

Perfumania Holdings, Inc.
Form 10-Q
September 09, 2016
Table of Contents

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 July 30, 2016 OR

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

For the transition period from _____ to _____

Commission file number: 0-19714

PERFUMANIA HOLDINGS, INC.
(Exact name of Registrant as specified in its charter)

Florida 65-0977964
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

35 Sawgrass Drive, Suite 2 11713
Bellport, NY

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (631) 866-4100

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 the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer Accelerated Filer
Non-accelerated Filer (Do not check if a smaller reporting company) Smaller Reporting Company

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

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The number of shares outstanding of the registrant's common stock, as of the latest practicable date: At September 8, 2016, there were 15,493,763 outstanding shares of its common stock, \$0.01 par value.

Table of Contents

TABLE OF CONTENTS

PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES

PART I

FINANCIAL INFORMATION

| | | |
|---------|---|-----------|
| ITEM 1 | <u>FINANCIAL STATEMENTS</u> | <u>3</u> |
| | <u>Condensed Consolidated Balance Sheets as of July 30, 2016 (unaudited) and January 30, 2016</u> | <u>3</u> |
| | <u>Condensed Consolidated Statements of Operations for the thirteen and twenty-six weeks ended July 30, 2016 and August 1, 2015 (unaudited)</u> | <u>4</u> |
| | <u>Condensed Consolidated Statement of Shareholders' Equity for the twenty-six weeks ended July 30, 2016 (unaudited)</u> | <u>5</u> |
| | <u>Condensed Consolidated Statements of Cash Flows for the twenty-six weeks ended July 30, 2016 and August 1, 2015 (unaudited)</u> | <u>6</u> |
| | <u>Notes to Condensed Consolidated Financial Statements (unaudited)</u> | <u>7</u> |
| ITEM 2 | <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u> | <u>16</u> |
| ITEM 3 | <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u> | <u>21</u> |
| ITEM 4 | <u>CONTROLS AND PROCEDURES</u> | <u>21</u> |
| | PART II | |
| | OTHER INFORMATION | |
| ITEM 1 | <u>LEGAL PROCEEDINGS</u> | <u>21</u> |
| ITEM 1A | <u>RISK FACTORS</u> | <u>21</u> |
| ITEM 2 | <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u> | <u>22</u> |
| ITEM 3 | <u>DEFAULTS UPON SENIOR SECURITIES</u> | <u>22</u> |
| ITEM 4 | <u>MINE SAFETY DISCLOSURES</u> | <u>22</u> |

| | | |
|--------|--------------------------|-----------|
| ITEM 5 | <u>OTHER INFORMATION</u> | <u>22</u> |
| ITEM 6 | <u>EXHIBITS</u> | <u>22</u> |
| | <u>SIGNATURES</u> | <u>23</u> |

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

| | July 30, 2016 (unaudited) | January 30, 2016 (Note 1) |
|--|---------------------------------|---------------------------------|
| ASSETS: | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,284 | \$ 5,640 |
| Accounts receivable, net of allowances of \$2,948 and \$1,233 as of July 30, 2016 and January 30, 2016, respectively | 29,755 | 29,602 |
| Inventories | 220,635 | 221,336 |
| Prepaid expenses and other current assets | 9,646 | 9,862 |
| Total current assets | 262,320 | 266,440 |
| Property and equipment, net | 23,832 | 25,892 |
| Goodwill | 38,769 | 38,769 |
| Intangible and other assets, net | 17,969 | 19,945 |
| Total assets | \$ 342,890 | \$ 351,046 |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | |
| Current liabilities: | | |
| Accounts payable | \$ 33,823 | \$ 32,175 |
| Accounts payable-affiliates | 953 | 300 |
| Accrued expenses and other liabilities | 27,159 | 33,205 |
| Current portion of obligations under capital leases | 1,332 | 1,248 |
| Total current liabilities | 63,267 | 66,928 |
| Revolving credit facility | 23,927 | 13,078 |
| Notes payable-affiliates | 125,366 | 125,366 |
| Long-term portion of obligations under capital leases | 549 | 1,223 |
| Other long-term liabilities | 63,189 | 60,474 |
| Total liabilities | 276,298 | 267,069 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, \$0.10 par value, 1,000,000 shares authorized; as of July 30, 2016 and January 30, 2016, none issued | — | — |
| Common stock, \$.01 par value, 35,000,000 shares authorized; 16,392,012 shares issued as of July 30, 2016 and January 30, 2016 | 164 | 164 |
| Additional paid-in capital | 222,001 | 221,961 |
| Accumulated deficit | (146,996) | (129,571) |
| Treasury stock, at cost, 898,249 shares as of July 30, 2016 and January 30, 2016 | (8,577) | (8,577) |
| Total shareholders' equity | 66,592 | 83,977 |
| Total liabilities and shareholders' equity | \$ 342,890 | \$ 351,046 |

See accompanying notes to condensed consolidated financial statements.

Table of ContentsPERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except share and per share amounts)

| | Thirteen Weeks Ended July 30, 2016 | Thirteen Weeks Ended August 1, 2015 | Twenty-six Weeks Ended July 30, 2016 | Twenty-six Weeks Ended August 1, 2015 |
|--|--|---|--|---|
| Net sales | \$ 97,020 | \$ 109,306 | \$ 202,159 | \$ 237,516 |
| Cost of goods sold | 51,996 | 58,250 | 105,366 | 123,982 |
| Gross profit | 45,024 | 51,056 | 96,793 | 113,534 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 52,333 | 63,475 | 106,261 | 121,667 |
| Share-based compensation expense | 8 | 74 | 40 | 174 |
| Depreciation and amortization | 2,025 | 2,581 | 4,536 | 5,200 |
| Total operating expenses | 54,366 | 66,130 | 110,837 | 127,041 |
| Loss from operations | (9,342) | (15,074) | (14,044) | (13,507) |
| Interest expense | (1,674) | (1,723) | (3,381) | (3,455) |
| Loss before income tax provision | (11,016) | (16,797) | (17,425) | (16,962) |
| Income tax provision | — | — | — | — |
| Net loss | \$ (11,016) | \$ (16,797) | \$ (17,425) | \$ (16,962) |
| Net loss per common share: | | | | |
| Basic and diluted | \$ (0.71) | \$ (1.08) | \$ (1.12) | \$ (1.10) |
| Weighted average number of common shares outstanding: | | | | |
| Basic and diluted | 15,493,763 | 15,483,640 | 15,493,763 | 15,480,151 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(Unaudited)

(in thousands, except share amounts)

| | Common Stock | | Additional | Accumulated | Treasury Stock | | |
|----------------------------------|--------------|--------|-----------------|---------------|----------------|-----------|-----------|
| | Shares | Amount | Paid-In Capital | Deficit | Shares | Amount | Total |
| Balance at January 30, 2016 | 16,392,012 | \$ 164 | \$ 221,961 | \$ (129,571) | 898,249 | \$(8,577) | \$83,977 |
| Share-based compensation expense | — | — | 40 | — | — | — | 40 |
| Net loss | — | — | — | (17,425) | — | — | (17,425) |
| Balance at July 30, 2016 | 16,392,012 | \$ 164 | \$ 222,001 | \$ (146,996) | 898,249 | \$(8,577) | \$66,592 |

See accompanying notes to condensed consolidated financial statements.

Table of ContentsPERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS(Unaudited)
(in thousands)

| | Twenty-six Weeks Ended July 30, 2016 | Twenty-six Weeks Ended August 1, 2015 |
|---|--|---|
| Cash flows from operating activities: | | |
| Net loss | \$(17,425) | \$(16,962) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Amortization of deferred financing costs | 174 | 172 |
| Depreciation and amortization | 4,536 | 5,200 |
| Provision (recovery) for losses on accounts receivable | 1,721 | (319) |
| Share-based compensation | 40 | 174 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,874) | 3,030 |
| Inventories | 701 | 8,379 |
| Prepaid expenses and other assets | 813 | 2,248 |
| Accounts payable | 1,648 | 4,785 |
| Accounts payable-affiliates | 653 | 844 |
| Accrued expenses and other liabilities and other long-term liabilities | (3,331) | 737 |
| Net cash (used in) provided by operating activities | (12,344) | 8,288 |
| Cash flows from investing activities: | | |
| Additions to property and equipment | (1,271) | (3,614) |
| Net cash used in investing activities | (1,271) | (3,614) |
| Cash flows from financing activities: | | |
| Net borrowings (repayments) under bank line of credit | 10,849 | (3,545) |
| Principal payments under capital lease obligations | (590) | (515) |
| Proceeds from exercise of stock options | — | 54 |
| Net cash provided by (used in) financing activities | 10,259 | (4,006) |
| Net (decrease) increase in cash and cash equivalents | (3,356) | 668 |
| Cash and cash equivalents at beginning of period | 5,640 | 1,533 |
| Cash and cash equivalents at end of period | \$2,284 | \$2,201 |
| Supplemental Information: | | |
| Cash paid during the period for: | | |
| Interest | \$447 | \$725 |
| Income taxes | \$193 | \$576 |
| See accompanying notes to condensed consolidated financial statements. | | |

Table of Contents

PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION AND OPERATIONS

The condensed consolidated balance sheet of Perfumania Holdings, Inc. and Subsidiaries (the "Company") as of January 30, 2016, which has been derived from our audited financial statements as of and for the year ended January 30, 2016, and the accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. Certain information and note disclosures normally included in annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"), have been condensed or omitted pursuant to those rules and regulations. The financial information presented herein, which is not necessarily indicative of results to be expected for the full current fiscal year, reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the interim unaudited condensed consolidated financial statements. Such adjustments are of a normal, recurring nature. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 30, 2016.

Due to the seasonality of the Company's business, with the most significant activity occurring from September through December each year, the results of operations for the twenty-six weeks ended July 30, 2016 are not necessarily indicative of results to be expected for the full fiscal year.

The Company is an independent, national, vertically integrated wholesale distributor and specialty retailer of perfumes and fragrances that conducts business through six wholly-owned operating subsidiaries; Perfumania, Inc. ("Perfumania"), Quality King Fragrance, Inc. ("QFG"), Scents of Worth, Inc. ("SOW"), Perfumania.com, Inc. ("Perfumania.com"), Parlux Fragrances, LLC ("Parlux") and Five Star Fragrance Company, Inc. ("Five Star"). We operate in two industry segments, wholesale distribution and specialty retail sales of designer fragrances and related products. Our wholesale businesses include QFG, Parlux and Five Star. QFG distributes designer fragrances to mass market retailers, drug and other chain stores, retail wholesale clubs, traditional wholesalers, and other distributors throughout the United States. It sells principally to retailers such as Burlington Coat Factory, CVS, Kohl's, Marshalls, Nordstrom Rack, Ross Stores, Sears, Target, Wal-Mart and Walgreens. The Company's manufacturing divisions, Parlux and Five Star, own and license designer and other fragrance brands that are sold to regional and national department stores, including Belk, Bon Ton, Boscovs, Dillards, Lord & Taylor, Macy's and Stage Stores, international distributors, on military bases throughout the United States, by QFG and through the Company's retail business which is discussed below. Parlux also fulfills a selection of fragrances for several online retailers, shipping directly to their customers and billing the retailers. Five Star also manufactures, on behalf of Perfumania, the Jerome Privee product line, which includes bath and body products and which is sold exclusively in Perfumania's retail stores. All manufacturing operations of Parlux and Five Star are outsourced.

Our retail business is conducted through the following subsidiaries:

- Perfumania, a specialty retailer of fragrances and related products,
- SOW, which sells fragrances in retail stores on a consignment basis, and
- Perfumania.com, an Internet retailer of fragrances and other specialty items.

As of July 30, 2016, Perfumania operated a chain of 297 retail stores specializing in the sale of fragrances and related products at discounted prices up to 75% below the manufacturers' suggested retail prices. Perfumania.com, our Company-owned website, offers a selection of our more popular products for sale online. SOW operates a national designer fragrance consignment program, with contractual relationships to sell products on a consignment basis in approximately 1,300 stores, including approximately 800 Kmart locations nationwide. Its other retail customers include Bealls, K & G and Steinmart.

NOTE 2 - RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, Leases, which replaces the existing guidance in Accounting Standard Codification 840, Leases. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. ASU 2016-02 requires a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use asset and corresponding lease liability. For finance leases the lessee would recognize interest expense and amortization of the right-of-use asset and for operating leases the lessee would recognize straight-line total lease expense. The Company is currently assessing the new standard and its impact on its consolidated financial statements.

Table of Contents

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, which modifies the presentation of noncurrent and current deferred taxes. ASU 2015-17 requires that all deferred tax assets and liabilities be classified as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. The standard is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted. The Company adopted ASU No. 2015-17 prospectively effective January 30, 2016. No prior periods were retrospectively adjusted.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, intended to simplify the presentation of debt issuance costs. The guidance requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with the presentation for debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. In August 2015, the FASB issued ASU No. 2015-15, Interest-Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements - Amendments to SEC Paragraphs Pursuant to Staff Announcements at the June 2015 EITF Meeting. ASU 2015-15 amends Subtopic 835-30 to include that the SEC would not object to the deferral and presentation of debt issuance costs as an asset and subsequent amortization of debt issuance costs over the term of the line-of-credit arrangement, whether or not there are any outstanding borrowings on the line-of-credit arrangement. This guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2015, and must be applied on a retrospective basis with early adoption permitted. This guidance did not have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. The update outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services. In August 2015, the FASB approved a one year deferral of the effective date, to make it effective for annual and interim reporting periods beginning after December 15, 2017. The standard allows for either a full retrospective or a modified retrospective transition method. The guidance is not expected to have a material impact on the Company's consolidated financial statements.

NOTE 3 - ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company's accounts receivable consist primarily of trade receivables due from wholesale customers. In May 2016, a Panama based customer of Parlux that distributes in certain Latin American countries was placed on the Specially Designated Nationals list by the Office of Foreign Assets Control of the U.S. Treasury Department. As a result, the customer's assets have been frozen and any dealings between U.S. companies, including Parlux, and the customer have been prohibited. Accordingly, during the thirteen weeks ended April 30, 2016, management reserved the outstanding accounts receivable balance from the customer of approximately \$1.7 million due to the uncertainty of future collection of these receivables.

NOTE 4 - GOODWILL AND INTANGIBLE ASSETS

Goodwill in the amount of \$38.8 million at July 30, 2016 and January 30, 2016 resulted from the April 18, 2012 acquisition of Parlux.

The following table provides information related to goodwill and intangible assets (in thousands). Intangible assets are included in intangible and other assets, net on the accompanying condensed consolidated balance sheets as of July 30, 2016 and January 30, 2016:

Table of Contents

| | Useful Life (years) | July 30, 2016 | | | January 30, 2016 | | |
|----------------------------|------------------------|------------------|-----------------------------|----------------------|------------------|-----------------------------|----------------------|
| | | Original Cost | Accumulated Amortization | Net Book Value | Original Cost | Accumulated Amortization | Net Book Value |
| Goodwill | N/A | \$38,769 | \$ — | \$38,769 | \$38,769 | \$ — | \$38,769 |
| Tradenames | 4-20 | 9,357 | 7,890 | 1,467 | 9,357 | 7,696 | 1,661 |
| Customer relationships | 10 | 5,171 | 2,240 | 2,931 | 5,171 | 1,982 | 3,189 |
| Favorable leases | 7 | 886 | 886 | — | 886 | 865 | 21 |
| License agreements | 3-5 | 16,313 | 15,366 | 947 | 16,313 | 14,640 | 1,673 |
| Tradename (non-amortizing) | N/A | 8,500 | — | 8,500 | 8,500 | — | 8,500 |
| | | \$78,996 | \$ 26,382 | \$52,614 | \$78,996 | \$ 25,183 | \$53,813 |

In accordance with US GAAP, goodwill and intangible assets with indefinite lives are not amortized, but rather tested for impairment at least annually by comparing the estimated fair values to their carrying values.

Trademarks, including tradenames and owned licenses having finite lives, are amortized over their respective lives to their estimated residual values and are also reviewed for impairment in accordance with accounting standards when changes in circumstances indicate the assets' values may be impaired. Customer relationships are amortized over the expected period of benefit and license agreements are amortized over the remaining contractual term. Impairment testing is based on a review of forecasted operating cash flows and the profitability of the related brand to determine its fair value. There were no triggering events during the thirteen or twenty-six weeks ended July 30, 2016 that would indicate potential impairment and the requirement to review the carrying value of goodwill and intangible assets. Amortization expense associated with intangible assets subject to amortization is included in depreciation and amortization on the accompanying condensed consolidated statements of operations. Amortization expense for intangible assets subject to amortization was \$0.4 million and \$1.1 million during the thirteen weeks ended July 30, 2016 and August 1, 2015, respectively, and \$1.2 million and \$2.2 million for the twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively. As of July 30, 2016, estimated future amortization expense associated with intangible assets subject to amortization is as follows (in thousands):

| Fiscal Year | Amortization Expense |
|-------------------|-------------------------|
| Remainder of 2016 | \$ 685 |
| 2017 | 1,366 |
| 2018 | 986 |
| 2019 | 709 |
| 2020 | 684 |
| 2021 | 682 |
| Thereafter | 233 |
| | \$ 5,345 |

NOTE 5 - ACCOUNTING FOR SHARE-BASED PAYMENTS

The 2010 Equity Incentive Plan (the "2010 Plan") provides for equity-based awards to the Company's employees, directors and consultants. Under the 2010 Plan, the Company initially reserved 1,000,000 shares of common stock for issuance. This number automatically increases on the first trading day of each fiscal year beginning with fiscal 2011, by an amount equal to 1.5% of the shares of common stock outstanding as of the last trading day of the immediately preceding fiscal year; accordingly, 2,194,305 shares of common stock were reserved for issuance as of July 30, 2016. The Company previously had two stock option plans which expired on October 31, 2010. No further awards will be granted under these plans, although all options previously granted and outstanding will remain outstanding until they

are either exercised or forfeited. As of July 30, 2016, 774,252 stock options have been granted pursuant to the 2010 Plan.

9

Table of Contents

The following is a summary of the stock option activity during the twenty-six weeks ended July 30, 2016:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value (in thousands) |
|---|---------------------|---------------------------------------|---|--|
| Outstanding as of January 30, 2016 | 975,916 | \$ 8.01 | | |
| Granted | 10,000 | 2.86 | | |
| Exercised | — | — | | |
| Forfeited | (153,164) | 7.83 | | |
| Outstanding as of July 30, 2016 | 832,752 | \$ 7.98 | 5.9 | \$ — |
| Vested and expected to vest as of July 30, 2016 | 832,752 | \$ 7.98 | 5.9 | \$ — |
| Exercisable as of July 30, 2016 | 812,748 | \$ 8.07 | 5.9 | \$ — |

The following is a summary of stock warrants activity during the twenty-six weeks ended July 30, 2016:

| | Number of Warrants | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value (in thousands) |
|------------------------------------|-----------------------|---------------------------------------|---|--|
| Outstanding as of January 30, 2016 | 6,299,971 | \$ 11.80 | | |
| Granted | — | — | | |
| Exercised | — | — | | |
| Forfeited | — | — | | |
| Outstanding as of July 30, 2016 | 6,299,971 | \$ 11.80 | 1.9 | \$ — |
| Vested as of July 30, 2016 | 6,299,971 | \$ 11.80 | 1.9 | \$ — |
| Exercisable as of July 30, 2016 | 6,299,971 | \$ 11.80 | 1.9 | \$ — |

Share-based compensation expense was less than \$0.1 million and \$0.1 million during the thirteen weeks ended July 30, 2016 and August 1, 2015 and less than \$0.1 million and \$0.2 million during the twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively.

NOTE 6 - REVOLVING CREDIT FACILITY AND NOTES PAYABLE TO AFFILIATES

The Company's revolving credit facility and notes payable to affiliates consist of the following:

| | July 30, 2016 | January 30, 2016 |
|---|------------------|---------------------|
| | (in thousands) | |
| Revolving credit facility, interest payable monthly, secured by a pledge of substantially all of the Company's assets | \$23,927 | \$ 13,078 |
| Subordinated notes payable-affiliates | 125,366 | 125,366 |
| | 149,293 | 138,444 |
| Less current portion | — | — |
| Total long-term debt | \$ 149,293 | \$ 138,444 |

Table of Contents

The Company has a revolving Senior Credit Facility with a syndicate of banks that is used for the Company's general corporate purposes including working capital and capital expenditures. The maximum borrowing amount under the Senior Credit Facility is \$175 million and the termination date is April 2019. Under this facility, which does not require amortization of principal, revolving loans may be drawn, repaid and reborrowed up to the amount available under a borrowing base calculated with reference to specified percentages of the Company's credit card and trade receivables and inventory, which may be reduced by the lender in its reasonable discretion. The Company must maintain excess availability under the facility of at least \$10 million. As of July 30, 2016, the Company had \$70.4 million of net availability which includes \$25 million for letters of credit.

Interest under the Senior Credit Facility is at variable rates plus specified margins that are determined based upon the Company's excess availability from time to time. The Company is also required to pay monthly commitment fees based on the unused amount of the Senior Credit Facility and a monthly fee with respect to outstanding letters of credit. As of July 30, 2016, the interest rate on LIBOR Rate borrowings was 2.5% and the interest rate on base rate borrowings was 4.5%.

All obligations of the Company related to the Senior Credit Facility are secured by first priority perfected security interests in all personal and real property owned by the Company, including without limitation 100% (or, in the case of excluded foreign subsidiaries, 66%) of the outstanding equity interests in the subsidiaries. The Company is subject to customary limitations on its ability to, among other things, pay dividends and make distributions, make investments and enter into joint ventures, and dispose of assets. The Company was in compliance with all financial and operating covenants as of July 30, 2016.

In addition, the Company has outstanding unsecured debt obligations to affiliates as follows:

(i) a promissory note in the principal amount of \$35 million, (the "QKD Note") held by Quality King Distributors, Inc. ("Quality King"), which provides for payment of principal in quarterly installments between July 31, 2019 and October 31, 2022, with a final installment on October 31, 2022 of the remaining balance, and payment of interest in quarterly installments commencing on January 31, 2011 at the then current senior debt rate, as defined in the Senior Credit Facility, plus 1% per annum;

(ii) promissory notes in the aggregate principal amount of approximately \$85.4 million held by six estate trusts established by Glenn, Stephen and Arlene Nussdorf (the "Nussdorf Trust Notes"), which provide for payment of the principal in full on July 31, 2019 and payments of interest in quarterly installments commencing on July 31, 2012 at the then current senior debt rate plus 2% per annum; and

(iii) a promissory note in the principal amount of \$5 million held by Glenn and Stephen Nussdorf (the "2004 Note"), which provided for payment in January 2009 and is currently in default because of the restrictions on payment described below, resulting in an increase of 2% in the nominal interest rate, which is the prime rate plus 1%.

These notes are subordinated to the Senior Credit Facility. No principal may be paid on any of them until three months after the Senior Credit Facility terminates and is paid in full, and payment of interest is subject to satisfaction of certain conditions, including the Company's maintaining excess availability under the Senior Credit Facility of the greater of \$17.5 million or 17.5% of the borrowing base certificate after giving effect to the payment, and a fixed charge coverage ratio, as defined in the credit agreement, of 1.1:1.0. Interest expense on these notes was approximately \$1.4 million and \$1.3 million for the thirteen weeks ended July 30, 2016 and August 1, 2015, respectively, and \$2.9 million million and \$2.6 million for the twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively, and is included in interest expense on the accompanying condensed consolidated statements of operations. No payments of principal or interest have been made on the QKD Note or the Nussdorf Trust Notes. On the 2004 Note, no payments of principal have been made and no interest payments have been made since October 2008. Accrued interest payable due at July 30, 2016 and January 30, 2016 on the Nussdorf Trust Notes, the QKD Note, and the 2004 Note was approximately \$47.7 million and \$44.8 million, respectively, and is included in other long-term liabilities on the accompanying condensed consolidated balance sheets as of July 30, 2016 and January 30, 2016, respectively.

NOTE 7 - ACCOUNTING FOR INCOME TAXES

The Company conducts business throughout the United States, Puerto Rico, Brazil and the United States Virgin Islands and, as a result, files income tax returns in the U.S. Federal and various state jurisdictions, Puerto Rico, Brazil and the United States Virgin Islands. In the normal course of business the Company is subject to examinations in these jurisdictions. With few exceptions, the Company is no longer subject to U.S. Federal, state, local or Puerto Rico income tax examinations for fiscal years prior to 2008. State and foreign income tax returns are generally subject to examination for a period of three to five years after filing of the respective return. The state impact of any Federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states.

Table of Contents

The Company continues to provide a full valuation allowance against its net deferred tax assets due to the uncertainty as to when business conditions will improve sufficiently to enable it to utilize its deferred tax assets. As a result, the Company did not record a Federal or state tax benefit on its operating losses for the thirteen and twenty-six weeks ended July 30, 2016, since the Company has pre-tax losses for those periods.

During the thirteen and twenty-six weeks ended July 30, 2016, there were no changes to the liability for income tax associated with uncertain tax positions. The Company accrues interest related to unrecognized tax benefits as well as any related penalties in the income tax provision in its condensed consolidated statements of operations, which is consistent with the recognition of these items in prior reporting periods. The accrual for interest and penalties related to uncertain tax positions as of July 30, 2016 and January 30, 2016 was not significant.

The Company does not anticipate any material adjustments relating to unrecognized tax benefits within the next twelve months; however, the ultimate outcome of tax matters is uncertain and unforeseen results can occur.

NOTE 8 - BASIC AND DILUTED NET LOSS PER COMMON SHARE

Basic net loss per common share has been computed by dividing net loss by the weighted average number of common shares outstanding during the period.

Diluted net loss per common share includes, in periods in which they are dilutive, the effect of those potentially dilutive securities where the average market price of the common stock exceeds the exercise prices for the respective periods.

During the thirteen and twenty-six weeks ended July 30, 2016 and August 1, 2015 there were 7,132,723 and 7,405,635, respectively, potentially dilutive shares of common stock related to stock options and warrants which were excluded from the diluted loss per share calculation because the effect of including these potentially dilutive shares was antidilutive.

NOTE 9 - FAIR VALUE MEASUREMENTS

The Company applies authoritative accounting guidance regarding fair value and disclosures as it applies to financial and non-financial assets and liabilities. The guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels are defined as follows:

Level 1: Observable inputs such as quoted prices in active markets (the fair value hierarchy gives the highest priority to

Level 1 inputs);

Level 2: Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3: Unobservable inputs in which there is little or no market data and require the reporting entity to develop its own assumptions.

As of July 30, 2016, the Company had no material financial assets or liabilities measured on a recurring basis at fair value. The Company measures certain assets at fair value on a non-recurring basis, specifically long-lived assets evaluated for impairment. No such impairments were recorded during the twenty-six weeks ended July 30, 2016 and August 1, 2015.

The fair values of the Company's assets and liabilities that qualify as financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and short-term debt are carried at cost, which approximates fair value due to the short-term maturity of these instruments. The reported amounts of long-term obligations approximate fair value, given management's evaluation of the instruments' current rates compared to market rates of interest and other factors.

NOTE 10 - CONTINGENCIES

The Company is involved in various legal proceedings in the ordinary course of business. Management cannot presently predict the outcome of these matters, although management believes, based in part on the advice of counsel, that the ultimate resolution of these matters will not have a materially adverse effect on the Company's consolidated financial position, results of operations or cash flows. See discussion of litigation with licensor in Note 11 of this Form 10-Q.

NOTE 11 - RELATED-PARTY TRANSACTIONS

Glenn, Stephen and Arlene Nussdorf owned an aggregate 7,742,282 shares or approximately 50.0% of the total number of shares of the Company's outstanding common stock as of July 30, 2016, excluding shares issuable upon exercise of certain

Table of Contents

warrants and not assuming the exercise of any outstanding options. Stephen Nussdorf has served as the Chairman of the Company's Board of Directors since February 2004 and Executive Chairman of the Board since April 2011.

The Nussdorfs are officers and principals of Quality King, which distributes pharmaceuticals and health and beauty care products, and the Company's President and Chief Executive Officer, Michael W. Katz, is also an executive of Quality King.

See Note 6 for a discussion of notes payable to affiliates.

Transactions With Affiliated Companies

Glenn Nussdorf has an ownership interest in Lighthouse Beauty Marketing, LLC, Lighthouse Beauty, LLC and Lighthouse Beauty KLO, LLC (collectively the "Lighthouse Companies"), all of which are manufacturers and distributors of prestige fragrances. He also had an ownership interest in Cloudbreak Holdings, LLC ("Cloudbreak"), which was a manufacturer and distributor of prestige fragrances. The Company has purchased merchandise from the Lighthouse Companies and Cloudbreak.

The Company purchases merchandise from Jacavi Beauty Supply, LLC ("Jacavi"), a fragrance distributor. Jacavi's managing member is Rene Garcia. Rene Garcia, his family trusts and related entities are members of a group (the "Garcia Group") that owned an aggregate 2,211,269 shares, or approximately 14.3%, of the total number of shares of the Company's outstanding common stock as of July 30, 2016, excluding shares issuable upon exercise of certain warrants. See disclosures of merchandise purchases in the table below.

The Company sells merchandise to Reba Americas LLC ("Reba"), which distributes fragrances primarily in Puerto Rico and the Caribbean. Family trusts of Rene Garcia own 50% of Reba. Net sales to Reba were approximately \$0.9 million and \$0.3 million during the thirteen weeks ended July 30, 2016 and August 1, 2015, respectively, and approximately \$1.6 million during each of the twenty-six weeks ended July 30, 2016 and August 1, 2015. The balance due from Reba as of July 30, 2016 and January 30, 2016 was approximately \$0.8 million and \$0.2 million, respectively, and is included in accounts receivable, net of allowances, on the accompanying condensed consolidated balance sheets. The Company also purchased certain merchandise from Reba during the twenty-six weeks ended July 30, 2016 and August 1, 2015.

The amounts due to these related companies are non-interest bearing and are included in accounts payable-affiliates in the accompanying condensed consolidated balance sheets. Transactions for merchandise purchases with these related companies during the thirteen and twenty-six weeks ended July 30, 2016 and August 1, 2015 were as follows (in thousands):

| | Total Purchases Thirteen Weeks Ended July 30, 2016 | Total Purchases Thirteen Weeks Ended August 1, 2015 | Total Purchases Twenty-six Weeks Ended July 30, 2016 | Total Purchases Twenty-six Weeks Ended August 1, 2015 | Balance Due July 30, 2016 | Balance Due January 30, 2016 |
|----------------------|---|--|---|--|---------------------------------|------------------------------------|
| Lighthouse Companies | \$ — | \$ — | \$ — | \$ — | \$ 117 | \$ 134 |
| Jacavi | 840 | 4,666 | 2,289 | 6,240 | 787 | 29 |
| Quality King | 37 | — | 50 | 31 | — | (9) |
| Cloudbreak | — | — | — | — | 18 | 18 |
| Reba | 2,172 | 395 | 2,294 | 803 | — | 90 |
| | \$ 3,049 | \$ 5,061 | \$ 4,633 | \$ 7,074 | \$ 922 | \$ 262 |

Glenn, Stephen and Arlene Nussdorf own GSN Trucking, Inc. ("GSN") which provides general transportation and freight services. The Company periodically utilizes GSN to transport both inbound purchases of merchandise and outbound shipments to wholesale customers. There were no payments to GSN during the twenty-six weeks ended July 30, 2016. During the twenty-six weeks ended August 1, 2015, total payments to GSN for transportation services provided were less than \$0.1 million. There was no balance due to GSN at July 30, 2016 or January 30, 2016.

Quality King leases a 560,000 square foot facility in Bellport, NY. The Company began occupying approximately half of this facility in December 2007 under a sublease that terminates on September 30, 2027 and this location serves as the Company's principal offices. As of July 30, 2016, the monthly current sublease payments are approximately \$226,000 and increase by 3% annually. Total payments by the Company to Quality King for this sublease were approximately \$0.7 million during each of the thirteen weeks ended July 30, 2016 and August 1, 2015, and \$1.4 million during each of the twenty-six weeks ended July 30, 2016 and August 1, 2015.

The Company and Quality King are parties to a Services Agreement providing for the Company's participation in certain third party arrangements at the Company's respective share of Quality King's cost, including allocated overhead, plus a 2%

Table of Contents

administrative fee, and the provision of legal services. The Company also shares with Quality King the economic benefit of the bulk rate contract that the Company has with UPS to ship Quality King's merchandise and related items. The Services Agreement will terminate on thirty days' written notice from either party. The expenses charged under these arrangements to the Company were \$0.2 million and \$0.1 million during the thirteen weeks ended July 30, 2016 and August 1, 2015, respectively, and \$0.4 million and \$0.6 million during the twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively. The balance due to Quality King for expenses charged under the Services Agreement was less than \$0.1 million at July 30, 2016 and January 30, 2016.

On April 18, 2012, Parlux, Artistic Brands Development LLC ("Artistic Brands") (a company controlled by Rene Garcia), Shawn C. Carter (who is the beneficial owner of 10% of the Company's common stock) and S. Carter Enterprises, LLC entered into a sublicense agreement and Artistic Brands, Shawn Carter and S. Carter Enterprises, LLC entered into a license agreement. In connection with these agreements, the Company issued to Artistic Brands and its designees, including Shawn Carter, warrants for the purchase of an aggregate of 1,599,999 shares of the Company's common stock at an exercise price of \$8.00 per share. Pursuant to the license agreement, Artistic Brands obtained the exclusive right and license to manufacture, promote, distribute, and sell prestige fragrances and related products under the Jay-Z trademark. The initial term of the license agreement expires at the earlier of (i) five years following the first date on which licensed products are shipped and (ii) December 31, 2018. Artistic Brands has the right to renew the license agreement, so long as certain financial conditions are met and it has not otherwise breached the agreement. Pursuant to the license agreement, Artistic Brands agreed to make certain royalty payments, including certain guaranteed minimum royalties. Pursuant to the sublicense agreement, Artistic Brands sublicensed all rights granted under the license agreement to the Company, and in return the Company assumed all of Artistic Brands' obligations under the license agreement, including making all royalty payments and certain guaranteed minimum royalties owed to S. Carter Enterprises, LLC. No royalties have been paid during the thirteen or twenty-six weeks ended July 30, 2016. During the twenty-six weeks ended August 1, 2015, the Company paid \$0.3 million of royalties pursuant to the sublicense agreement.

On January 8, 2016, the Company and Parlux filed a lawsuit against S. Carter Enterprises, LLC and Shawn C. Carter in the Supreme Court of the State of New York, County of New York. In general, the lawsuit alleges that the defendants have breached the license described above and related agreements by not acting timely or in good-faith in approving products and launches under the license and not supporting the brand via personal appearances as required by the license. The lawsuit seeks a determination that such breaches undermine the essence of the license thereby warranting rescission of the license, return of the consideration paid on account of the license and related agreements, monetary damages, and other relief. On May 6, 2016, the defendants filed an answer in the nature of a general denial, with a counterclaim for inter alia amounts allegedly due to them under the license agreements in the amount of approximately \$2.7 million. The Company has filed a reply to that counterclaim in the nature of a general denial. Discovery has commenced. The Court has set a schedule which calls for the conclusion of fact and expert discovery by June 23, 2017, with dispositive motion practice to follow. The parties have begun the initial discovery process, which is ongoing. The Company intends to vigorously pursue its claims and to defend the counterclaim.

NOTE 12 - SEGMENT INFORMATION

The Company operates in two industry segments, wholesale distribution and specialty retail sales of designer fragrance and related products. Management reviews segment information by segment and on a consolidated basis each month. Retail sales include sales through Perfumania retail stores, the SOW consignment business and the Company's internet site, Perfumania.com. Wholesale sales include sales through QFG, Parlux and Five Star to unrelated customers. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Annual Report on Form 10-K for the fiscal year ended January 30, 2016. The Company's chief operating decision maker, who is its Chief Executive Officer, assesses segment performance by reference to gross profit. Each of the segments has its own assets, liabilities, revenues and cost of goods sold. While each segment has certain unallocated operating expenses, these expenses are not reviewed by the chief operating decision maker on a segment basis, but rather on a consolidated basis. Financial information for these segments is

summarized in the following table:

14

Table of Contents

| | Thirteen Weeks Ended July 30, 2016 (in thousands) | Thirteen Weeks Ended August 1, 2015 | Twenty-six Weeks Ended July 30, 2016 | Twenty-six Weeks Ended August 1, 2015 |
|---|--|---|--|---|
| Net sales: | | | | |
| Retail | \$54,351 | \$68,653 | \$106,026 | \$137,323 |
| Wholesale | 42,669 | 40,653 | 96,133 | 100,193 |
| | \$97,020 | \$109,306 | \$202,159 | \$237,516 |
| Gross profit: | | | | |
| Retail | \$27,128 | \$34,514 | \$53,457 | \$67,994 |
| Wholesale | 17,896 | 16,542 | 43,336 | 45,540 |
| | \$45,024 | \$51,056 | \$96,793 | \$113,534 |
| | July 30, 2016 | January 30, 2016 | | |
| Total assets: | | | | |
| Wholesale | \$679,489 | \$636,924 | | |
| Retail | 366,717 | 372,651 | | |
| | 1,046,206 | 1,009,575 | | |
| Eliminations (a) | (703,316) | (658,529) | | |
| Consolidated assets | \$342,890 | \$351,046 | | |
| (a) Adjustment to eliminate intercompany receivables and investment in subsidiaries | | | | |

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We are an independent, national, vertically integrated wholesale distributor and specialty retailer of designer perfumes and fragrances. We source the majority of these products directly from the brand owners/manufacturers. We also own and license certain designer brands that we manufacture, through subcontractors, and sell through our wholesale and retail operating subsidiaries.

Net sales during the thirteen weeks ended July 30, 2016, our second quarter in fiscal 2016, decreased 11.2% compared to the second quarter of fiscal 2015, while net sales during the twenty-six weeks ended July 30, 2016 decreased 14.9% compared to the twenty-six weeks ended August 1, 2015. Our wholesale segment's net sales during the second quarter of fiscal 2016 increased by 5.0% from the second quarter of fiscal 2015 while wholesale sales during the twenty-six weeks ended July 30, 2016 decreased by 4.1%. During the year, wholesale sales fluctuate due to seasonal demand, new product launches, the size and timing of certain orders from our customers, additions or losses of brand distribution rights, changes in foreign exchange rates against the U.S. dollar and the timing of industry trade shows, and, accordingly, sales and results of operations can vary significantly from quarter to quarter. Our retail segment's net sales decreased by 20.8% and 22.8%, respectively, from the thirteen and twenty-six weeks ended July 30, 2016 because of the transition of SOW's largest consignment account to a wholesale customer, fewer Perfumania stores compared with last year's second quarter and lower mall traffic at Perfumania stores.

Gross profit during the thirteen and twenty-six weeks ended July 30, 2016 was \$45.0 million and \$96.8 million, respectively, decreases of 11.8% and 14.7%. The decreases in gross profit are due primarily to lower retail net sales. Total operating expenses were \$54.4 million and \$110.8 million during the thirteen and twenty-six weeks ended July 30, 2016, respectively, decreases of 17.8% and 12.8%, respectively, compared to the thirteen and twenty-six weeks ended August 1, 2015. The decrease during the thirteen and twenty-six weeks ended July 30, 2016 was attributable to lower commissions, advertising and sales promotion expense offset by higher provision for bad debts. Interest expense was \$1.7 million during each of the thirteen weeks ended July 30, 2016 and August 1, 2015, and \$3.4 million and \$3.5 million for the thirteen and twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively. We did not record a tax provision during the thirteen and twenty-six weeks ended July 30, 2016 and August 1, 2015 since we have operating losses for those periods. We record a full valuation allowance against all deferred tax assets, thus no income tax benefit was recorded during the thirteen and twenty-six weeks ended July 30, 2016 and August 1, 2015.

As a result of the above, our net loss decreased to \$11.0 million during the second quarter of fiscal 2016 from \$16.8 million during last year's second quarter, and increased by 2.7% to \$17.4 million during the twenty-six weeks ended July 30, 2016 from \$17.0 million for the twenty-six weeks ended August 1, 2015.

Comparison of the Thirteen Weeks Ended July 30, 2016 with the Thirteen Weeks Ended August 1, 2015.

Net Sales

| | Thirteen Weeks Ended July 30, 2016 | Percentage of Net Sales | Thirteen Weeks Ended August 1, 2015 | Percentage of Net Sales | Dollar Change |
|-----------------|---|-------------------------------|--|-------------------------------|------------------|
| | (\$ in thousands) | | | | |
| Retail | \$54,351 | 56.0% | \$68,653 | 62.8% | \$(14,302) |
| Wholesale | 42,669 | 44.0% | 40,653 | 37.2% | 2,016 |
| Total net sales | \$97,020 | 100.0% | \$109,306 | 100% | \$(12,286) |

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Net sales decreased 11.2% from \$109.3 million in the thirteen weeks ended August 1, 2015 to \$97.0 million in the thirteen weeks ended July 30, 2016. The decrease in sales included a \$14.3 million decrease in retail sales offset by a \$2.0 million increase in wholesale sales.

Retail sales decreased by 20.8% from \$68.7 million in the thirteen weeks ended August 1, 2015 to \$54.4 million in the thirteen weeks ended July 30, 2016. Perfumania's retail sales decreased by \$6.8 million and SOW's consignment sales decreased by \$7.5 million.

Wholesale sales increased by 5.0% from \$40.7 million in the thirteen weeks ended August 1, 2015 to \$42.7 million in the thirteen weeks ended July 30, 2016 due to higher customer demand. QFG's sales increased from \$28.3 million in the thirteen

Table of Contents

weeks ended August 1, 2015 to \$31.7 million in the thirteen weeks ended July 30, 2016. Parlux's sales decreased from \$12.2 million in the thirteen weeks ended August 1, 2015 to \$11.0 million in the thirteen weeks ended July 30, 2016. Perfumania's retail sales decreased from \$56.4 million in the thirteen weeks ended August 1, 2015 to \$49.6 million in the thirteen weeks ended July 30, 2016. The decrease in Perfumania's sales was due primarily to fewer stores being operated and lower mall traffic. The average number of stores operated was 298 in the thirteen weeks ended July 30, 2016 and 319 in the thirteen weeks ended August 1, 2015 due to the closure of under-performing stores over the past year. Perfumania's comparable store sales decreased by 8.4% during the thirteen weeks ended July 30, 2016 from the same period in 2015 due to lower mall traffic. Comparable store sales measure sales from stores that have been open for one year or more. We exclude stores that are closed for renovation from comparable store sales from the month during which renovation commences until the first full month after reopening. The average retail price per unit sold during the thirteen weeks ended July 30, 2016 decreased by 0.1% from the prior year's comparable period, while the total number of units sold decreased by 11.8% due to the decrease in Perfumania's sales.

SOW's consignment sales decreased from \$12.3 million in the thirteen weeks ended August 1, 2015 to \$4.8 million in the thirteen weeks ended July 30, 2016. The decrease in SOW's net sales is due to a decrease in sales of approximately \$7.4 million to \$0.3 million during the thirteen weeks ended July 30, 2016 by Burlington Coat Factory ("Burlington"), formerly SOW's largest consignment account, which has been transitioned to be a wholesale customer of QFG. We anticipate that we will continue to sell merchandise to Burlington through QFG. During the thirteen weeks ended July 30, 2016, sales by QFG to Burlington were approximately \$1.8 million compared with \$1.1 million during the comparative period in fiscal 2015.

Gross Profit

| | Thirteen Weeks Ended July 30, 2016 | Thirteen Weeks Ended August 1, 2015 | Dollar Change |
|--------------------|------------------------------------|-------------------------------------|---------------|
| | (\$ in thousands) | | |
| Retail | \$27,128 | \$34,514 | \$(7,386) |
| Wholesale | 17,896 | 16,542 | 1,354 |
| Total gross profit | \$45,024 | \$51,056 | \$(6,032) |

Gross Profit Percentages

| | Thirteen Weeks Ended July 30, 2016 | Thirteen Weeks Ended August 1, 2015 |
|-------------------------------|------------------------------------|-------------------------------------|
| Retail | 49.9% | 50.3% |
| Wholesale | 41.9% | 40.7% |
| Total gross profit percentage | 46.4% | 46.7% |

Gross profit decreased 11.8% from \$51.1 million in the thirteen weeks ended August 1, 2015 to \$45.0 million in the thirteen weeks ended July 30, 2016.

Perfumania's retail gross profit dollars decreased from \$28.5 million during the thirteen weeks ended August 1, 2015 to \$23.8 million during the thirteen weeks ended July 30, 2016 due to lower net sales discussed above. For these same periods, Perfumania's retail gross margins were 48.0% and 50.5%, respectively. The decrease in gross margins is due to more promotional pricing at Perfumania stores.

SOW's gross profit dollars decreased from \$6.0 million during the thirteen weeks ended August 1, 2015 to \$3.3 million during the thirteen weeks ended July 30, 2016 primarily due to lower sales by SOW discussed above. For these same periods, SOW's gross margins were 69.6% and 49.3%, respectively. The increase in gross margins is due to the reversal of inventory reserves related to the transition of Burlington to a wholesale customer of QFG.

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QFG's gross profit dollars increased from \$10.7 million during the thirteen weeks ended August 1, 2015 to \$13.0 million during the thirteen weeks ended July 30, 2016 due to higher net sales discussed above. Parlux's gross profit dollars decreased from \$6.1 million during the thirteen weeks ended August 1, 2015 to \$4.9 million during the thirteen weeks ended July 30, 2016. Wholesale gross profit percentage increased from 40.7% during the thirteen weeks ended August 1, 2015 to 41.9% during the thirteen weeks ended July 30, 2016.

Table of Contents

Expenses

Selling, general and administrative expenses include payroll and related benefits for our distribution centers, sales, store operations, field management, purchasing and other corporate office and administrative personnel; rent, common area maintenance, real estate taxes and utilities for our stores, distribution centers and corporate office; advertising, consignment fees, sales promotion, royalties, insurance, supplies, freight out, certain costs related to the implementation of a new computer system and other administrative expenses. Selling, general and administrative expenses were \$52.3 million in the thirteen weeks ended July 30, 2016, compared to \$63.5 million in the thirteen weeks ended August 1, 2015. The decrease in selling, general and administrative expenses is attributable to lower sales commissions on consignment sales, due to lower sales by SOW as discussed above, lower advertising expenses and lower Perfumania store occupancy costs. Included in selling, general and administrative expenses are expenses in connection with the Services Agreement with Quality King, which were \$0.2 million and \$0.1 million during the thirteen weeks ended July 30, 2016 and August 1, 2015, respectively.

Depreciation and amortization was approximately \$2.0 million and \$2.6 million in the thirteen weeks ended July 30, 2016 and August 1, 2015, respectively.

Share-based compensation expense of \$0.1 million during the thirteen weeks ended August 1, 2015 represents the expense incurred on outstanding stock options.

Interest expense was approximately \$1.7 million for each of the thirteen weeks ended July 30, 2016 and August 1, 2015.

The Company did not record a tax provision during the thirteen weeks ended July 30, 2016 and August 1, 2015 since the Company has pre-tax losses for those periods.

As a result of the foregoing, we generated net loss of approximately \$11.0 million in the thirteen weeks ended July 30, 2016 compared to net loss of \$16.8 million in the thirteen weeks ended August 1, 2015.

Comparison of the Twenty-six Weeks Ended July 30, 2016 with the Twenty-six Weeks Ended August 1, 2015.

Net Sales

| | Twenty-six Weeks Ended July 30, 2016 | Percentage of Net Sales | Twenty-six Weeks Ended August 1, 2015 | Percentage of Net Sales | Dollar Change |
|-----------------|--|-------------------------------|---|-------------------------------|------------------|
| | (\$ in thousands) | | | | |
| Retail | \$106,026 | 52.4% | \$137,323 | 57.8% | \$(31,297) |
| Wholesale | 96,133 | 47.6% | 100,193 | 42.2% | (4,060) |
| Total net sales | \$202,159 | 100.0% | \$237,516 | 100.0% | \$(35,357) |

Net sales decreased 14.9% from \$237.5 million in the twenty-six weeks ended August 1, 2015 to \$202.2 million in the twenty-six weeks ended July 30, 2016. The decrease in sales included a decrease in retail sales of \$31.3 million and a decrease in wholesale sales of \$4.0 million.

Retail sales decreased by 22.8% from \$137.3 million in the twenty-six weeks ended August 1, 2015 to \$106.0 million in the twenty-six weeks ended July 30, 2016. The decrease included a decrease in Perfumania's retail sales of \$15.4 million and a decrease in SOW's consignment sales of \$15.9 million.

Wholesale sales decreased by 4.1% from \$100.2 million in the twenty-six weeks ended August 1, 2015 to \$96.1 million in the twenty-six weeks ended July 30, 2016. QFG's sales increased from \$64.7 million in the twenty-six weeks ended August 1, 2015 to \$65.7 million in the twenty-six weeks ended July 30, 2016. Parlux's sales decreased from \$35.3 million in the twenty-six weeks ended August 1, 2015 to \$30.1 million during the twenty-six weeks ended

July 30, 2016.

Perfumania's retail sales decreased from \$110.2 million in the twenty-six weeks ended August 1, 2015 to \$94.8 million in the twenty-six weeks ended July 30, 2016. Perfumania's comparable store sales decreased by 11.4% during the twenty-six weeks ended July 30, 2016. The average retail price per unit sold during the twenty-six weeks ended July 30, 2016 decreased 0.3% from the prior year's comparable period while the total number of units sold decreased by 13.3%. The average number of stores operated was 304 in the twenty-six weeks ended July 30, 2016, versus 318 in the prior year's comparable period due to the closure of under-performing stores over the past year.

18

Table of Contents

SOW's consignment sales decreased from \$27.1 million in the twenty-six weeks ended August 1, 2015 to \$11.2 million in the twenty-six weeks ended July 30, 2016. The decrease in SOW's net sales is due to the transition of Burlington to a wholesale customer discussed above.

Gross Profit

| | Twenty-six Weeks Ended July 30, 2016 | Twenty-six Weeks Ended August 1, 2015 | Dollar Change |
|--------------------|--|---|------------------|
| | (\$ in thousands) | | |
| Retail | \$53,457 | \$67,994 | \$(14,537) |
| Wholesale | 43,336 | 45,540 | (2,204) |
| Total gross profit | \$96,793 | \$113,534 | \$(16,741) |

Gross Profit Percentages

| | Twenty-six Weeks Ended July 30, 2016 | Twenty-six Weeks Ended August 1, 2015 |
|-------------------------------|--|---|
| Retail | 50.4% | 49.5% |
| Wholesale | 45.1% | 45.5% |
| Total gross profit percentage | 47.9% | 47.8% |

Gross profit decreased 14.7% from \$113.5 million in the twenty-six weeks ended August 1, 2015 to \$96.8 million in the twenty-six weeks ended July 30, 2016.

Perfumania's retail gross profit decreased from \$55.2 million for the twenty-six weeks ended August 1, 2015 to \$46.2 million during the twenty-six weeks ended July 30, 2016. For these same periods, Perfumania's retail gross margins were 50.1% and 48.7%, respectively. The decrease in Perfumania's gross margins is attributable to more promotional pricing at Perfumania stores.

SOW's gross profit dollars decreased from \$12.8 million during the twenty-six weeks ended August 1, 2015 to \$7.3 million during the twenty-six weeks ended July 30, 2016 due to lower sales by SOW discussed above. For these same periods, SOW's gross margins were 47.3% and 65.2%, respectively. The increase in gross margin is due to the reversal of inventory reserves due to the transition of Burlington to a wholesale customer of QFG.

QFG's gross profit dollars increased from \$26.6 million during the twenty-six weeks ended August 1, 2015 to \$27.7 million during the twenty-six weeks ended July 30, 2016. Parlux's gross profit decreased from \$19.5 million during the twenty-six weeks ended August 1, 2015 to \$15.7 million during the twenty-six weeks ended July 30, 2016 due to lower sales discussed above. Wholesale gross profit percentage decreased from 45.5% during the twenty-six weeks ended August 1, 2015 to 45.1% during the twenty-six weeks ended July 30, 2016.

Expenses

Selling, general and administrative expenses were \$106.3 million in the twenty-six weeks ended July 30, 2016, compared to \$121.7 million in the twenty-six weeks ended August 1, 2015. The decrease in selling, general and administrative expenses is primarily attributable to lower sales commissions on consignment sales due to lower sales by SOW as discussed above, and lower advertising and sales promotion expenses offset by higher provision for bad debts on accounts receivable. The increase in bad debt expense is the result of a Panama based customer of Parlux that distributes in certain Latin American countries which was placed on the Specially Designated Nationals list by the Office of Foreign Assets Control of the U.S. Treasury Department in May 2016. As a result, the customer's assets

have been frozen and any dealings between U.S. companies, including Parlux, and the customer have been prohibited. Management has reserved the outstanding accounts receivable balance from the customer of approximately \$1.7 million as of July 30, 2016 due to the uncertainty of future collection of this receivable. Also included in selling, general and administrative expenses are expenses in connection with the Services Agreement with Quality King, which were \$0.4 million and \$0.6 million for the twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively.

Table of Contents

Depreciation and amortization was approximately \$4.5 million in the twenty-six weeks ended July 30, 2016, compared to \$5.2 million for the twenty-six weeks ended August 1, 2015.

Share-based compensation expense of less than \$0.1 million and \$0.2 million during the twenty-six week periods ended July 30, 2016 and August 1, 2015, respectively, represents the expense incurred on outstanding stock options. Interest expense was approximately \$3.4 million and \$3.5 million during the twenty-six week periods ended July 30, 2016 and August 1, 2015, respectively.

Since the Company continues to record a full valuation allowance against all deferred tax assets, no income tax benefit was recorded during either of the twenty-six week periods ended July 30, 2016 and August 1, 2015.

As a result of the foregoing, we realized a net loss of approximately \$17.4 million in the twenty-six weeks ended July 30, 2016, compared to a net loss of \$17.0 million in the twenty-six weeks ended August 1, 2015.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities during the twenty-six weeks ended July 30, 2016 was approximately \$12.3 million, compared with approximately \$8.3 million provided by operating activities during the twenty-six weeks ended August 1, 2015. This increase in cash used in operations primarily reflected changes in working capital. The seasonality of our operations may lead to significant fluctuations in certain asset and liability accounts between fiscal year-end and subsequent interim periods.

Net cash used in investing activities was approximately \$1.3 million in the twenty-six weeks ended July 30, 2016 compared to \$3.6 million in the twenty-six weeks ended August 1, 2015. Investing activities during the twenty-six weeks ended July 30, 2016 consisted of Perfumania store construction and remodels, new point-of-sale equipment for certain Perfumania stores and other corporate and information technology enhancements. The decrease in cash used in investing activities resulted from less information technology spending during the twenty-six weeks ended July 30, 2016 versus last year's comparative period and fewer new Perfumania store openings during the twenty-six weeks ended July 30, 2016 compared with the twenty-six weeks ended August 1, 2015. The Company also completed the first phase of a multi-year business transformation program involving new technology and processes for the Perfumania retail business at the end of fiscal 2015 accounting for most of the reduction in information technology spending. During the twenty-six weeks ended July 30, 2016, Perfumania opened 2 new stores and closed 18 stores compared with 3 new stores and 3 store closures during the twenty-six weeks ended August 1, 2015. We plan to open 6 stores and close up to 10 stores during the remainder of fiscal 2016. During fiscal 2016, management has focused on closing marginal and under-performing Perfumania stores by negotiating early lease terminations with landlords, exercising lease termination options included in certain store leases and by choosing not to renew/extend leases on maturing leases. We continuously evaluate the appropriate new store growth rate in light of economic conditions and may adjust the growth rate as conditions change. Furthermore, we continue to evaluate the need to close, remodel or relocate existing stores.

Net cash provided by financing activities during the twenty-six weeks ended July 30, 2016 was approximately \$10.3 million, compared with \$4.0 million used in financing activities for the twenty-six weeks ended August 1, 2015. The \$14.3 million increase in cash provided by financing activities is due primarily to higher borrowings under our bank line of credit. Our borrowings under our line of credit increased due to the timing of payments to trade vendors during the twenty-six weeks ended July 30, 2016 compared with the twenty-six weeks ended August 1, 2015.

The Company has a \$175 million revolving credit facility with a syndicate of banks (the "Senior Credit Facility"), which is used for the Company's general corporate purposes and those of its subsidiaries, including working capital. The Company and certain of its subsidiaries are co-borrowers under the Senior Credit Facility, and the Company's other subsidiaries have guaranteed all of their obligations thereunder. The Company was in compliance with all financial and operating covenants under the Senior Credit facility as of July 30, 2016. As of July 30, 2016, the Company had \$70.4 million available to borrow under the Senior Credit Facility which includes \$25 million for letters of credit, based on the borrowing base at that date.

The Company has various unsecured notes payable outstanding to affiliates which in aggregate total \$125.4 million of principal. No payments of principal may be made on any of these notes payable to affiliates before the maturity of the

Senior Credit Facility although interest payments are permitted under certain conditions. See further discussion of our notes payable to affiliates and our Senior Credit Facility in Note 6 of our condensed consolidated financial statements included in this Form 10-Q.

Our liquidity is impacted by a number of factors, including our sales levels, the amount of credit that our vendors extend to us and our borrowing capacity under our Senior Credit Facility. Our principal funding requirements are for inventory purchases, financing extended terms on accounts receivable, paying down accounts payable and debt, information system enhancements, opening new stores and renovation of existing stores. These capital requirements generally have been satisfied through borrowings under the Senior Credit Facility and funds from operations. Based on current internal sales and cash flow projections, current vendor payable support and our projected available borrowing capacity under our Senior Credit Facility, as

Table of Contents

well as other initiatives to maximize cash flow, we believe that these resources will be adequate to meet our requirements in both the short and long-term.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our condensed consolidated financial statements have been prepared in accordance with US GAAP. Preparation of these statements requires management to make judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, management evaluates its estimates, including those related to bad debts, inventories, asset impairments, sales returns and allowances, income taxes and other contingent assets and liabilities. As such, some accounting policies have a significant impact on amounts reported in these financial statements. The judgments and estimates made can significantly affect results. Materially different amounts might be reported under different conditions or by using different assumptions. We consider an accounting policy to be critical if it is both important to the portrayal of our financial condition and results of operations, and requires significant judgment and estimates by management in its application. We have identified certain critical accounting policies that affect the significant estimates and judgments used in the preparation of its financial statements. There have been no significant changes to our critical accounting policies and estimates as discussed in our Annual Report on Form 10-K for the year ended January 30, 2016.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report (July 30, 2016), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

During the second quarter of fiscal 2016 there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There have been no material developments in the litigation with S. Carter Enterprises, LLC and Shawn C. Carter which was disclosed in Part I, Item 3, of the Company's Form 10-K for the fiscal year ended January 30, 2016.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors described in Item 1A to our Annual Report on Form 10-K for the year ended January 30, 2016.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-Q, may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are typically identified by words or phrases such as “may,” “will,” “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe,” “target,” “forecast,” “objective,” “assume,” “strategic” words and terms of similar meaning. Forward-looking statements involve estimates, expectations, projections, goals, forecasts, assumptions, risks and uncertainties. We caution readers that any forward-looking statement is not a guarantee of future performance and that actual results could differ materially from those contained in the forward-looking statement.

Among the factors that could cause actual results, performance or achievement to differ materially from those described or implied in the forward-looking statements are our ability to service our obligations, our ability to comply with the covenants in our Senior Credit Facility, any deterioration of general economic conditions, including weaker than anticipated discretionary spending by consumers, competition, the ability to raise additional capital to finance our expansion and other factors included in our filings with the SEC. Copies of our SEC filings are available from the SEC or may be obtained upon request from us.

You should also consider carefully the statements under “Risk Factors” in our Form 10-K which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect our business, operating results and financial condition. We cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The exhibits listed in the following Exhibit Index are filed herewith.

- 3.1 Amended and Restated Articles of Incorporation, as amended through August 8, 2008 (Incorporated by reference to Exhibit 3.1 to the Company's Form 10-K filed July 2, 2009).
- 3.2 Articles of Amendment to Amended and Restated Articles of Incorporation, filed April 17, 2012 (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed April 19, 2012).
- 3.3 Bylaws (Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (No 33-46833)).
- 31.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document

PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES
SIGNATURES

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

PERFUMANIA HOLDINGS, INC.
(Registrant)

Date: September 9, 2016 By: By: /s/ Michael W. Katz
Michael W. Katz
President and Chief Executive Officer
(Principal Executive Officer)

By: By: /s/ Donna L. Dellomo
Donna L. Dellomo
Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)