

bebe stores, inc.
Form 10-Q
February 12, 2015

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

FORM 10-Q

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

For the quarterly period ended January 3, 2015

OR

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

Commission File Number 0-24395

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

California
(State or Jurisdiction of
Incorporation or Organization)

94-2450490
(IRS Employer
Identification Number)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of January 30, 2015 was 79,615,796.

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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 January 3, 2015	As of July 5, 2014	As of January 4, 2014
Assets:			
Current assets:			
Cash and equivalents	\$75,214	\$94,345	\$130,862
Available for sale securities	19,996	18,665	21,977
Receivables	5,503	4,814	7,780
Inventories, net	30,108	31,683	31,877
Deferred income taxes, net	59	88	168
Prepaid and other	11,466	10,704	13,819
Total current assets	142,346	160,299	206,483
Available for sale securities	5,455	11,941	11,124
Property and equipment, net	93,730	93,640	99,593
Intangible asset	917	917	917
Other assets	3,619	3,558	4,690
Total assets	\$246,067	\$270,355	\$322,807
Liabilities and Shareholders' Equity:			
Current liabilities:			
Accounts payable	\$16,831	\$20,022	\$15,127
Accrued liabilities and other	34,696	39,277	31,089
Total current liabilities	51,527	59,299	46,216
Deferred rent and other lease incentives	24,858	25,847	31,866
Uncertain tax positions	79	78	383
Total liabilities	76,464	85,224	78,465
Commitments and contingencies			
Shareholders' equity:			
Preferred stock-authorized 1,000,000 shares at \$0.001 par value per share; no shares issued and outstanding	—	—	—
Common stock-authorized 135,000,000 shares at \$0.001 par value per share; issued and outstanding 79,614,296, 79,555,064 and 79,062,470 shares	80	80	79
Additional paid-in capital	143,850	142,868	140,251
Accumulated other comprehensive income	244	3,161	2,257
Retained earnings	25,429	39,022	101,755
Total shareholders' equity	169,603	185,131	244,342
Total liabilities and shareholders' equity	\$246,067	\$270,355	\$322,807
See accompanying notes to condensed consolidated financial statements.			

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except per share data)

(unaudited)

	Three Months Ended		Six Months Ended	
	January 3, 2015	January 4, 2014	January 3, 2015	January 4, 2014
Net sales	\$128,914	\$123,261	\$231,070	\$232,529
Cost of sales, including production and occupancy	81,007	81,261	150,393	150,907
Gross margin	47,907	42,000	80,677	81,622
Selling, general and administrative expenses	47,816	46,514	89,943	94,338
Operating income (loss)	91	(4,514)	(9,266)	(12,716)
Interest and other income, net	28	86	435	244
Income (loss) from continuing operations, before income taxes	119	(4,428)	(8,831)	(12,472)
Income tax provision (benefit)	139	(59)	175	(205)
Loss from continuing operations, net of tax	\$(20)	\$(4,369)	\$(9,006)	\$(12,267)
Loss from discontinued operations, net of tax	(365)	(1,096)	\$(2,196)	\$(2,352)
Net loss	\$(385)	\$(5,465)	\$(11,202)	\$(14,619)
Basic per share amounts:				
Net loss from continuing operations, net of tax	\$—	\$(0.06)	\$(0.11)	\$(0.16)
Net loss from discontinued operations, net of tax	—	(0.01)	\$(0.03)	\$(0.03)
Net loss	\$—	\$(0.07)	\$(0.14)	\$(0.18)
Diluted per share amounts:				
Net loss from continuing operations, net of tax	\$—	\$(0.06)	\$(0.11)	\$(0.16)
Net loss from discontinued operations, net of tax	—	(0.01)	\$(0.03)	\$(0.03)
Net loss	\$—	\$(0.07)	\$(0.14)	\$(0.18)
Basic weighted average shares outstanding	79,617	79,119	79,598	79,087
Diluted weighted average shares outstanding	79,617	79,119	79,598	79,087
Dividends declared per share	\$0.015	\$0.025	\$0.030	\$0.050
Other comprehensive income (loss)				
Gain (loss) on available for sale securities	\$52	\$(3)	\$89	\$1,793
Foreign currency translation adjustments	(1,221)	991	(3,006)	(321)
Other comprehensive income (loss)	(1,169)	988	(2,917)	1,472
Comprehensive loss	\$(1,554)	\$(4,477)	\$(14,119)	\$(13,147)

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Six Months Ended	
	January 3, 2015	January 4, 2014
Cash flows from operating activities:		
Net loss	\$(11,202	) \$(14,619
Adjustments to reconcile net loss to cash used by operating activities:		
Non-cash compensation expense	942	1,772
Depreciation and amortization	7,955	10,067
Non-cash charge for asset impairment	224	904
Deferred income taxes	71	(397
Other	(229	) (825
Changes in operating assets and liabilities:		
Receivables	(691	) (736
Inventories	1,574	1,986
Prepaid expenses and other	983	(334
Accounts payable	(90	) (1,685
Deferred rent and other lease incentives	(989	) (2,522
Accrued liabilities	(3,266	) 1,157
Net cash used by operating activities	(4,718	) (5,232
Cash flows from investing activities:		
Purchase of property and equipment and store construction deposits	(15,085	) (8,372
Purchase of marketable securities	(12,042) —
Proceeds from sales of investment securities	15,080	61,590
Net cash (used) provided by investing activities	(12,047	) 53,218
Cash flows from financing activities:		
Proceeds from issuance of common stock	11	172
Excess tax benefit from exercise of stock options and awards	—	62
Cash dividends paid	(2,388	) (3,956
Net cash used by financing activities	(2,377	) (3,722
Net decrease in cash and equivalents	(19,142	) 44,264
Effect of exchange rate changes on cash	11	(367
Cash and equivalents:		
Beginning of period	94,345	86,965
End of period	\$75,214	\$130,862
See accompanying notes to condensed consolidated financial statements.		

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
INTERIM FINANCIAL STATEMENTS

The accompanying condensed consolidated balance sheets of bebe stores, inc. (the "Company") as of January 3, 2015 and January 4, 2014, the condensed consolidated statements of operations and comprehensive loss for the three and six months ended January 3, 2015 and January 4, 2014 and the condensed consolidated statements of cash flows for the three and six months ended January 3, 2015 and January 4, 2014 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, without audit. Accordingly, they do not include all of the information required by accounting principles generally accepted in the United States of America for annual financial statements. Therefore, these condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended July 5, 2014.

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

FISCAL YEAR

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

The three month periods ended January 3, 2015 and January 4, 2014 each include 13 weeks. The six month periods ended January 3, 2015 and January 4, 2014 each included 26 weeks.

RECENT ACCOUNTING PRONOUNCEMENTS

Presentation of Financial Statements

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update (ASU) No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity", or ASU 2014-08. Under ASU 2014-08, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results. Additionally, ASU 2014-08 required expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income and expenses of discontinued operations. ASU 2014-08 is effective for fiscal and interim periods beginning on or after December 15, 2014 and is to be applied prospectively. The Company adopted this standard beginning with the three month period ended January 3, 2015 and will apply this standard to any new transactions occurring in future periods.

Revenue Recognition

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

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Going Concern

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

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 January 3, 2015, the Company has a remaining reserve of \$2.1 million for future costs associated with discontinued operations. This reserve has been included within the "Accrued liabilities" line in the consolidated balance sheets. A roll forward of the reserve is presented as follows:

	Lease Obligations	Other Costs	Total
	(In thousands)		
Balance as of July 5, 2014	\$6,385	\$1,000	\$7,385
Costs incurred in fiscal 2015	1,481	718	2,199
Cash payments, markdowns or adjustments applied	(6,165	) (1,323	) (7,488
Balance as of January 3, 2015	\$1,701	\$395	\$2,096

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

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

INVESTMENTS

The Company's investment portfolio consists of certificates of deposit and auction rate securities. The Company held short term available for sale securities totaling \$20.0 million as of January 3, 2015, that consisted entirely of certificates of deposit at cost which approximates fair value. The Company also holds long term available for sale securities at fair value totaling \$5.5 million as of January 3, 2015, that consisted entirely of interest bearing auction rate securities ("ARS").

The Company holds interest bearing ARS consisting of federally insured student loan backed securities. As of January 3, 2015, the Company's ARS portfolio consisted of two securities with a fair value of approximately \$5.5 million and was classified as available for sale securities, net of a temporary impairment charge of \$3.5 million. As of that date, the Company's ARS portfolio consisted of approximately 22% A rated investments and 78% CCC rated investments. As of July 5, 2014, the Company's ARS consisted of 36% A rated investments, 19% BBB rated investments and 45% CCC rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected the Company's holdings in ARS investments and auctions for the Company's investments in these securities have failed to settle on their respective settlement dates. During the six months ended January 3, 2015, \$6.6 million of ARS held by the Company were settled at par. While the Company continues to earn interest on its ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and the Company will not be

able to access these funds until a future auction of these investments is successful, the issuer redeems the securities or at maturity. Maturity dates for the ARS investments are 2031 and 2033 with principal distributions occurring on certain securities prior to maturity. To date, principal distributions and maturities of the securities held by the Company have all been at par value.

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The Company reviews its investments for impairment in accordance with guidance issued by the FASB and SEC in order to determine the classification of the impairment as “temporary” or “other-than-temporary”. A temporary impairment charge results in an unrealized loss being recorded in the accumulated other comprehensive income component of shareholders’ equity. Such an unrealized loss does not affect net income for the applicable accounting period. An other-than-temporary impairment charge is recorded as a loss in the condensed consolidated statements of operations and comprehensive loss for the applicable accounting period. When evaluating the investments for other-than-temporary impairment, the Company estimates the expected cash flows of the underlying collateral by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and any changes thereto, and the Company’s intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment’s amortized cost basis. The Company has not recorded any impairment loss from its available for sale investments as other-than-temporary based on such analysis.

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

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

	As of January 3, 2015			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(In thousands)			
Short term certificates of deposit	\$19,996	\$—	\$—	\$19,996
Long term auction rate securities	\$9,000	\$—	\$3,545	\$5,455

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

	As of January 4, 2014			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(In thousands)			
Short term certificates of deposit	\$21,977	\$—	\$—	\$21,977
Long term auction rate securities	\$15,575	\$—	\$4,451	\$11,124

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 January 3, 2015, the Company held financial instruments that are measured at fair value on a recurring basis. These included cash equivalents and available for sale securities. Cash equivalents consist of money market funds.

Short term

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available for sale securities consist of certificates of deposit. Long term available for sale securities consist of ARS. These ARS consist of federally insured student loan backed securities.

The Company determined the estimated fair value of its investment in ARS as of January 3, 2015 by reviewing trading activity for similar securities in secondary markets as well as by using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for liquidity (average of LIBOR +5.27%), interest rates (weighted average of 0.2%), timing (range from 11 – 14 years), credit ratings and amount of cash flows and expected holding periods of the ARS and recent trading activity in the secondary marketplace.

The following items are measured at fair value on a recurring basis as of January 3, 2015:

Description	January 3, 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	\$75,214	\$75,214	\$—	\$—
Current available for sale securities	19,996	—	19,996	—
Non-current available for sale securities	5,455	—	—	5,455
Total	\$100,665	\$75,214	\$19,996	\$5,455

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

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

The following items are measured at fair value on a recurring basis as of January 4, 2014:

Description	January 4, 2014	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements at reporting date (In thousands)				
Cash and cash equivalents	\$46,409	\$46,409	\$—	\$—
Current available for sale securities	21,977	—	21,977	—
Non-current available for sale securities	11,124	—	—	11,124
Total	\$79,510	\$46,409	\$21,977	\$11,124

During the quarter ended January 3, 2015, there were no transfers of assets and liabilities between Level 1 (quoted prices in active markets for identical assets) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy. An impairment charge has been recorded in accumulated other comprehensive income that reduces the carrying amount of the applicable non-current assets of \$9.0 million to their fair value of \$5.5 million as of January 3, 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 six months ended January 3, 2015:

	Three Months Ended January 3, 2015 (In thousands)	Six Months Ended January 3, 2015
Balance at beginning of period	\$5,403	\$11,941
Total gains or (losses) (realized or unrealized)		
Included in net loss	—	—
Included in accumulated other comprehensive income	52	89
Settlements	—	(6,575)
Balance at end of period	\$5,455	\$5,455

Non-Financial Assets:

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The Company measures certain non-financial assets and liabilities, including long-lived assets, at fair value on a non-recurring basis. During the three months ended January 3, 2015 and January 4, 2014, the Company recorded impairment charges of approximately \$0.2 million and \$0.7 million, respectively, related to under-performing stores. During the six months ended January 3, 2015 and January 4, 2014, the Company recorded impairment charges of approximately \$0.2 million and \$0.9 million, respectively, related to under-performing stores.

The following table presents the Company's considerations of at-risk assets for the three month and six month periods ended January 3, 2015 and January 4, 2014, respectively (amounts in millions, except for store count):

	Three Months Ended		Six Months Ended	
	January 3, 2015	January 4, 2014	January 3, 2015	January 4, 2014
Number of stores identified as at risk and evaluated for impairment	16	24	21	26
Total carrying amount of stores identified as at risk prior to any impairment charges taken	\$2.7	\$4.1	\$3.4	\$4.3
Less: impairment charges recorded during the period	0.2	0.7	0.2	0.9
Remaining carrying amount of stores identified as at risk after impairment charges taken	\$2.5	\$3.4	\$3.2	\$3.4
Number of stores considered at risk, but not impaired	12	18	17	19
Total carrying amount of stores identified as at risk, but not impaired	\$2.5	\$3.3	\$3.2	\$3.3

The fair market value of these assets was determined using the income approach and level 3 inputs, which require management to make significant estimates about future operating plans and projected cash flows. Management estimates the amount and timing of future cash flows based on its experience and knowledge of the retail market in which each store operates. The assumptions used in preparing the discounted cash flow model and the related sensitivity analysis around the discounted cash flow model include estimates for weighted average cost of capital 11.0% and annual revenue growth rates (range from 2.0% – 5.0%). The stores not impaired had undiscounted cash flows that exceeded their net carrying amount at a weighted average of 182% and 130% for the three and six month period ended January 3, 2015, respectively. For the three and six month periods ended January 4, 2014, the stores not impaired had undiscounted cash flows that exceeded their net carrying amount at a weighted average of 145% and 154%, respectively.

The impairment charge is included in selling, general and administrative expenses ("SG&A") in the accompanying condensed consolidated statements of operations and comprehensive loss. The Company was not required to measure any other significant non-financial assets and liabilities at fair value.

INVENTORIES

The Company's inventories consisted of:

	As of		
	January 3, 2015 (In thousands)	July 5, 2014	January 4, 2014
Raw materials	\$619	\$1,206	\$1,048
Merchandise available for sale	29,489	30,477	30,829
Inventories, net	\$30,108	\$31,683	\$31,877

LETTERS OF CREDIT

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On May 14, 2014 the Company entered into a secured stand-by letter of credit agreement which provides for issuance of one or more stand-by letters of credit. As of January 3, 2015, the Company had \$3.8 million available, related to two stand-by letters of credit. To date, no beneficiary has drawn upon the stand-by letter of credit.

INCOME TAXES

Deferred income taxes arise from temporary differences between the tax and financial statement recognition of revenue and expenses. The Company regularly assesses the need for a valuation allowance against its deferred tax assets. In evaluating whether it is more likely than not that some or all of the Company's deferred tax assets will not be realized, it considers all available positive and negative evidence, including recent year's operational results which is objectively verifiable evidence. As a result of its evaluation of the realizability of its deferred tax assets as of January 3, 2015, the Company continues to believe, based upon all available evidence, that it is more likely than not that the majority of its deferred tax assets will continue to not be realized. Accordingly, the majority of the tax benefit related to the current quarter losses is not recognized. The Company will continue to maintain a valuation allowance against its deferred tax assets until the Company believes it is more likely than not that these assets will be realized in the future. If sufficient positive evidence arises in the future indicating that all or a portion of the deferred tax assets meet the more likely than not standard, the valuation allowance will be reversed accordingly in the period that such determination is made.

EARNINGS PER SHARE

Basic earnings per share is computed as net earnings divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur from common shares issuable through the exercise of dilutive stock options.

There is no difference between the number of shares used in the basic and diluted earnings per share computations. Excluded from the computation of the number of diluted weighted average shares outstanding were options to purchase 4,630,404 and 5,293,313 shares of common stock for the three months ended January 3, 2015 and January 4, 2014, respectively, and 4,731,887 and 4,947,432, for the six months ended January 3, 2015 and January 4, 2014, respectively, which would have been anti-dilutive.

STOCK BASED COMPENSATION

The following table summarizes the stock based compensation expense recognized under the Company's stock plan during the three and six months ended January 3, 2015 and January 4, 2014:

	Three Months Ended		Six Months Ended	
	January 3, 2015	January 4, 2014	January 3, 2015	January 4, 2014
	(In thousands)			
Stock options	\$(19)	\$352	\$414	\$859
Stock awards/units	211	512	528	913
Total stock based compensation expense	\$192	\$864	\$942	\$1,772

Unrecognized compensation cost related to nonvested stock options and nonvested stock awards/units totaled approximately \$0.5 million and \$1.7 million, respectively, as of January 3, 2015. This cost is expected to be recognized over a weighted average period of 2.7 years. There were no stock options granted during the three months ended January 3, 2015 and January 4, 2014. During the six month periods ended January 3, 2015 and January 4, 2014, the weighted average fair value of stock options at their grant date was \$0.84 and \$1.79, respectively.

LEGAL MATTERS

As of the date of this filing, the Company is involved in ongoing legal proceedings as described below. A former employee filed a lawsuit against the Company on November 2, 2010 in the Superior Court of California, San Bernardino County (Case No. CIVRS1011823) alleging a failure to pay all wages, overtime wages, minimum wages, failure to pay/provide meal and rest periods, various other violations of the California Labor Code and a violation of California Business & Professions Code §17200 et seq. The plaintiff purports to bring the action also on behalf of current and former California bebe stylists and sales associates who are similarly situated. Both parties have conducted some discovery and depositions and the Company continues to prepare its defense. A hearing regarding

class certification is scheduled to take place on February 25, 2015.

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A customer served the Company with a complaint on January 31, 2014 in the United States District Court for the Northern District of California (Civil Action No. C14-267 DMR) alleging negligent violations of the Telephone Consumer Protection Act (47 U.S.C. §§227 et seq.), knowing and/or willful violations of the Telephone Consumer Protection Act (47U.S.C. §§227 et seq.) and violations of California's unfair competition law (California Business and Professions Code §§ 17200, et seq.) each stemming from an alleged failure to obtain customer consent prior to sending text messages. The plaintiff purports to bring the action also on behalf of others similarly situated. The lawsuit seeks statutory and injunctive relief and other remedies. The Company completed its initial investigation into the claims, filed its initial response with the court, commenced discovery practice and is vigorously pursuing its defense.

A customer served the Company with a complaint on May 20, 2014 in the United States District Court for the Northern District of California (Civil Action No. 3:14-CV-01968) alleging negligent and willful violations of the Telephone Consumer Protection Act (47 U.S.C. §§227 et seq.) stemming from an alleged failure to obtain customer consent prior to sending text messages. The plaintiff purports to bring the action also on behalf of others similarly situated. The lawsuit seeks statutory and injunctive relief and other remedies. The Company completed its initial investigation into the claim, filed its response with the court and is vigorously pursuing its defense.

The Company is also involved in various other legal proceedings arising in the normal course of business.

Regarding all matters referenced herein, the Company intends to defend itself vigorously and has, accrued estimated amounts of liability where required, appropriate and determinable. Any such estimates may be revised as further information becomes available. The results of any litigation are inherently uncertain and as such bebe cannot assure that it will be able to successfully defend itself in these lawsuits nor that any amounts accrued are sufficient. The Company believes that the legal proceedings referenced herein, as well as the amounts accrued as of this filing, either individually or in the aggregate, will not have a material adverse effect on our business, financial condition or results of operations.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, which involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements. Statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates," "thinks" and similar expressions are forward-looking statements. Forward-looking statements include statements about our expected results of operations, capital expenditures and store openings. Although we believe that these statements are based upon reasonable assumptions, we cannot assure you that our goals will be achieved. These forward-looking statements are made as of the date of this Form 10-Q, and we assume no obligation to update or revise them or provide reasons why actual results may differ. Factors that might cause such a difference include, but are not limited to, our ability to respond to changing fashion trends, obtain raw materials and find manufacturing facilities, attract and retain key management personnel, develop new concepts, successfully open future stores, successfully manage our online business, maintain and protect information technology, respond effectively to competitive pressures in the apparel industry and adverse economic conditions and protect our intellectual property as well as declines in comparable store sales performance, changes in the level of consumer spending or preferences in apparel and/or other factors discussed in "Risk Factors" and elsewhere in this Form 10-Q.

OVERVIEW

We design, develop and produce a distinctive line of contemporary women's apparel and accessories. We are a global fashion brand that believes feeling confident and looking great are cornerstones for today's sophisticated woman. The bebe woman is glamorous, feminine and sophisticated and takes pride in her appearance. She is powerful and ageless and wants to stand out in a crowd. Our expert designs and a personal retail experience aim to provide the bebe woman with all of her fashion needs. The bebe woman also expects value in the form of current fashion and high quality at a competitive price.

Our distinctive product offering includes a full range of separates, tops, dresses, active wear and accessories to satisfy our customers every day wardrobe needs for a variety of occasions. We design and develop the majority of our merchandise in-house, which is manufactured to our specifications. The remainder is sourced directly from third-party manufacturers.

We market our products under the bebe, BEBE SPORT and bbsp brand names through our 211 retail stores, of which 175 are bebe stores, including an on-line store at www.bebe.com, and 36 are bebe outlet stores. Our 92 international licensees operated stores in 23 countries and, pursuant to our product licensing, through certain select domestic and international retailers. During the three months ended January 3, 2015, we opened 3 bebe stores and 1 outlet store, and during the six months ended January 3, 2015, we opened 3 bebe stores and 3 outlet stores, and closed 2 bebe stores. bebe. We were founded by Manny Mashouf, our Chairman of the Board. We opened our first store in San Francisco, California in 1976, which was also the year we incorporated in California. As of January 3, 2015, we operated 175 bebe stores in 34 states, Puerto Rico, the U.S. Virgin Islands, Canada and on-line. www.bebe.com is our bebe on-line retail store and an extension of the bebe store experience that provides a complete assortment of bebe and BEBE SPORT merchandise and is used as a vehicle to communicate with our customers.

bebe outlet. Our bebe outlet stores are an extension of the full-price bebe store and provide everyday lifestyle offerings for our aspirational buyers. As of January 3, 2015, we operated a total of 36 bebe outlet stores.

2b bebe. In the fourth quarter of fiscal 2014, we discontinued operations of our 2b bebe division, allowing us to focus on the core bebe brand; we closed all of the 2b bebe stores by the end of fiscal 2014. We recorded the net costs associated with the disposition of these stores during fiscal 2014 as the stores closed and the related assets were disposed of or written off. Both current and prior year results for these stores have been classified within discontinued operations on our consolidated statements of operations and comprehensive income (loss).

CRITICAL ACCOUNTING POLICIES

Management's Discussion and Analysis of Financial Condition and Results of Operations are based upon our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America.

The preparation of these financial statements requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the financial statements. We believe our application of accounting policies, and the estimates inherently required therein, are reasonable. Our most critical accounting policies are

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those related to revenue recognition, stock based compensation, inventories, marketable securities, impairment of long lived assets and income taxes. We continually evaluate these accounting policies and estimates, and we make adjustments when facts and circumstances dictate a change. Our accounting policies are described in Note 1 to the consolidated financial statements in our annual report on Form 10-K for the fiscal year ended July 5, 2014. This discussion and analysis should be read in conjunction with such discussion and with our condensed consolidated financial statements and related notes included in Part 1, Item 1 of this quarterly report.

RESULTS OF OPERATIONS

Our fiscal year is a 52 or 53 week period, each period ending on the first Saturday on or after June 30. Both fiscal 2015 and fiscal 2014 include 52 weeks. The three months ended January 3, 2015 and January 4, 2014 each include 13 weeks. The six months ended January 3, 2015 and January 4, 2014 each include 26 weeks.

The following table sets forth certain financial data as a percentage of net sales for the periods indicated:

	Three Months Ended				Six Months Ended			
	January 3, 2015		January 4, 2014		January 3, 2015		January 4, 2014	
		%		%		%		%
Net sales	100.0		100.0		100.0		100.0	
Cost of sales, including production and occupancy (1)	62.8		65.9		65.1		64.9	
Gross margin	37.2		34.1		34.9		35.1	
Selling, general and administrative expenses (2)	37.1		37.7		38.9		40.6	
Operating loss	0.1		(3.6)	)	(4.0)	)	(5.5))
Interest and other income, net	—		0.1		0.2		0.1	
Loss from continuing operations before income taxes	0.1		(3.5)	)	(3.8)	)	(5.4))
Income tax (benefit)/provision	0.2		(0.1)	)	0.1		(0.1))
Loss from continuing operations, net of tax	—		(3.5)	)	(3.9)	)	(5.3))
Loss from discontinued operations, net of tax	(0.3)	)	(0.9)	)	(0.9)	)	(1.0))
Net loss	(0.3)	)%	(4.4)	)%	(4.8)	)%	(6.3))%

(1) Cost of sales includes the cost of merchandise, occupancy costs, distribution center costs and production costs.

(2) Selling, general and administrative expenses primarily consist of non-occupancy store costs, corporate overhead and advertising costs.

Net Sales. Net sales increased to \$128.9 million during the three months ended January 3, 2015 from \$123.3 million for the comparable period of the prior year, an increase of \$5.7 million, or 4.6%. The increase in net sales is primarily due to the increased sales volumes in both our bebe and outlet businesses coupled with higher sales dollars per transaction.

For the six months ended January 3, 2015, net sales remained generally consistent, decreasing slightly to \$231.1 million from \$232.5 million for the comparable period of the prior year, a decrease of \$1.5 million, or (0.6)%.

	Three Months Ended				Six Months Ended			
	January 3, 2015		January 4, 2014		January 3, 2015		January 4, 2014	
		%		%		%		%
Net sales (In thousands)	\$128,914		\$123,261		\$231,070		\$232,529	
Net sales increase (decrease) percentage	4.6		(4.8)	)%	(0.6)		(4.0))%
Comparable store percentage (1)	8.0		(2.6)	)%	4.7		(2.8))%
Net sales per average square foot (2)	\$120		\$112		\$216		\$212	
Square footage at end of period (In thousands)	828		852		828		852	
Number of store locations:								
Beginning of period	207		235		207		242	
New store locations	4		—		6		1	
Closed store locations	—		3		2		11	

Number of stores open at end of period	211	232	211	232
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- We calculate comparable store sales by including the net sales of stores that have been open at least one year. Therefore, a store is included in the comparable store sales base beginning with its thirteenth month. Stores that have been expanded or remodeled by 15 percent or more or have been permanently relocated are excluded from the comparable store sales base. In addition, we calculate comparable store sales using a same day sales comparison.
- (1) Our e-commerce store sales are also included in our comparable store sales base. For the three months ended January 3, 2015 and January 4, 2014, the inclusion of our e-commerce store sales increased the comparable store sales 2.5% and 2.5%, respectively. For the six months ended January 3, 2015 and January 4, 2014, the inclusion of our e-commerce store sales increased the comparable store sales 2.8% and 2.3%, respectively.
 - (2) We calculate net sales per average square foot using net store sales less e-commerce net sales and monthly average store square footage.

Gross Margin. Gross margin increased to \$47.9 million during the three months ended January 3, 2015 from \$42.0 million for the comparable period of the prior year, an increase of \$5.9 million, or 14.1%. As a percentage of net sales, gross margin increased to 37.2% for the three months ended January 3, 2015 from 34.1% in the comparable period of the prior year. The increase in margin primarily reflects fewer markdowns on merchandise sold during the quarter at bebe, partially offset by increased promotions of aged product in bebe outlet stores and on our flash sale site.

For the six months ended January 3, 2015, gross margin remained generally consistent, decreasing slightly to \$80.7 million from \$81.6 million for the comparable period of the prior year, a decrease of \$0.9 million, or 1.2%. As a percentage of net sales, gross margin was 34.9% for the six months ended January 3, 2015 compared to 35.1% in the comparable period of the prior year.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased to \$47.8 million during the three months ended January 3, 2015 from \$46.5 million for the comparable period of the prior year, an increase of \$1.3 million, or 2.8%. SG&A for the second quarter was impacted by severance expense, cyber breach related costs and store impairment and closure charges. As a percentage of net sales, selling, general and administrative expenses decreased to 37.1% during the three months ended January 3, 2015 from 37.7% in the comparable period of the prior year.

For the six months ended January 3, 2015, selling, general and administrative expenses decreased to \$89.9 million from \$94.3 million for the comparable period of the prior year, a decrease of \$4.4 million or 4.7%. As a percentage of net sales, selling, general and administrative expenses decreased to 38.9% during the six months ended January 3, 2015 from 40.6% in the comparable period of the prior year. The decrease is primarily the result of reduced advertising expense.

Provision for Income Taxes. The tax rate for the second quarter of fiscal 2015 was 116.8% compared to 1.3% for the comparable period of the prior year. The current quarter effective tax rate primarily reflects the effects of foreign income taxes and the continuing impact of maintaining a valuation allowance against net deferred tax assets recorded in the third quarter of fiscal 2013.

For the six months ended January 3, 2015, effective tax rate was (2.0)% compared to 1.6% for the comparable period of the prior year. Due to the existence of the valuation allowance, most of the tax benefit related to the current fiscal year to date losses is not recognized. Our effective tax rate for both fiscal year 2015 and 2014 continues to approximate 0% due to the impact of the valuation allowance.

Discontinued Operations. Loss from discontinued operations was \$0.4 million for the three months ended January 3, 2015 compared to \$1.1 million for the three months ended January 4, 2014. The loss in the second quarter of fiscal 2015 primarily represented costs related to settling our remaining 2b lease obligations.

For the six months ended January 3, 2015, loss from discontinued operations was \$2.2 million compared to \$2.4 million for the six months ended January 4, 2014. The loss to date in fiscal 2015 primarily represented costs related to settling our remaining 2b lease obligations and severance incurred and paid in the period.

SEASONALITY OF BUSINESS AND QUARTERLY RESULTS

Our business varies with general seasonal trends that are characteristic of the retail and apparel industries. As a result, our typical store generates a higher percentage of our annual net sales and profitability in the second quarter of our fiscal year, which includes the holiday selling season, compared to the other quarters of our fiscal year. If for any

reason our sales were below seasonal norms during the second quarter of our fiscal year, our annual operating results would be negatively impacted.

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Because of the seasonality of our business, results for any quarter are not necessarily indicative of results that may be achieved for a full fiscal year or for any other fiscal quarter.

LIQUIDITY AND CAPITAL RESOURCES

Our working capital requirements vary widely throughout the year and generally peak during the first and second fiscal quarters. As of January 3, 2015, we had approximately \$100.7 million of cash and equivalents and investments on hand of which \$75.2 million were cash and equivalents, approximately \$20.0 million were invested in certificates of deposit and approximately \$5.5 million, net of temporary impairment charges of \$3.5 million, were invested in auction rate securities (“ARS”). We do not anticipate the lack of liquidity in the ARS to impact our ability to fund our operations in the foreseeable future, and believe we have sufficient cash and equivalents to fund ongoing operations. As of January 3, 2015, we had cash and equivalents of \$75.2 million held in accounts managed by third-party financial institutions consisting of invested cash and cash in our operating accounts. The invested cash is invested in interest bearing funds managed by third-party financial institutions. These funds invest in direct obligations of the government of the United States. To date, we have experienced no loss or lack of access to our invested cash or equivalents; however, we can provide no assurances that access to our invested cash and equivalents will not be impacted by adverse conditions in the financial markets.

We hold our operating and invested cash in accounts that are with third-party financial institutions. These balances exceed the Federal Deposit Insurance Corporation insurance limits. While we monitor daily the cash balances in our operating accounts and adjust the cash balances as appropriate, these cash balances could be impacted if the underlying financial institutions fail or could be subject to other adverse conditions in the financial markets. To date, we have experienced no loss or lack of access to invested cash or cash in our operating accounts.

Net cash used by operating activities for the six months ended January 3, 2015 was \$4.7 million compared to net cash used by operating activities of \$5.2 million for the six months ended January 4, 2014. The decrease of \$0.5 million from the comparable period was due to decreased net operating loss and the effects of changes in working capital. The decrease of \$1.7 million in working capital was primarily related to decreased payables and accrued liabilities.

Net cash used by investing activities for the six months ended January 3, 2015 was \$12.0 million compared to \$53.2 million provided by investing activities for the six months ended January 4, 2014. The \$65.3 million change versus the prior year comparable period was primarily due to lower proceeds from sale of investment securities in the current year, offset by increased capital expenditures. Total capital expenditures for the year are anticipated to be approximately \$18 million for new stores, remodels and information technology systems.

Net cash used by financing activities was \$2.4 million for the six months ended January 3, 2015 compared to \$3.7 million used by financing activities for the six months ended January 4, 2014. The decrease of \$1.3 million from the prior year comparable period was primarily due to a reduction in the amount of cash dividends paid.

We hold interest bearing ARS consisting of federally insured student loan backed securities. As of January 3, 2015, our ARS portfolio totaled approximately \$5.5 million and is classified as available for sale securities, net of a temporary impairment charge of \$3.5 million. As of that date, our ARS portfolio consisted of approximately 22% A rated investments and 78% CCC rated investments. As of July 5, 2014, our ARS consisted of 36% A rated investments, 19% BBB rated investments and 45% CCC rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected our holdings in ARS investments and auctions for our investments in these securities have failed to settle on their respective settlement dates. During the six months ended January 3, 2015, \$6.6 million of ARS held by the Company were settled at par. While the Company continues to earn interest on its ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and we will not be able to access these funds until a future auction of these investments is successful, the issuer redeems the securities or at maturity. Maturity dates for the ARS investments are 2031 and 2033 with principal distributions occurring on certain securities prior to maturity. To date, principal distributions and maturities of the securities held by us have all been at par value.

We also hold short-term available for sale securities totaling \$20.0 million at January 3, 2015 that consist of certificates of deposit.

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In November 2012, our board of directors authorized a program to repurchase up to \$30 million of our common stock. We intend, from time to time, as business conditions warrant, to purchase stock in the open market or through private transactions. Purchases may be increased, decreased or discontinued at any time without prior notice. The plan does not obligate us to repurchase any specific number of shares and may be suspended at any time at our discretion. No shares were repurchased during the three months and six months ended January 3, 2015 and January 4, 2014 and none are currently planned.

We believe that our cash and cash equivalents on hand will be sufficient to meet our capital and operating requirements for at least the next twelve months. Our future capital requirements, however, will depend on numerous factors, including without limitation, liquidity of our auction rate securities, the size and number of new and expanded stores and/or store concepts, investment costs for management information systems, potential acquisitions and/or joint ventures, repurchase of stock and future results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks, which include changes in U.S. interest rates and, to a lesser extent, foreign exchange rates. We do not engage in financial transactions for trading or speculative purposes.

Interest Rate Risk

We currently maintain a portfolio of variable interest rate investments consisting of cash equivalents, guaranteed investment certificates and long term investments consisting of ARS. According to our investment policy, we may invest in taxable and tax-exempt instruments. In addition, the policy establishes limits on credit quality, maturity, issuer and type of instrument. Marketable securities are classified as “trading” or “available for sale”. We do not use derivative financial instruments in our investment portfolio.

All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents. Investments are considered short-term available for sale securities if the original maturity is between three months and twelve months, or long term investments if the original maturity is greater than twelve months. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value.

Accordingly, the estimated fair value of ARS no longer approximates par value. We determined the estimated fair value of our investment in ARS as of January 3, 2015 by reviewing trading activity for similar securities in secondary markets as well as by using a discounted cash flow model to estimate the fair value of our investments in ARS. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows and expected holding periods of the ARS. We have modified our investment strategy and increased our investments in more liquid money market investments.

The following table lists our cash, cash equivalents and investments as of January 3, 2015:

	Fair Value (Dollars in thousands)	
Cash	\$ 55,809	
Weighted average interest rate	0.01	%
Cash equivalents	\$ 19,405	
Weighted average interest rate	0.01	%
Current available for sale securities	\$ 19,996	
Weighted average interest rate	0.27	%
Non-current available for sale securities (1)	\$ 5,455	
Weighted average interest rate	0.17	%
Total	\$ 100,665	

(1) As of January 3, 2015, the company holds non-current available for sale securities with a fair value of \$5.5 million and a par value of \$9.0 million.

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Foreign Currency Risks

We enter into a significant amount of purchase obligations outside of the United States, substantially all of which are negotiated and settled in U.S. Dollars and, therefore, have only minimal exposure to foreign currency exchange risks. We also operate a subsidiary for which the functional currency is the Canadian Dollar. We translate assets and liabilities of Canada's operations into U.S. dollars at month-end rates, while we translate income and expenses at the weighted average exchange rates for the month. We record the related translation adjustments in accumulated other comprehensive income as a separate component of shareholders' equity. Fluctuations in exchange rates therefore impact our financial condition and results of operations, as reported in U.S. Dollars. We do not hedge against foreign currency risks and believe that foreign currency exchange risk is immaterial.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report at the reasonable assurance level. There has been no change in our internal control over financial reporting during the quarter ended January 3, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See the Legal Matters section of the Notes to the Condensed Consolidated Financial Statements for a discussion of legal proceedings.

ITEM 1A. RISK FACTORS

Our past performance may not be a reliable indicator of future performance because actual future results and trends may differ materially depending on a variety of factors, including, but not limited to, the risks and uncertainties discussed below. In addition, historical trends should not be used to anticipate results or trends in future periods. Factors that might cause our actual results to differ materially from the forward looking statements discussed elsewhere in this report, as well as affect our ability to achieve our financial and other goals, include, but are not limited to, those set forth below.

1. The success of our business depends in large part on our ability to identify fashion trends as well as to react to changing customer demand in a timely manner. Our future success depends, in part, upon our ability to anticipate, identify and respond effectively to changing customer demands and fashion trends in a timely manner. The specialty retail apparel business fluctuates according to changes in customer preferences directed by trends and fashions. If we miscalculate our customers' product preferences or the demand for our products, we may be faced with excess inventory. Historically, this has resulted in excess fabric for some products and markdowns and/or write-offs of raw materials as well as finished goods, which has impaired our profitability, and may do so in the future. Similarly, any failure on our part to anticipate, identify and respond effectively to changing customer demands and fashion trends will adversely affect our business. In addition, from time to time, we may pursue new concepts, and if the new concepts are not successful, our business could be harmed.
2. The success of our business depends in large part on our ability to maintain our brand. Our ability to maintain our brand image and reputation is integral to our business as well as the implementation of strategies to expand it. Maintaining, promoting and growing our brand will depend largely on the success of our design, merchandising and marketing efforts and our ability to provide a consistent, high-quality client experience. In addition, while our brand is mature, our success depends on our ability to retain existing customers and attract new customers to shop our brand. Our business would be adversely affected if we fail to achieve these objectives for our brand. In addition, failure to achieve consistent, positive performance or the receipt of any negative publicity could adversely impact our brand and the brand loyalty of our customers, which would adversely impact our business.
3. We face increasing product costs from our manufacturing partners, which could result in margin erosion. Increases in our product costs, such as raw materials and labor, may result in margin erosion. Recently, worldwide prices for raw materials that we use in our products have increased. Additionally, clothing manufacturers in China, where a significant percentage of our apparel products are manufactured, are experiencing increased costs due to labor shortages and the fluctuation of the Chinese Yuan in relation to the U.S. dollar, and these increased costs are often passed on to us. If we are unable to successfully mitigate a significant portion of such product cost increases, our business may be harmed.
4. We rely on third-party manufacturers to manufacture all of our products. Our future success depends, in part, on our ability to find manufacturing facilities that perform acceptably. We do not own any manufacturing facilities and therefore depend on third parties to manufacture our products. In addition, we place all of our orders for production by purchase order and do not have long-term contracts with any manufacturers. If we fail to maintain favorable relationships with our manufacturers, our business could be materially and adversely affected.

We cannot assure you that third-party manufacturers (1) will not supply similar products to our competitors, (2) will not stop supplying products to us completely or (3) will supply products in a timely manner. Untimely receipt of products may result in lower than anticipated sales and markdowns which would have a negative impact on earnings. Furthermore, we have received in the past, and may receive in the future, shipments of products from manufacturers that fail to conform to our quality control standards. In such event, unless we are able to obtain replacement products in a timely manner, we may lose sales.

5. If an independent manufacturer violates labor or other laws, or is accused of violating any such laws, or if their labor practices diverge from those generally accepted as ethical, it could harm our business and brand image. Our success depends, in part, on our ability to find and contract with independent manufactures which conduct their businesses using ethical or legal labor practices. While we maintain a policy to monitor the operations of our independent manufacturers by having an independent firm inspect these manufacturing sites, and all manufacturers are contractually required to comply with such labor practices, we cannot assure the compliance of these manufacturers. In addition, we cannot control the public's

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perceptions of such manufacturers or their practices, even if they are compliant with law but are viewed in a negative light by the public. Because manufacturers act in their own interests, they may act in a manner that results in negative public perceptions of us. Moreover, in certain circumstances, we may be subject to liability or negative publicity that could adversely affect our brand and our business as a result of actions taken by these manufacturers.

6. If we are unable to obtain raw materials for our products, our business could be materially adversely affected. We place all of our orders for raw materials by purchase order and do not have any long-term contracts with any supplier. If we fail to maintain favorable relationships with our suppliers or are unable to obtain sufficient quantities of quality raw materials on commercially reasonable terms, it could harm our business.

In addition, certain of our third-party manufacturers store our raw materials. In the event our inventory was damaged or destroyed and we were unable to obtain replacement raw materials, our earnings and our business could be materially and adversely impacted.

7. We face significant competition in the retail and apparel industry, which could harm our business. The retail and apparel industries are highly competitive and are characterized by low barriers to entry. We expect competition in our markets to increase. The primary competitive factors in our markets are: brand name recognition and appeal, sourcing, product styling, quality, presentation and pricing, timeliness of product development and delivery, store ambiance, customer service and convenience. We compete with traditional department stores, specialty store retailers, lower price point retailers, business to consumer websites, off-price retailers and direct marketers for, among other things, raw materials, market share, retail space, finished goods, sourcing and personnel. Because many of these competitors are larger and have substantially greater financial, distribution and marketing resources than we do or maintain comparatively lower cost of operations, we may lack the resources to effectively compete with them. If we fail to remain competitive in any way, it could harm our business, financial condition and results of operations. In addition, if we are unable to address the challenges of declining store traffic in a highly promotional, low growth environment, our business will be negatively affected.

8. General economic conditions, including increases in energy and commodity prices, that are largely out of our control may adversely affect our financial condition and results of operations. The demand for our products is influenced by national and local economic factors that may affect consumer spending or buying habits. Factors that could adversely affect the demand for our products include recessionary economic cycles, higher interest rates, higher fuel and other energy costs, inflation, deflation, increases in commodity prices, higher levels of unemployment, higher consumer debt levels, higher tax rates and other changes in tax laws. A decline in economic conditions could also result in reduced traffic in our stores or limitations on the prices we can charge for our products, either of which could adversely affect our business. We can provide no assurance that demand for our products will not be adversely affected by national or local economic conditions, thereby harming our business.

In addition, economic factors such as those listed above and increased transportation costs, inflation, higher costs of labor, insurance and healthcare, and changes in other laws and regulations may increase our cost of sales and our operating, selling, general and administrative expenses. Any such increase would also negatively impact our business, including our financial results.

9. Because Manny Mashouf beneficially owns a substantial portion of the outstanding shares, other shareholders may not be able to influence the direction the company takes. As of January 31, 2015, Manny Mashouf, our Chairman of the Board, beneficially owned approximately 52% of the outstanding shares of our common stock. As a result, he can control the election of directors and the outcome of all issues submitted to the shareholders. This may make it more difficult for a third party to acquire shares, may discourage acquisition bids, and could limit the price that certain investors might be willing to pay for shares of common stock. This concentration of stock ownership may have the effect of delaying, deferring or preventing a change in control of our company.

10. We cannot assure that future store openings will be successful and new store openings may impact existing stores. We expect to open approximately 4 bebe stores and 2 bebe outlet stores in fiscal 2015, while our international licensee operated point-of-sale locations are expected to remain unchanged. We cannot provide assurance that the stores we plan to open in fiscal 2015, or any other stores that we might open in the future, will be successful or that our overall results will improve as a result of opening these stores.

The success of a future store depends on our ability to effectively obtain real estate that meets our criteria, including traffic, square footage, co-tenancies, average sales per square foot, lease economics, demographics and other factors. In addition, continued consolidation in the commercial retail real estate market could affect our ability to successfully negotiate favorable rental terms for our stores in the future. Should significant consolidation continue, a large proportion of our store base could be concentrated with one or a few entities that could then be in a position to dictate unfavorable terms to us due to their significant negotiating

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leverage. If we are unable to negotiate favorable lease terms with these entities, this could affect our ability to profitably operate our stores, which would adversely impact our business.

In addition, many of our stores are located in shopping malls and other retail centers that benefit from the ability of “anchor” retail tenants, generally large department stores, and other attractions, to generate sufficient levels of consumer traffic in the vicinity of our stores. Any decline in the volume of consumer traffic at shopping centers, whether because of the economic slowdown, a decline in the popularity of shopping centers, the closing of anchor stores or otherwise, could result in reduced sales at our stores and excess inventory. We may have to respond by increasing markdowns or initiating marketing promotions to reduce excess inventory, which could have a material adverse effect on our business. In addition, new store openings have the potential to cannibalize the net sales and profitability of other existing stores.

11. We may be forced to close stores or write-down store assets that are not able to achieve planned financial performance, which may force us to record losses in future quarters. The results achieved by our stores may not be indicative of long-term performance or the potential performance of stores in other locations. The failure of stores to achieve acceptable results could result in additional store asset impairment charges, which could adversely affect our business.

In addition, in the past, we have had to close stores as a result of poor performance. For example, in fiscal year 2014, we closed 37 stores, including 2b stores which are part of discontinued operations, and during fiscal 2015, we anticipate closing up to 12 bebe and outlet stores. Closing stores because of poor performance could have a material adverse effect on our business, and such impairment and other charges have an adverse impact on our financial results.

12. Our sales, margins and operating results are subject to seasonal and quarterly fluctuations. Our business varies with general seasonal trends that are characteristic of the retail and apparel industries, such as the timing of seasonal wholesale shipments and other events affecting retail sales. As a result, our stores typically generate a higher percentage of our annual net sales and profitability in our second fiscal quarter which includes the holiday selling season, compared to other quarters.

In addition, our quarterly comparable store sales have fluctuated significantly in the past, and we expect that they will continue to fluctuate in the future. A variety of factors affect comparable store sales, including fashion trends, competition, current economic conditions, the timing of release of new merchandise and promotional events, changes in our merchandise mix, the success of marketing programs and weather conditions. Our ability to deliver strong comparable store sales results and margins depends in large part on accurately forecasting demand and fashion trends, selecting effective marketing techniques, providing an appropriate mix of merchandise for our customer base, managing inventory effectively, and optimizing store performance by closing under-performing stores. Such fluctuations may adversely affect the market price of our common stock.

13. We are subject to cyber-security risks and may incur increasing costs in an effort to minimize those risks and to respond to cyber incidents. Our business involves the storage and transmission of customers’ personal information, consumer preferences and credit card information. We also use mobile devices, social networking and other on-line activities to connect with our customers. If we experience a significant data security breach or fail to detect and appropriately respond to a significant data security breach, we could be exposed to government enforcement actions and private litigation, and our business could be adversely affected. For example, in November 2014, we detected suspicious activity on computers that operate the payment processing system for our stores, which appeared to be limited to data from payment cards swiped in the United States and its territories between November 8, 2014 and November 26, 2014. The data may have included cardholder name, account number, expiration date and verification codes, although we have no indication of fraudulent charges to date. We cannot assure you that we will not suffer future breaches of the portion of our network that handles payment card data, with further payment card and client information being stolen. These sorts of breaches might cause our customers to lose confidence in our ability to protect their personal information, which could cause them to discontinue usage of our club bebe loyalty program, or stop shopping with us altogether and potential significant cost. The loss of confidence from a significant data security breach involving team members could also hurt our reputation, cause team member recruiting and retention challenges, increase our labor costs and adversely affect our business and financial results.

14. Our success depends on our ability to attract and retain key employees in order to support our existing businesses and future expansion. From time to time we actively recruit qualified candidates to fill key executive positions within our company. There is substantial competition for experienced personnel, which we expect will continue. We compete for experienced personnel with companies who may have greater financial resources than we do. During fiscal 2014, we experienced significant turnover of our executive management team as part of a restructure. We are also exposed to employment practice litigation due to the large number of employees and high turnover of our sales associates. If we fail to attract, motivate and retain qualified personnel, it could harm our business and limit our ability to expand.

15. We rely on information technology to help manage our operations and our e-commerce store, the disruption of which could adversely impact our business. We rely on various information systems to help manage our operations and regularly assess the cost-benefit analysis associated with making additional investments to upgrade, enhance or replace such

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systems. If at any time we experience any disruptions affecting our information systems we could experience a material adverse impact on our business.

In addition, we operate an e-commerce store at www.bebe.com to sell our merchandise. Our on-line operations are subject to numerous risks, including unanticipated operating problems, reliance on third-party computer software providers and system failures. If at any time we experience any disruptions affecting our e-commerce store we could experience a material adverse impact on our business. The e-commerce operations also involve other risks that could have an adverse impact on our results of operations including but not limited to diversion of sales from our other stores, rapid technological change, liability for on-line content, credit card fraud and loss of sensitive data. We cannot assure that our e-commerce store will continue to achieve sales and profitability growth or even remain at its current level.

16. Our business could be adversely impacted by unfavorable international political conditions. Our sales and operating results are, and will continue to be, affected by international social, political, legal and economic conditions. In particular, our business could be adversely impacted by instability or changes resulting in the disruption of trade with the countries in which our contractors, suppliers or customers are located, significant fluctuations in the value of the dollar against foreign currencies or restrictions on the transfer of funds, or additional trade restrictions imposed by the United States and other foreign governments. We can provide no assurance that our business will not be adversely affected by such international events.

In addition, trade restrictions, including increased tariffs or quotas, embargoes and customs restrictions could increase the cost or reduce the supply of merchandise available to us and adversely affect our business. In addition, we purchase a substantial amount of our raw materials from China and our business and operating results may be affected by changes in the political, social or economic environment in China.

17. Our ability to conduct business could be negatively impacted by the effects of natural disasters, war, terrorism, public health concerns or other catastrophes. We currently operate a corporate office in Brisbane, California, a distribution facility in Benicia, California, a design studio in Los Angeles, California, and a satellite office in New York, New York. Any serious disruption at these facilities whether due to construction, relocation, fire, flood, earthquake, terrorist acts or otherwise could harm our business. Natural disasters, extreme weather and public health concerns, including severe infectious diseases, could impact our ability to open and run our corporate offices, distribution center, stores and other operations in affected areas and/or negatively impact our foreign sourcing offices and the operations of our vendors. In addition, our ability to continue to operate our business without significant interruption in the event of a disaster or other disruption depends, in part, on the ability of our information systems to operate in accordance with our disaster recovery and business continuity plans. Lower client traffic due to the effect of natural disasters or extreme weather, security concerns, war or the threat of war and public health concerns could result in decreased sales that could have a material adverse impact on our business. For example, our sales results were negatively impacted by extreme weather throughout the third quarter of the current fiscal year. In addition, threat of terrorist attacks or actual terrorist events in the United States and world-wide could cause damage or disruption to international commerce and the global economy, disrupt the production, shipment or receipt of our merchandise or lead to lower client traffic. Our ability to mitigate the adverse impact of these events depends, in part, upon the effectiveness of our disaster preparedness and response planning as well as business continuity planning. However, we cannot be certain that our plans will be adequate or implemented properly in the event of an actual disaster or other catastrophic situation. In addition, although we maintain business interruption and property insurance, there can be no assurance that our insurance coverage will be sufficient or that insurance proceeds will be timely paid to us.

18. If we are not able to protect our intellectual property our business may be harmed. Although we take actions to protect our trademarks and other proprietary rights we cannot assure you that we will be successful or that others will not imitate our products or infringe upon our intellectual property rights we cannot assure you that we will be successful. In addition, we cannot assure that others will not resist or seek to block the sale of our products as infringements of their trademark and proprietary rights.

We are seeking to register our trademarks domestically and internationally. Obstacles may exist that may prevent us from obtaining a trademark for the bebe, BEBE SPORT and bbsp brand names or related names. We may not be able to register certain trademarks, purchase the right or obtain a license to use these names or related names on

commercially reasonable terms. If we fail to obtain trademark, ownership or license the requisite rights, it would limit our ability to expand our business under the bebe brand.

In some jurisdictions, despite successful registration of our trademarks, third parties may allege infringement and bring actions against us. In addition, if our licensees fail to use our intellectual property correctly, the reputation and value associated with our trademarks may be diluted. Furthermore, if we do not demonstrate use of our trademarks, our trademark rights may lapse over time.

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In addition, we face the potential of receiving claims that the technology we use or license infringes on another's proprietary rights. In certain circumstances, we may be subject to having to defend ourselves from such claims and/or be subject to unanticipated license fees or the necessity to transition away from technology we are using or abandon such use altogether.

19. Our business may be negatively impacted by any failure to comply with regulatory requirements. As a public company, we are subject to numerous regulatory requirements, including those imposed by the Sarbanes-Oxley Act of 2002, the SEC and the NASDAQ Stock Market. In addition, we are subject to numerous domestic and foreign laws and regulations affecting our business, including those related to labor, employment, worker health and safety, competition, privacy, consumer protection, credit cards, import/export and anti-corruption, including the Foreign Corrupt Practices Act and the Telephone Consumer Protection Act. Our employees, subcontractors, vendors and suppliers could take actions that violate these requirements and/or our compliance policies and procedures, which could have a material adverse effect on our reputation, financial condition and on the market price of our common stock. Regulatory developments regarding the use of "conflict minerals," certain minerals originating from the Democratic Republic of Congo and adjoining countries, could affect the sourcing and availability of raw materials used by suppliers and subject us to costs associated with the regulations, including for the diligence pertaining to the presence of any conflict minerals used in our products, possible changes to products, processes or sources of our inputs, and reporting requirements.

20. A decline in value of our investments in auction rate securities or as a result of a change in our ability to hold our investments in auction rate securities may impact our financial condition. We hold a variety of interest bearing auction rate securities, or ARS, comprised of federally insured student loan backed securities. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected our holdings in ARS investments and the majority of auctions for our investments in these securities have continued to fail to settle on their respective settlement dates. Consequently, \$9.0 million par value of our ARS are not currently liquid and do not mature before 2031. Of this \$9.0 million, \$3.5 million has been temporarily impaired. We will not be able to access these funds until a future auction of these investments is successful or the securities are purchased or redeemed outside of the auction process or repayment at maturity. Maturity dates for these ARS investments range from 2031 to 2033, with principal distributions occurring on certain securities prior to maturity.

The valuation of our investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact its valuation include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates and ongoing strength and quality of market credit and liquidity. If the current market conditions deteriorate further, or the anticipated recovery in market values does not occur, we may be required to record additional losses in other comprehensive income or losses in net income in future quarters.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

(a) Exhibits. The following is a list of exhibits filed as part of this Report on Form 10-Q.

Exhibit	Description
10.1	Employment Agreement between bebe stores, inc. and Jim Wiggett dated as of December 15, 2014, and incorporated by reference to the Current Report on Form 8-K filed on December 15, 2014.
10.2	Separation Agreement between bebe stores, inc. and Lawrence Smith dated as of November 21, 2014, and incorporated by reference to the Current Report on Form 8-K filed on December 9, 2014.
31.1	Section 302 Certification of Chief Executive Officer.
31.2	Section 302 Certification of Chief Financial Officer.
32.1	Section 906 Certification of Chief Executive Officer.
32.2	Section 906 Certification of Chief Financial Officer.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Presentation Linkbase

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SIGNATURE

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.

Dated February 12, 2015

bebe stores, inc.

/s/ Liyuan Woo

Liyuan Woo, Chief Financial Officer

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31.2	Section 302 Certification of Chief Financial Officer
32.1	Section 906 Certification of Chief Executive Officer
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101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Presentation Linkbase