bebe stores, inc.
Form 10-Q
May 13, 2016

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended April 2, 2016
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	94-2450490
(State or Jurisdiction of Incorporation or Organization)	(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 x 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 x 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 x

Indicate by check mark whether the registrant is a shell company (as defined Rule12b-2 of the Exchange Act). Yes ¨ No x

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The number of shares of the registrant's common stock, par value $0.001 per share, outstanding as of May 6, 2016 was 80,033,479.

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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 2, 2016	As of July 4, 2015	As of April 4, 2015
Assets:			
Current assets:			
Cash and equivalents	$25,181	$46,947	$51,865
Available for sale securities	2,689	17,880	19,681
Receivables	8,447	7,122	6,206
Inventories, net	31,673	31,317	32,589
Prepaid and other	11,194	10,774	10,849
Total current assets	79,184	114,040	121,190
Available for sale securities	—	5,241	5,343
Property and equipment, net	77,261	93,229	93,924
Other assets	3,633	3,903	4,719
Total assets	$160,078	$216,413	$225,176
Liabilities and Shareholders' Equity:			
Current liabilities:			
Accounts payable	$16,149	$12,595	$15,531
Accrued liabilities and other	21,512	28,217	28,428
Total current liabilities	37,661	40,812	43,959
Deferred rent and other lease incentives	19,096	23,952	25,071
Uncertain tax positions	84	81	80
Total liabilities	56,841	64,845	69,110
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 80,032,065, 79,660,973 and 79,609,749 shares	80	80	80
Additional paid-in capital	147,278	145,499	144,759
Accumulated other comprehensive income (loss)	681	(1,776)	(1,762)
Retained earnings (accumulated deficit)	(44,802)	7,765	12,989
Total shareholders' equity	103,237	151,568	156,066
Total liabilities and shareholders' equity	$160,078	$216,413	$225,176

See accompanying notes to condensed consolidated financial statements.

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bebe stores, inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(In thousands, except per share data)
(unaudited)

	Three Months Ended		Nine Months Ended	
	April 2, 2016	April 4, 2015	April 2, 2016	April 4, 2015
Net sales	$79,939	$92,668	$298,669	$323,738
Cost of sales, including production and occupancy	56,968	64,481	206,155	214,873
Gross margin	22,971	28,187	92,514	108,865
Selling, general and administrative expenses	49,417	39,047	141,423	128,991
Operating loss	(26,446)	(10,860)	(48,909)	(20,126)
Interest and other income (loss), net	(3,564)	43	(3,643)	478
Loss from continuing operations, before income taxes	(30,010)	(10,817)	(52,552)	(19,648)
Income tax provision (benefit)	(42)	75	15	250
Loss from continuing operations, net of tax	(29,968)	(10,892)	(52,567)	(19,898)
Loss from discontinued operations, net of tax	—	(354)	—	(2,548)
Net loss	$(29,968)	$(11,246)	$(52,567)	$(22,446)
Basic per share amounts:				
Loss from continuing operations, net of tax	$(0.37)	$(0.14)	$(0.66)	$(0.25)
Loss from discontinued operations, net of tax	—	—	—	(0.03)
Net loss	$(0.37)	$(0.14)	$(0.66)	$(0.28)
Diluted per share amounts:				
Loss from continuing operations, net of tax	$(0.37)	$(0.14)	$(0.66)	$(0.25)
Loss from discontinued operations, net of tax	—	—	—	(0.03)
Net loss	$(0.37)	$(0.14)	$(0.66)	$(0.28)
Basic weighted average shares outstanding	80,027	79,630	79,888	79,607
Diluted weighted average shares outstanding	80,027	79,630	79,888	79,607
Dividends declared per share	$—	$0.015	$—	$0.045
Other comprehensive income (loss)				
Unrealized loss on available for sale securities	$—	$(112)	$—	$(23)
Reclassification of realized loss on available for sale securities	3,834	—	3,759	—
Foreign currency translation adjustments	424	(1,894)	(1,302)	(4,900)
Other comprehensive income (loss)	4,258	(2,006)	2,457	(4,923)
Comprehensive loss	$(25,710)	$(13,252)	$(50,110)	$(27,369)

See accompanying notes to condensed consolidated financial statements.

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bebe stores, inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Nine Months Ended	
	April 2, 2016	April 4, 2015
Cash flows from operating activities:		
Net loss	$(52,567)	$(22,446)
Adjustments to reconcile net loss to cash used by operating activities:		
Stock compensation expense	1,770	1,846
Depreciation and amortization	15,840	12,175
Loss on sale of available for sale securities	3,624	—
Non-cash charge for asset impairment	5,477	224
Other	153	(4)
Changes in operating assets and liabilities:		
Receivables	(1,332)	(1,700)
Inventories	(380)	(895)
Prepaid expenses and other	(132)	1,445
Accounts payable	3,848	(1,718)
Deferred rent and other lease incentives	(4,781)	(775)
Accrued liabilities	(5,850)	(9,755)
Net cash used by operating activities	(34,330)	(21,603)
Cash flows from investing activities:		
Purchase of property and equipment and store construction deposits	(6,753)	(18,779)
Purchase of investment securities	(2,576)	(14,490)
Proceeds from sales of investment securities	22,031	18,373
Net cash provided (used) by investing activities	12,702	(14,896)
Cash flows from financing activities:		
Proceeds from issuance of common stock	8	16
Cash dividends paid	—	(3,582)
Net cash provided (used) by financing activities	8	(3,566)
Net decrease in cash and equivalents	(21,620)	(40,065)
Effect of exchange rate changes on cash	(146)	(2,415)
Cash and equivalents:		
Beginning of period	46,947	94,345
End of period	$25,181	$51,865

See accompanying notes to condensed consolidated financial statements.

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bebe stores, inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
INTERIM FINANCIAL STATEMENTS
The accompanying condensed consolidated balance sheets of bebe stores, inc. (the “Company”) as of April 2, 2016 and April 4, 2015, the condensed consolidated statements of operations and comprehensive loss for the three and nine months ended April 2, 2016 and April 4, 2015 and the condensed consolidated statements of cash flows for the nine months ended April 2, 2016 and April 4, 2015 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 4, 2015.
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 4, 2015, 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 4, 2015.

LIQUIDITY

The Company incurred net losses and used cash in operating activities in the first nine months of fiscal 2016 and in each of fiscal 2015, 2014 and 2013. Cash and equivalents and short-term available securities were $64.8 million as of July 4, 2015. During the nine months ended April 2, 2016, net loss and net cash used in operating activities were $52.6 million and $34.3 million, respectively. As a result, cash and equivalents and short-term available for sale securities were $27.9 million as of April 2, 2016. In addition, the Company's arrangements with its card processors allow them to impose a holdback the amount and duration of which is at their discretion. As of April 2, 2016, the processor had withheld $3.5 million, which is included in receivables. Furthermore, the Company's vendors may require letters of credit prior to fulfilling orders. Holdbacks and/or additional letters of credit could further reduce the Company's liquidity.

The Company used $34.3 million, $25.0 million, $30.3 million and $8.4 million net of cash in operating activities in the first nine months of fiscal 2016 and in the fiscal years 2015, 2014 and 2013, respectively. The Company's liquidity is dependent upon its ability to generate cash from operations along with usage of its existing cash and cash equivalents and short-term investments.

During the third quarter of fiscal 2016 the Company took significant steps to restructure its organization which included headcount reductions and the closure of non-productive stores. As the Company enters the fourth fiscal quarter it will continue to implement its strategy to streamline the production cycle for our product, improve the product assortment, further rationalize the store fleet and continue to reduce discretionary spending while evaluating several opportunities to monetize its assets. The Company believes that improvements to production and assortment will result in a more compelling fashion offering for our customers leading to increased comparable store sales. Furthermore, reductions in discretionary spending and rationalization of the store fleet will result in combined annual operating expense savings that are estimated to be approximately $25 million. The Company believes it will see the benefit of this in fiscal 2017. Furthermore, in the first nine months of fiscal 2016 the Company incurred $6.3 million in severance expense and $2.6 million in lease termination expense that it currently does not anticipate incurring in fiscal 2017. In addition to these expense savings the Company currently anticipates closing up to 40 stores that had a trailing 12 month loss of approximately $5.5 million. The Company believes the efforts discussed in this section will significantly reduce the amount of net cash used in operating activities in fiscal 2017.

The Company is also evaluating potential sources of additional liquidity, including potentially obtaining a borrowing arrangement as well as opportunities for monetizing assets such as the Company's intellectual and real property. However, the Company cannot assure that any additional liquidity will be available on favorable terms or at all.

The Company's ability to continue as a going concern is dependent on its ability to generate cash flow from operations or to obtain additional liquidity through borrowing or other arrangements and may also be impacted by the effects of holdbacks and letters of credit.

The Company believes its cash and equivalents and short-term available for sale securities, together with cash flows from operations, will be sufficient to meet its operating and capital requirements for at least the next twelve months. However, if the

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financial results anticipated as a result of the restructuring and cost-saving measures discussed previously in this section are not achieved, the Company's current cash and equivalents and short-term securities may not be sufficient to meet its operating and capital requirements for at least the next twelve months without obtaining additional sources of liquidity which may not be available on favorable terms or at all. The Company's future operating and capital requirements will depend on numerous factors, including without limitation, future results of operations, investment costs for management information systems, imposed holdbacks, the requirement to maintain letters of credit and potential investments and/or licensing arrangements. If the Company is unable to generate positive cash flow from operations or to obtain funds from additional sources, this could have a material adverse effect on its business and financial condition.

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 2016 and 2015 both include 52 weeks.

The three month periods ended April 2, 2016 and April 4, 2015 each include 13 weeks. The nine month periods ended April 2, 2016 and April 4, 2015 each included 39 weeks.

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.

RECENT ACCOUNTING PRONOUNCEMENTS

Stock Compensation

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09, "Compensation - Stock Compensation (Topic 718)", which is part of the FASB's Simplification Initiative. The updated guidance simplifies the accounting for share-based payment transactions. The amended guidance is effective for fiscal years, and interim periods within those years, beginning with fiscal 2017, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

Leases

In February 2016 the FASB issued ASU 2016-02 "Leases". This standard requires lessees to put most leases on their balance sheets as a right-to-use asset and a lease liability, but to continue to recognize expenses in the statements of operations in a manner similar to current accounting. The Company will adopt this standard at the beginning of its 2020 fiscal year and is currently assessing the impact to its consolidated financial statements.

Income Taxes

In November 2015, the FASB issued ASU No. 2015-17 "Income Taxes, Balance Sheet Classification of Deferred Taxes". This standard requires the Company to classify all deferred tax assets and liabilities as non-current on the balance sheet instead of separating deferred taxes into current and non-current amounts. The Company will adopt this standard beginning with its annual report for the 2016 fiscal year.

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 with the Company's 2019 fiscal year. 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

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is effective for the annual reporting period ending in 2017, 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.

Inventory

In July 2015, the FASB issued ASU No. 2015-11, "Simplifying the Measurement of Inventory". The new standard amends the guidelines for the measurement of inventory from lower of cost or market to the lower of cost and net realizable value (NRV). NRV is defined as the estimated selling prices in the ordinary course of business less reasonably predictable costs of completion, disposal and transportation. Under existing standards, inventory is measured at lower of cost or market, which requires the consideration of replacement cost, NRV and NRV less an amount that approximates a normal profit margin. This ASU eliminates the requirement to determine and consider replacement cost or NRV less an approximately normal profit margin for inventory measurement. The new standard is effective prospectively at the beginning of the Company's 2018 fiscal year. The Company is currently evaluating the impact, if any, of adopting this new accounting guidance on its results of operations and financial position.

RESULTS OF OPERATIONS

In the third quarter of fiscal 2016, the Company closed one of its stores and recorded $2.3 million in expense in connection with terminating the lease. This amount has been included in selling, general and administrative expenses within the consolidated statements of operations.

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 had a remaining reserve of $1.7 million for future costs associated with discontinued operations. This reserve was 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 was not yet reached, the obligation was adjusted to represent the Company's best estimate of the amount of settlement.

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

There was no reserve as of July 4, 2015.

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 $2.7 million as of April 2, 2016, that consisted entirely of certificates of deposit at cost which approximates fair value. On January 20, 2016 the board approved management to proceed with the sale of the Company's remaining two ARS seeking the most commercially reasonable terms and both securities were sold during the quarter. As a result, during the three months ended April, 2, 2016, the Company sold its remaining two interest bearing auction rate securities with a face value totaling $9 million for proceeds totaling $5.4 million and recorded a loss of $3.6 million in other income (expense), which included the reclassification of accumulated comprehensive income into the consolidated statement of operations, adjusted to reflect the final loss on the sale. As of April 2, 2016, the Company had no remaining interest bearing auction rate securities ("ARS").

The following is a summary of the Company's available for sale securities:

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	As of April 2, 2016			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(In thousands)			
Short term certificates of deposit	$2,689	$ —	$ —	$ 2,689

	As of July 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	$17,880	$ —	$ —	$ 17,880
Long term auction rate securities	$9,000	$ —	$ 3,759	$ 5,241

	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

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 2, 2016, 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.

The Company determined the estimated fair value of its investment in ARS 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 +6.09%), interest rates (weighted average of 0.2%), timing (range from 9 – 13 years), credit ratings and amount of cash flows and expected holding periods of the ARS and recent trading activity in the secondary marketplace.

The following items are measured at fair value on a recurring basis as of April 2, 2016:

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Description	April 2, 2016	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	$ 25,380	$ 25,380	$ —	$ —
Current available for sale securities	2,689	—	2,689	—
Non-current available for sale securities	—	—	—	—
Total	$ 28,069	$ 25,380	$ 2,689	$ —

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

Description	July 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	$ 14,426	$ 14,426	$ —	$ —
Current available for sale securities	17,880	—	17,880	—
Non-current available for sale securities	5,241	—	—	5,241
Total	$ 37,547	$ 14,426	$ 17,880	$ 5,241

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

During the quarter ended April 2, 2016, 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. An impairment charge was recorded in accumulated other comprehensive income that reduced 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.
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 2, 2016:

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	Three Months Ended April 2, 2016	Nine Months Ended April 2, 2016
	(In thousands)	
Balance at beginning of period	$5,166	$5,241
Total gains or (losses) (realized or unrealized)		
Included in net loss	(3,623)	(3,623)
Included in accumulated other comprehensive income (1)	3,834	3,759