014 each included 39 weeks.

RECENT ACCOUNTING PRONOUNCEMENTS

Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers", or ASU 2014-09, which states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this, an entity will need to: identify the contract with a customer; identify the separate performance obligations in the contract; determine the transaction price; allocate the transaction price to the separate performance obligation in the contract; and recognize revenue when (or as) the entity satisfies each performance obligation. ASU No. 2014-09 will be effective beginning January 1, 2017 and can be adopted on a full retrospective basis or on a modified retrospective basis. The Company is currently assessing its approach to the adoption of this standard and the impact on its results of operations and financial position.

Going Concern

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40); Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern," which requires management of a company to evaluate whether there is substantial doubt about the company's ability to continue as a going concern. This ASU is effective for the annual reporting period ending after December 15, 2016, and for interim and annual reporting periods thereafter, with early adoption permitted. The Company will evaluate the impact of this standard at the time it becomes effective.

Extraordinary Items

In January 2015, the FASB issued ASU No. 2015-01, "Income Statement - Extraordinary and Unusual Items (Subtopic 225-20), Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items". The guidance eliminates the classification of income statement items as extraordinary. The Company will adopt this standard at the beginning of its 2016 fiscal year, and does not expect there to be an impact on adoption.

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DISCONTINUED OPERATIONS

In the fourth quarter of fiscal 2014, the Company discontinued the operations of the 2b division by closing all existing 18 2b stores including 2b.com, allowing the Company to focus its efforts on the core bebe brand's retail and outlet stores, e-commerce and international licensing business.

As of April 4, 2015, the Company has a remaining reserve of \$1.7 million for future costs associated with discontinued operations. This reserve has been included within the "Accrued liabilities" line in the consolidated balance sheets. A roll forward of the reserve is presented as follows:

	Lease Obligations	Other Costs	Total
	(In thousands)		
Balance as of July 5, 2014	\$6,385	\$1,000	\$7,385
Costs incurred in fiscal 2015	1,652	896	2,548
Cash payments, markdowns or adjustments applied	(6,317	) (1,874	) (8,191
Balance as of April 4, 2015	\$1,720	\$22	\$1,742

For leases where a settlement has not yet been reached, the obligation has been adjusted to represent the Company's best estimate of the amount of settlement.

Other costs consist primarily of a reserve for estimated losses on 2b inventory purchased pursuant to purchase orders that were open when operations were discontinued and severance.

INVESTMENTS

The Company's investment portfolio consists of certificates of deposit and auction rate securities. The Company held short term available for sale securities totaling \$19.7 million as of April 4, 2015, that consisted entirely of certificates of deposit at cost which approximates fair value. The Company also holds long term available for sale securities at fair value totaling \$5.3 million as of April 4, 2015, that consisted entirely of interest bearing auction rate securities ("ARS"). The Company's interest bearing ARS consists of federally insured student loan backed securities. As of April 4, 2015, the Company's ARS portfolio consisted of two securities with a fair value of approximately \$5.3 million and was classified as available for sale securities, and included a temporary impairment charge of \$3.7 million. As of that date, the Company's ARS portfolio consisted of approximately 22% A rated investments and 78% CCC rated investments. As of July 5, 2014, the Company's ARS consisted of 36% A rated investments, 19% BBB rated investments and 45% CCC rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected the Company's holdings in ARS investments and auctions for the Company's investments in these securities have failed to settle on their respective settlement dates. During the nine months ended April 4, 2015, \$6.6 million of ARS held by the Company were settled at par. While the Company continues to earn interest on its ARS investments at the maximum contractual rate, these investments are not currently trading and therefore the Company used level 3 inputs to determine the fair value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and the Company will not be able to access these funds until a future auction of these investments is successful, the issuer redeems the securities or at maturity. Maturity dates for the ARS investments are 2031 and 2033 with principal distributions occurring on certain securities prior to maturity. To date, principal distributions and maturities of the securities held by the Company have all been at par value.

The Company reviews its investments for impairment in accordance with guidance issued by the FASB and SEC in order to determine the classification of the impairment as "temporary" or "other-than-temporary". A temporary impairment charge results in an unrealized loss being recorded in the accumulated other comprehensive income component of shareholders' equity. Such an unrealized loss does not affect net income for the applicable accounting

period. An other-than-temporary impairment charge is recorded as a loss in the condensed consolidated statements of operations and comprehensive loss for the applicable accounting period. When evaluating the investments for other-than-temporary impairment, the Company estimates the expected cash flows of the underlying collateral by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and any changes thereto, and the Company's intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment's amortized cost basis. The

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Company has not recorded any impairment loss from its available for sale investments as other-than-temporary based on such analysis.

The valuation of the Company's investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact its valuation include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates and ongoing strength and quality of market credit and liquidity.

The following is a summary of our available for sale securities:

	As of April 4, 2015			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(In thousands)			
Short term certificates of deposit	\$19,681	\$—	\$—	\$19,681
Long term auction rate securities	\$9,000	\$—	\$3,657	\$5,343

	As of July 5, 2014			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(In thousands)			
Short term certificates of deposit	\$18,665	\$—	\$—	\$18,665
Long term auction rate securities	\$15,575	\$—	\$3,634	\$11,941

	As of April 5, 2014			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(In thousands)			
Short term certificates of deposit	\$11,504	\$—	\$—	\$11,504
Long term auction rate securities	\$15,575	\$—	\$4,069	\$11,506

FAIR VALUE MEASUREMENTS

The FASB has established a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of April 4, 2015, the Company held financial instruments that are measured at fair value on a recurring basis. These included cash equivalents and available for sale securities. Cash equivalents consist of money market funds. Short term available for sale securities consist of certificates of deposit. Long term available for sale securities consist of ARS. These ARS consist of federally insured student loan backed securities.

The Company determined the estimated fair value of its investment in ARS as of April 4, 2015 by reviewing trading activity for similar securities in secondary markets as well as by using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for liquidity (average of LIBOR +5.27%), interest rates (weighted average of 0.2%), timing (range from 11 – 14 years), credit ratings and amount of cash flows and

expected holding periods of the ARS and recent trading activity in the secondary marketplace.

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The following items are measured at fair value on a recurring basis as of April 4, 2015:

Description	April 4, 2015	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Fair value measurements at reporting date (In thousands)			
Cash and cash equivalents	\$51,865	\$51,865	\$—	\$—
Current available for sale securities	19,681	—	19,681	—
Non-current available for sale securities	5,343	—	—	5,343
Total	\$76,889	\$51,865	\$19,681	\$5,343

The following items are measured at fair value on a recurring basis as of July 5, 2014:

Description	July 5, 2014	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Fair value measurements at reporting date (In thousands)			
Cash and cash equivalents	\$46,423	\$46,423	\$—	\$—
Current available for sale securities	18,665	—	18,665	—
Non-current available for sale securities	11,941	—	—	11,941
Total	\$77,029	\$46,423	\$18,665	\$11,941

The following items are measured at fair value on a recurring basis as of April 5, 2014:

Description	April 5, 2014	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Fair value measurements at reporting date (In thousands)			
Cash and cash equivalents	\$49,118	\$49,118	\$—	\$—
Current available for sale securities	11,504	—	11,504	—
Non-current available for sale securities	11,506	—	—	11,506
Total	\$72,128	\$49,118	\$11,504	\$11,506

During the quarter ended April 4, 2015, there were no transfers of assets and liabilities between Level 1 (quoted prices in active markets for identical assets) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy. Impairment charges have been recorded in accumulated other comprehensive income that reduces the carrying amount of the applicable non-current assets of \$9.0 million to their fair value of \$5.3 million as of April 4, 2015.

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The following table presents the Company's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months and nine months ended April 4, 2015:

	Three Months Ended April 4, 2015 (In thousands)	Nine Months Ended April 4, 2015
Balance at beginning of period	\$5,455	\$11,941
Total gains or (losses) (realized or unrealized)		
Included in net loss	—	—
Included in accumulated other comprehensive income	(112	) (23
Settlements	—	(6,575
Balance at end of period	\$5,343	\$5,343

Non-Financial Assets:

The Company measures certain non-f