

bebe stores, inc.  
Form 10-Q  
February 07, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended December 29, 2012

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)

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<b>California</b> (State or Jurisdiction of Incorporation or Organization)	<b>94-2450490</b> (IRS Employer Identification Number)
<b>400 Valley Drive</b> <b>Brisbane, California 94005</b> (Address of principal executive offices)	
<b>Telephone: (415) 715-3900</b>	

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 <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of January 31, 2013 was 82,854,420.

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## ITEM 1. Condensed Consolidated Financial Statements

bebe stores, inc.

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)

(unaudited)

	As of December 29, 2012	As of June 30, 2012	As of December 31, 2011
<b>Assets:</b>			
Current assets:			
Cash and equivalents	\$ 92,653	\$ 104,982	\$ 119,897
Available for sale securities	64,086	76,428	87,582
Receivables (net of allowance of \$1,356, \$1,255 and \$1,259)	8,436	9,190	6,143
Inventories, net	37,421	33,292	30,756
Deferred income taxes, net	4,609	4,609	4,930
Prepaid and other	21,694	17,135	10,374
<b>Total current assets</b>	<b>228,899</b>	<b>245,636</b>	<b>259,682</b>
Available for sale securities	59,240	60,002	64,047
Property and equipment, net	112,595	114,707	90,127
Deferred income taxes, net	24,486	24,675	29,453
Intangible asset	912	912	912
Other assets	4,009	4,488	3,985
<b>Total assets</b>	<b>\$ 430,141</b>	<b>\$ 450,420</b>	<b>\$ 448,206</b>
<b>Liabilities and Shareholders' Equity:</b>			
Current liabilities:			
Accounts payable	\$ 13,076	\$ 16,520	\$ 15,856
Accrued liabilities	30,028	31,668	32,186
<b>Total current liabilities</b>	<b>43,104</b>	<b>48,188</b>	<b>48,042</b>
Deferred rent and other lease incentives	37,531	37,876	37,306
Uncertain tax positions	2,280	2,236	2,226
<b>Total liabilities</b>	<b>82,915</b>	<b>88,300</b>	<b>87,574</b>
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 82,622,158, 84,360,349 and 84,226,366 shares			
	83	84	84
Additional paid-in capital	142,368	144,180	143,332
Accumulated other comprehensive income (loss)	2,439	152	(1,899)

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Retained earnings	202,336	217,704	219,115
Total shareholders' equity	347,226	362,120	360,632
Total liabilities and shareholders' equity	\$ 430,141	\$ 450,420	\$ 448,206

See accompanying notes to condensed consolidated financial statements.

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 29, 2012</b>	<b>December 31, 2011</b>	<b>December 29, 2012</b>	<b>December 31, 2011</b>
Net sales	\$ 135,535	\$ 151,987	\$ 252,626	\$ 278,259
Cost of sales, including production and occupancy	89,607	91,067	164,423	166,853
Gross margin	45,928	60,920	88,203	111,406
Selling, general and administrative expenses	53,393	49,927	99,588	96,969
Operating income (loss)	(7,465)	10,993	(11,385)	14,437
Interest and other income, net	219	107	452	410
Income (loss) before income taxes	(7,246)	11,100	(10,933)	14,847
Income tax provision (benefit)	(2,427)	4,539	(3,533)	5,932
Net income (loss)	\$ (4,819)	\$ 6,561	\$ (7,400)	\$ 8,915
Basic per share amounts:				
Net income (loss)	\$ (0.06)	\$ 0.08	\$ (0.09)	\$ 0.11
Diluted per share amounts:				
Net income (loss)	\$ (0.06)	\$ 0.08	\$ (0.09)	\$ 0.11
Basic weighted average shares outstanding	84,054	84,190	84,216	84,156
Diluted weighted average shares outstanding	84,054	84,323	84,216	84,284
Other comprehensive income (loss)				
Gain on available for sale securities, net of tax	\$ 467	\$ 105	\$ 1,638	\$ 83
Foreign currency translation adjustments	(633)	(743)	649	(1,977)
Other comprehensive income (loss)	(166)	(638)	2,287	(1,894)
Comprehensive income (loss)	\$ (4,985)	\$ 5,923	\$ (5,113)	\$ 7,021

See accompanying notes to condensed consolidated financial statements.

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**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(unaudited)

	Six Months Ended	
	December 29, 2012	December 31, 2011
Cash flows from operating activities:		
Net income (loss)	\$ (7,400)	\$ 8,915
Adjustments to reconcile net income (loss) to cash provided (used) by operating activities:		
Non-cash compensation expense	1,206	1,089
Depreciation and amortization	10,404	10,309
Non-cash charge for asset impairment	1,817	391
Net loss (gain) on disposal of property	994	(418)
Tax benefit from exercise of stock options and awards	84	166
Excess tax benefit from exercise of stock options and awards	(1)	(32)
Deferred rent and other lease incentives	(47)	(67)
Deferred income taxes	13	(366)
Changes in operating assets and liabilities:		
Receivables	761	1,108
Inventories	(4,129)	2,668
Prepaid expenses and other	(4,117)	3,562
Accounts payable	(1,664)	(1,565)
Accrued liabilities	(984)	6,137
Long term income taxes payable	44	167
<b>Net cash provided (used) by operating activities</b>	<b>(3,019)</b>	<b>32,064</b>
Cash flows from investing activities:		
Purchase of property and equipment	(14,994)	(10,957)
Insurance proceeds from property and equipment		650
Purchase of marketable securities	(44,080)	(31,772)
Proceeds from sales of investment securities	59,423	40,817
<b>Net cash provided (used) by investing activities</b>	<b>349</b>	<b>(1,262)</b>
Cash flows from financing activities:		
Proceeds from issuance of common stock	113	567
Excess tax benefit from exercise of stock options and awards	1	32
Cash dividends paid	(4,219)	(4,209)
Purchase of common stock	(5,438)	
<b>Net cash used by financing activities</b>	<b>(9,543)</b>	<b>(3,610)</b>
Net increase (decrease) in cash and equivalents	(12,213)	27,192
Effect of exchange rate changes on cash	(116)	(2,472)
Cash and equivalents:		
Beginning of period	104,982	95,177
End of period	\$ 92,653	\$ 119,897

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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 December 29, 2012, June 30, 2012 and December 31, 2011, the condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended December 29, 2012 and December 31, 2011 and the condensed consolidated statements of cash flows for the six months ended December 29, 2012 and December 31, 2011 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 June 30, 2012.

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 June 30, 2012, 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 June 30, 2012.

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 after June 30. Fiscal year 2013 includes 53 weeks and 2012 includes 52 weeks.

The three month periods ended December 29, 2012 and December 31, 2011 each include 13 weeks. The six month periods ended December 29, 2012 and December 31, 2011 each include 26 weeks.

**RECENT ACCOUNTING PRONOUNCEMENTS**

*Fair Value*

In May 2011, the Financial Accounting Standards Board (FASB) issued guidance to amend the accounting and disclosure requirements on fair value measurements. The new guidance limits the highest-and-best-use measure to nonfinancial assets, permits certain financial assets and liabilities with offsetting positions in market or counterparty credit risks to be measured on a net basis and provides guidance on the applicability of premiums and discounts. Additionally, the new guidance expands the disclosures on Level 3 inputs by requiring quantitative disclosure of the unobservable inputs and assumptions, as well as description of the valuation processes and the sensitivity of the fair value to changes in unobservable inputs. The new guidance was effective for the Company beginning in fiscal 2013, which is July 1, 2012. The disclosure guidance adopted July 1, 2012 did not have a material impact on the Company's consolidated financial statements.

*Other Comprehensive Income*

In June 2011, the FASB issued ASU 2011-05, which requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income and the total of comprehensive income. The new guidance eliminates the current option to report other comprehensive income and its components in the consolidated statements of shareholders' equity. For public entities, the amendments in ASU 2011-05 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and are to be applied retrospectively, with early adoption permitted. This guidance became effective for the Company's fiscal year and interim periods beginning July 1, 2012. The adoption did not have a material effect on the Company's consolidated financial statements.



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**INVESTMENTS**

The Company's investment portfolio consists of treasury bills, certificates of deposit and auction rate securities. The Company held short term available for sale securities totaling \$64.1 million as of December 29, 2012, that consisted of \$36.9 million in treasury bills and \$27.1 million in certificates of deposit at cost which approximates fair value. The Company also holds long term available for sale securities at fair value totaling \$59.2 million as of December 29, 2012, that consisted of \$19.9 million in treasury bills and \$39.3 million of interest bearing auction rate securities ( ARS ).

The Company holds a variety of interest ARS consisting of federally insured student loan backed securities and insured municipal authority bonds. As of December 29, 2012, the Company's ARS portfolio totaled approximately \$45.6 million classified as available for sale securities, net of a temporary impairment charge of \$6.3 million. As of that date, the Company's ARS portfolio included approximately 92% federally insured student loan backed securities and 8% municipal authority bonds and consisted of approximately 20% AAA rated investments, 7% AA rated investments, 40% A rated investments, 18% BBB rated investments and 15% CCC rated investments. As of June 30, 2012, the Company's ARS consisted of 27% AAA rated investments, 23% AA rated investments, 28% A rated investments, 12% BBB rated investments and 10% 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. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. 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 these ARS investments range from 2018 to 2042 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. During the three and six months ended December 29, 2012, \$2.6 million and \$22.4 million, respectively, of ARS were settled at par.

The Company reviews its impairments 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 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.

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

	Cost	As of December 29, 2012		Estimated Fair Value
		Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	
(In thousands)				
Short term treasury bills	\$ 36,941	\$	\$	\$ 36,941
Short term certificates of deposit	27,145			27,145
	\$ 64,086	\$	\$	\$ 64,086
Long term treasury bills	\$ 19,950	\$	\$	\$ 19,950
Long term auction rate securities	45,550		(6,260)	39,290
	\$ 65,500	\$	\$ (6,260)	\$ 59,240

  

	Cost	As of June 30, 2012		Estimated Fair Value
		Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	
(In thousands)				
Short term treasury bills	\$ 49,960	\$	\$	\$ 49,960
Short term certificates of deposit	26,468			26,468
	\$ 76,428	\$	\$	\$ 76,428
Long term auction rate securities	\$ 67,900	\$	\$ (7,898)	\$ 60,002

  

	Cost	As of December 31, 2011		Estimated Fair Value
		Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	
(In thousands)				
Short term treasury bills	\$ 71,951	\$	\$	\$ 71,951
Short term certificates of deposit	15,631			15,631
	\$ 87,582	\$	\$	\$ 87,582
Long term auction rate securities	\$ 74,000	\$	\$ (9,953)	\$ 64,047

**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

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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 December 29, 2012, the Company held financial instruments that are measured at fair value on a recurring basis. These included cash equivalents and available for sale securities. Cash equivalents consist of money market funds. Short term available for sale securities consist of government treasury bills and certificates of deposit. Long term available for sale securities consist of government treasury bills and ARS. These ARS consist of federally insured student loan backed securities and insured municipal authority bonds.

The Company determined the estimated fair value of its investment in ARS as of December 29, 2012 using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for liquidity (range from 0.93% 5.0%), interest rates (average of 0.4%), timing (average 3 years), credit ratings (range from 0.75% 2.75%), credit wrap and amount of cash flows and expected holding periods of the ARS.

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The following items are measured at fair value on a recurring basis as of December 29, 2012:

Description	December 29, 2012	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 equivalents	\$ 46,393	\$ 46,393	\$	\$
Current available for sale securities	64,086	36,941	27,145	
Non-current available for sale securities	59,240	19,950		39,290
Total	\$ 169,719	\$ 103,284	\$ 27,145	\$ 39,290

The following items are measured at fair value on a recurring basis as of December 31, 2011:

Description	December 31, 2011	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 equivalents	\$ 54,655	\$ 54,655	\$	\$
Current available for sale securities	87,582	87,582		
Non-current available for sale securities	64,047			64,047
Total	\$ 206,284	\$ 142,237	\$	\$ 64,047

Beginning in the quarter ended March 31, 2012, certificates of deposit previously classified as Level 1 are now classified as Level 2. During the quarter ended December 29, 2012, 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 \$45.6 million to their fair value of \$39.3 million as of December 29, 2012. 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 and six months ended December 29, 2012:

	Three Months Ended December 29, 2012	Six Months Ended December 29, 2012
	(In thousands)	
Balance at beginning of period	\$ 41,373	\$ 60,002
Total gains or (losses) (realized or unrealized)		
Included in net loss		
Included in accumulated other comprehensive income (loss)	467	1,638
Settlements	(2,550)	(22,350)
Balance at December 29, 2012	\$ 39,290	\$ 39,290

*Non-Financial Assets:*

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 December 29, 2012 and December 31, 2011, the Company recorded impairment charges of approximately \$1.7 million and \$0.4 million, respectively, related to under-performing stores. During the six months ended December 29, 2012 and December 31, 2011, the Company recorded impairment charges of approximately \$1.8 million and \$0.4 million, respectively, related to under-performing stores. The fair market value of these assets was determined using the income approach and level 3 inputs, which required 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. This impairment charge is included in selling, general and administrative expenses ( SG&A ) in the accompanying condensed consolidated statements of operations and comprehensive income (loss). The Company was not required to measure any other significant non-financial assets and liabilities at fair value.

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The Company's inventories consisted of:

	December 29, 2012	As of June 30, 2012 (In thousands)	December 31, 2011
Raw materials	\$ 999	\$ 1,193	\$ 654
Merchandise available for sale	36,422	32,099	30,102
Inventories, net	\$ 37,421	\$ 33,292	\$ 30,756

**CREDIT FACILITIES**

The Company has an unsecured commercial line of credit agreement which provides for borrowings and issuance of letters of credit of up to a combined total of \$25.0 million. This agreement was amended on February 1, 2013 to shorten the term and to eliminate the profitability requirement from the financial covenants, and expires on January 31, 2014. The outstanding balance bears interest at either the bank's reference rate (which was 3.25% as of December 29, 2012) or the LIBOR rate (which was 0.21% as of December 29, 2012) plus 1.75 percentage points. As of December 29, 2012, there were no outstanding cash borrowings or trade letters of credit outstanding and \$3.0 million of an outstanding stand-by letter of credit. To date, no beneficiary has drawn upon the stand-by letter of credit.

As amended, this credit facility requires the Company to comply with certain financial covenants, including minimum tangible net worth and unencumbered liquid assets, and contains certain restrictions on making loans and investments. The Company is in compliance with all covenants in the credit agreement.

**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.

The following is a reconciliation of the number of shares used in the basic and diluted earnings per share computations:

	Three Months Ended		Six Months Ended	
	December 29, 2012	December 31, 2011	December 29, 2012	December 31, 2011
	(In thousands)			
Basic weighted average number of shares outstanding	84,054	84,190	84,216	84,156
Incremental shares from the assumed issuance of stock options		133		128
Diluted weighted average number of shares outstanding	84,054	84,323	84,216	84,284

Excluded from the computation of the number of diluted weighted average shares outstanding were options to purchase 5,201,743 and 4,282,954 shares of common stock for the three months ended December 29, 2012 and December 31, 2011, respectively, and 5,047,859 and 4,171,436 for the six months ended December 29, 2012 and December 31, 2011, respectively, which would have been anti-dilutive.



**Table of Contents****COMMON STOCK PURCHASES**

In November 2012, the board of directors authorized a program to repurchase up to \$30 million of the Company's common stock. The Company intends, 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 the Company to repurchase any specific number of shares and may be suspended at any time at the Company's discretion. During the three and the six months ended December 29, 2012, the Company repurchased approximately 1.8 million shares at an average price per share of \$3.81 for an aggregate purchase price of approximately \$6.8 million. As of December 29, 2012, all except approximately \$1.4 million of these share repurchases were paid for. No shares were repurchased during the three or the six months ended December 31, 2011.

**STOCK BASED COMPENSATION**

The following table summarizes the stock based compensation expense recognized under the Company's stock plan during the three and the six months ended December 29, 2012 and December 31, 2011:

	Three Months Ended		Six Months Ended	
	December 29, 2012	December 31, 2011	December 29, 2012	December 31, 2011
	(In thousands)			
Stock options	\$ 342	\$ 425	\$ 968	\$ 981
Nonvested stock awards/units	112	59	238	108
<b>Total stock based compensation expense</b>	<b>\$ 454</b>	<b>\$ 484</b>	<b>\$ 1,206</b>	<b>\$ 1,089</b>

Unrecognized compensation cost related to nonvested stock options and nonvested stock awards/units totaled approximately \$2.5 million and \$0.5 million, respectively, as of December 29, 2012. This cost is expected to be recognized over a weighted average period of 2.8 years. The weighted average fair value of stock options at their grant date during the three months ended December 29, 2012 and December 31, 2011 was \$1.23 and \$2.78, respectively. For the six month periods ended December 29, 2012 and December 31, 2011, the weighted average fair value of stock options at their grant date was \$1.39 and \$2.78, respectively.

**LEGAL MATTERS**

As of the date of this filing, the Company is involved in ongoing legal proceedings as described below.

A former employee sued the Company in a complaint filed July 27, 2006 in the Superior Court of California, San Mateo County (Case No. CIV 456550) alleging a failure to pay all wages, failure to pay overtime wages, failure to pay minimum wages, failure to provide meal periods, violation of Labor Code §450, violation of Labor Code §2802 and California Code of Regulations §11040(9)(A), statutory wage violations (late payment of wages), unlawful business practices under Business and Professions Code §16720 and §17200, conversion of wages and violation of Civil Code §52.1. The plaintiff purports to bring the action also on behalf of current and former California bebe employees who are similarly situated. In September 2011, the Court certified a class of store managers who allege they were required to buy and wear our product as a condition of employment and denied certification relating to claims of missed meal periods and rest breaks. The parties wait to see if a verbal arrangement reached by the parties in principal, wherein neither party makes any admission and all of the plaintiff's claims would be resolved, can be fully developed, written in a mutually acceptable agreement and ultimately approved by the court.

A former employee sued the Company in a complaint filed November 2, 2010 in the Superior Court of California, San Bernardino County (Case No. CIV-RS-10-11823), on her own and purportedly on behalf of other employees similarly situated, alleging violations based on wage and hour laws, missed meal and rest breaks, late payment of wages, failure to pay expense reimbursement and failing to provide adequate seating. The case remains at an early stage, with only modest discovery begun.

A former employee sued the Company in a complaint filed a second amended complaint on or about September 7, 2010 in the Superior Court of California, Los Angeles County (Case No. BC429140) alleging the Company failed to provide adequate disclosure of its commission policy and wrongfully reduced and delayed commission payments. The plaintiff purported to bring the action also on behalf of current and former California bebe employees who are similarly situated. The lawsuit sought compensatory, statutory, punitive, restitution and injunctive relief. The case was settled for a nominal amount and was dismissed with prejudice.

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The Company is also involved in various other legal proceedings arising in the normal course of business. For such legal proceedings, and including the matters discussed in the paragraphs above, the Company has accrued an amount that reflects the aggregate liability deemed probable and estimable, but this amount is not material, individually or in the aggregate, to have a material adverse effect on its business, financial condition or results of operations. Because of the preliminary nature of many of these proceedings, the difficulty in ascertaining the applicable facts relating to many of these proceedings, the inconsistent treatment of claims made in many of these proceedings and the difficulty of predicting the settlement value of many of these proceedings, the Company is unable to estimate an amount or range of any reasonably possible additional losses. However, based on the Company's historical experience, the resolution of these proceedings is not expected to have a material effect on its business, financial condition or results of operations.

The Company intends to defend itself vigorously against each of these claims. However, the results of any litigation are inherently uncertain. The Company cannot assure you that it will be able to successfully defend itself in these lawsuits. Where required, and/or otherwise appropriate and determinable, the Company has recorded an estimate of potential liabilities that it believes is reasonable. Any estimates are revised as further information becomes available.

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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 are a global specialty retailer who designs, develops and produces a distinctive line of contemporary women's apparel and accessories. The "bebe look" appeals to a chic, sexy, sophisticated, body-conscious woman who takes pride in her appearance and seeks current fashion trends to suit her lifestyle. The bebe customer 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, sweaters, dresses, active wear and accessories to satisfy her wear-to-work, weekend and party lifestyles. We design and develop the majority of our merchandise in-house, which is manufactured to our specifications. The remainder of our merchandise is sourced directly from third-party manufacturers.

We market our products under the bebe, BEBE SPORT, bbsp and 2b bebe brand names through our 250 retail stores, of which 197 are bebe stores, including an on-line store at [www.bebe.com](http://www.bebe.com), and 53 are 2b bebe stores, including an on-line store at [www.2bstores.com](http://www.2bstores.com), as of December 29, 2012. These stores are located in 36 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada and Japan. In addition, our licensees operate 129 international point-of-sale locations in 24 countries as of December 29, 2012. During the six months ended December 29, 2012, we opened 6 2b bebe stores and successfully migrated our bebe.com product offerings to a company-managed platform.

*bebe stores.* 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. [www.bebe.com](http://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.

*2b bebe stores.* Our 2b bebe ( "2b" ) stores were originally structured as bebe outlets and were later expanded into the 2b concept stores. We focus on fun and playful everyday lifestyle offerings for our aspirational buyers. As of December 29, 2012, we operated a total of 53 2b stores, including an on-line store at [www.2bstores.com](http://www.2bstores.com). Of these, 19 are mall based stores that sell 2b merchandise only, 14 are hybrid 2b stores that sell a combination of 2b merchandise and bebe logo merchandise and 19 are outlet concept 2b stores that sell a mix of 2b, bebe logo and bebe retail markdown merchandise. [www.2bstores.com](http://www.2bstores.com) is our 2b bebe on-line retail store and an extension of the 2b bebe store experience that provides a complete assortment of 2b bebe merchandise and is also used as a vehicle to communicate with our customers.

**Table of Contents****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 those related to revenue recognition, stock based compensation, inventories, marketable securities, impairment of long lived assets and uncertain tax positions. 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 June 30, 2012. 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 after June 30. Fiscal year 2013 includes 53 weeks and fiscal year 2012 includes 52 weeks. The three months ended December 29, 2012 and December 31, 2011 each include 13 weeks. The six months ended December 29, 2012 and December 31, 2011 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	
	December 29, 2012	December 31, 2011	December 29, 2012	December 31, 2011
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales, including production and occupancy (1)	66.1	59.9	65.1	60.0
Gross margin	33.9	40.1	34.9	40.0
Selling, general and administrative expenses (2)	39.4	32.8	39.4	34.8
Operating income (loss)	(5.5)	7.2	(4.5)	5.2
Interest and other income, net	0.2	0.1	0.2	0.1
Income (loss) before income taxes	(5.3)	7.3	(4.3)	5.3
Income tax provision (benefit)	(1.8)	3.0	(1.4)	2.1
Net income (loss)	(3.5)%	4.3%	(2.9)%	3.2%

(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 decreased to \$135.5 million during the three months ended December 29, 2012 from \$152.0 million for the comparable period of the prior year, a decrease of \$16.5 million, or 10.9%. The decrease in net sales was primarily due to a decrease in comparable store traffic during the quarter. Comparable store sales for the fiscal quarter ended December 29, 2012 decreased 10.5% compared to an increase of 9.6% in the second fiscal quarter of the prior year.

For the six months ended December 29, 2012, net sales decreased to \$252.6 million from \$278.3 million for the comparable period of the prior year, a decrease of \$25.7 million, or 9.2%. The decrease in net sales was primarily due to a 9.7% decrease in comparable store sales driven by

the deceleration in store traffic.

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	Three Months Ended		Six Months Ended	
	December 29, 2012	December 31, 2011	December 29, 2012	December 31, 2011
Net sales (In thousands)	\$ 135,535	\$ 151,987	\$ 252,626	\$ 278,259
Total net sales increase (decrease) percentage	(10.9)%	11.6%	(9.2)%	10.7%
Comparable store increase (decrease) percentage (1)	(10.5)%	9.6%	(9.7)%	8.4%
Net sales per average square foot (2)	\$ 108	\$ 125	\$ 202	\$ 227
Square footage at end of period (In thousands)	1,002	1,018	1,002	1,018
Number of store locations:				
Beginning of period	250	251	252	253
New store locations	1	5	6	5
Closed store locations	1		8	2
Number of stores open at end of period	250	256	250	256

- (1) 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. Our on-line stores are included as stores in our comparable store sales base. 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.
- (2) We calculate net sales per average square foot using net store sales less on-line net sales and monthly average store square footage.

*Gross Margin.* Gross margin decreased to \$45.9 million during the three months ended December 29, 2012 from \$60.9 million for the comparable period of the prior year, a decrease of \$15.0 million, or 24.6%. As a percentage of net sales, gross margin decreased to 33.9% for the three months ended December 29, 2012 from 40.1% in the comparable period of the prior year. The decrease in gross margin as a percentage of net sales was primarily due to increased markdowns coupled with unfavorable occupancy leverage.

For the six months ended December 29, 2012, gross margin decreased to \$88.2 million from \$111.4 million for the comparable period of the prior year, a decrease of \$23.2 million, or 20.8%. As a percentage of net sales, gross margin from continuing operations decreased to 34.9% for the six months ended December 29, 2012 from 40.0% in the comparable period of the prior year. The decrease in gross margin as a percentage of net sales was primarily due to an increase in markdowns, coupled with increased inventory reserves and unfavorable occupancy leverage.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased to \$53.4 million during the three months ended December 29, 2012 from \$49.9 million for the comparable period of the prior year, an increase of \$3.5 million, or 7.0%. As a percentage of net sales, selling, general and administrative expenses increased to 39.4% during the three months ended December 29, 2012 from 32.8% in the comparable period of the prior year. The increase over the prior year was primarily due to increases in certain costs including impairment and store closure costs, as well as recruiting costs.

For the six months ended December 29, 2012, selling, general and administrative expenses increased to \$99.6 million from \$97.0 million for the comparable period of the prior year, an increase of \$2.6 million, or 2.7%. As a percentage of net sales, selling, general and administrative expenses increased to 39.4% from 34.8% in the comparable period of the prior year. The increase over the prior year primarily related to higher impairment and store closure costs combined with lower insurance proceeds and was partially offset by lower compensation expenses.

*Provision for Income Taxes.* The tax rate for the second quarter of fiscal 2013 was 33.5% compared to the rate for the comparable period of the prior year of 40.9%. The lower tax benefit in the current quarter compared to the tax expense in the prior year period was primarily due to the impact of permanent adjustments.

For the six months ended December 29, 2012, our effective tax rate was 32.3% compared to 40.0% for the comparable period for the prior year. The lower tax benefit in the current year compared to the tax expense in the prior year was primarily due to various discrete items including a valuation allowance against a foreign NOL recorded during the year.

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**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. 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.

**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 December 29, 2012, we had approximately \$216.0 million of cash and equivalents and investments on hand of which \$92.7 million were cash and equivalents, approximately \$56.9 million were invested in government treasury bills, approximately \$27.1 million were invested in certificates of deposit and approximately \$39.3 million, net of temporary impairment charges of \$6.3 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. In addition, we have a revolving line of credit, under which we may borrow or issue letters of credit up to a combined total of \$25 million. As of December 29, 2012, there were no cash borrowings outstanding under the line of credit, no trade letters of credit outstanding and \$3.0 million in a stand-by letter of credit outstanding. This credit facility requires us to comply with certain financial covenants, including minimum tangible net worth and unencumbered liquid assets, and certain restrictions on making loans and investments. We are in compliance with all covenants.

As of December 29, 2012, we had cash and equivalents of \$92.7 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 December 29, 2012 was \$3.0 million compared to net cash provided by operating activities of \$32.1 million for the six months ended December 31, 2011. The decrease of \$35.1 million from the comparable period was due to lower overall net income and a change in working capital decrease of \$22.0 million, primarily related to changes in accrued expenses caused by the payout of incentive compensation earned in the prior year, changes in prepaid expenses and other related to income tax as well as increased inventory expenditures related to our initiatives to expand our wear-to-work collection, focused localization initiatives and higher average unit costs related to elevated product offerings.

Net cash provided by investing activities for the six months ended December 29, 2012 was \$0.3 million versus \$1.3 million used by investing activities for the six months ended December 31, 2011. The increase of \$1.6 million versus the prior year comparable period was primarily due to proceeds from sale of investment securities partially offset by increased investments in property and equipment. We expect that total capital expenditures will be approximately \$27 million in fiscal 2013, which will include capital expenditures for new stores, remodels, store expansions, information technology systems and office improvements.

Net cash used by financing activities was \$9.5 million for the six months ended December 29, 2012 versus \$3.6 million used by financing activities for the six months ended December 31, 2011. The increase of \$5.9 million from the prior year comparable period was primarily due to purchases of our common stock.

We hold a variety of interest bearing ARS consisting of federally insured student loan backed securities and insured municipal authority bonds. As of December 29, 2012, our ARS portfolio totaled approximately \$45.6 million classified as available for sale securities. As of that date, our ARS portfolio included approximately 92% federally insured student loan backed securities and 8% municipal authority bonds and consisted of approximately 20% AAA rated investments, 7% AA rated investments, 40% A rated investments, 18% BBB rated investments and 15% CCC rated investments. As of June 30, 2012, the Company's ARS consisted of 27% AAA rated investments, 23% AA rated investments, 28% A rated investments, 12% BBB rated investments and 10% 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. 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. 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 these ARS investments range from 2018 to 2042 with principal distributions occurring on certain securities prior to maturity. During the three and six months ended December 29, 2012, \$2.6 million and \$22.4 million, respectively, of ARS were settled at par.

We also hold short-term available for sale securities totaling \$64.1 million at December 29, 2012 that consist of treasury bills and certificates of deposit as well as long-term available for sale securities totaling \$59.2 million that consist of ARS and treasury bills.

In November 2012, our board of directors authorized a program to repurchase up to \$30 million of our common stock. During the three and the six months ended December 29, 2012, the Company repurchased approximately 1.8 million shares at an average price per share of \$3.81 for an aggregate purchase price of approximately \$6.8 million. As of December 29, 2012, all except approximately \$1.4 million of these share repurchases were paid for. No shares were repurchased during the three or the six months ended December 31, 2011.

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.



**Table of Contents***Interest Rate Risk*

We currently maintain a portfolio of variable interest rate investments consisting of cash equivalents, government treasury bills, guaranteed investment certificates and both short term 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 December 29, 2012 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 December 29, 2012:

	<b>Fair Value</b> <b>(Dollars in thousands)</b>
Cash	\$ 46,260
Weighted average interest rate	0.00%
Cash equivalents	\$ 46,393
Weighted average interest rate	0.10%
Current available for sale securities	\$ 64,086
Weighted average interest rate	0.76%
Non-current available for sale securities	\$ 59,240
Weighted average interest rate	0.24%
Total	\$ 215,979

The interest payable on outstanding cash borrowings under our bank line of credit is based on variable interest rates and is therefore affected by changes in market interest rates. If interest rates rose significantly, our results from operations and cash flows would not be materially affected since we have no outstanding borrowings.

*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**

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.

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There has been no change in our internal control over financial reporting during the quarter ended December 29, 2012 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. Except for the addition of the security risk factor, there have been no material changes in our risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2012.

**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.** Consequently, we depend in part upon the customer response to the creative efforts of our merchandising, design and marketing teams and their ability to anticipate trends and fashions that will appeal to our consumer base. If we miscalculate our customers product preferences or the demand for our products, we may be faced with excess inventory. Historically, this type of occurrence has resulted in excess fabric for some products and markdowns and/or write-offs, 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 sales. In addition, from time to time, we may pursue new concepts, and if the new concepts are not successful, our financial condition may be harmed.

**2. We face increasing product costs from our manufacturing partners, which could result in significant margin erosion.** Worldwide prices for raw materials have increased significantly year-over-year. We currently estimate that these increasing product costs could result in significant margin erosion. Additionally, a significant percentage of our apparel products are manufactured in China. Manufacturers in that country are currently experiencing increased costs due to shortages of labor and the fluctuation of the Chinese Yuan in relation to the U.S. dollar. In addition, our business and operating results may be affected by changes in the political, social or economic environment in China. If we are unable to successfully mitigate a significant portion of such product costs, our results of operations may be materially adversely affected.

**3. If we are unable to obtain raw materials or unable to find manufacturing facilities or our manufacturers perform unacceptably, our sales may be negatively affected and our financial condition may be harmed.** We do not own any manufacturing facilities and therefore depend on contractors and third parties to manufacture our products. We place all of our orders for production of merchandise and raw materials by purchase order and do not have any long-term contracts with any manufacturer or supplier. If we fail to maintain favorable relationships with our manufacturers and suppliers or are unable to obtain sufficient quantities of quality raw materials on commercially reasonable terms, it could harm our business and results of operations.

We cannot assure you that contractors and 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. 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 could be negatively impacted.

**4. We face significant competition in the retail and apparel industry, which could harm our sales and profitability.** 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, 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 adequately compete with them. If we fail to remain competitive in any way, it could harm our business, financial condition and results of operations.

**5. 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.** We are sensitive to changes in general economic conditions, both nationally and locally. 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 or other economic factors that may affect consumer spending or buying habits could adversely affect the demand for products we sell in our stores. In addition, the recent turmoil in the financial markets may have an adverse effect on the U.S. and world economy, which could negatively impact consumer spending patterns. We cannot assure you that government responses to the disruptions in the financial markets will restore consumer confidence.

Furthermore, we could experience reduced traffic in our stores or limitations on the prices we can charge for our products, either of which could reduce our sales and profit margins and have a material adverse effect on our financial condition and results of operations. Also, 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, and otherwise adversely affect our financial condition and results of operations.

**6. We cannot assure that future store openings will be successful and new store openings may impact existing stores.** We expect to open approximately 11 stores for bebe and 2b bebe in fiscal 2013 as well as up to 25 international licensee operated point-of-sale locations. In the past, we have closed stores as a result of poor performance, and we cannot assure that the stores that we plan to open in fiscal 2013, or any other stores that we might open in the future, will be successful or that our overall operating profit will increase as a result of opening these stores. During fiscal 2012, we closed 13 stores, and during fiscal 2013, we anticipate closing approximately 14 bebe stores, one 2b store and one 2b bebe pop-up location. Most of our domestic new store openings in fiscal 2013 will be in existing markets. These openings may affect the existing stores' net sales and profitability. Our failure to predict accurately the demographic or retail environment at any future store location could have a material adverse effect on our business, financial condition and results of operations.

Our ability to effectively obtain real estate to open new stores depends upon the availability of real estate that meets our criteria, including traffic, square footage, co-tenancies, average sales per square foot, lease economics, demographics, and other factors, and our ability to negotiate terms that meet our financial targets. In addition, we must be able to effectively renew our existing store leases. Failure to secure real estate locations adequate to meet annual targets as well as effectively managing the profitability of our existing fleet of stores could have a material adverse effect on our business, financial condition and results of operations.

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**7. 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 the second quarter of our fiscal year (which includes the holiday selling season) compared to other quarters.

In addition, our 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.

**8. 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 from within our company. There is substantial competition for experienced personnel, which we expect will continue. We compete for experienced personnel with companies who have greater financial resources than we do. In the past, we have experienced significant turnover of our executive management team and retail store personnel. 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.

In addition, we depend upon the expertise and execution of our key employees, particularly: Steve Birkhold, our Chief Executive Officer and member of the Board of Directors. If we lose the services of Mr. Birkhold or any key officers or employees, it could harm our business and results of operations.

**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, 2013, Manny Mashouf, our founder and Chairman of the Board, beneficially owned approximately 55% 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 rely on information technology, 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 systems. If at any time we do not have adequate systems in place, or should we experience any delays or difficulties in transitioning to these or other new systems, or in integrating these systems with our current systems, or we experience any other disruptions affecting our information systems, we could experience a material adverse impact on our business. Should we experience unauthorized access, disclosure or use of any of our systems, or if our security controls, computer assets and sensitive data, including client data, are breached, this could also damage our reputation with our clients. Further, with increased technology and other patent litigation hitting the industry, and especially given our reliance on our vendor's purported ownership of third party software we license, we face the potential of receiving claims that the technology we use or license infringes on another's proprietary rights. Should this occur, and while we may secure indemnification rights in certain transactions, 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.

**11. Any serious disruption at our major facilities could have a harmful effect on our business.** We currently operate a corporate office in Brisbane, California, a distribution facility in Benicia, California, and a design studio in Los Angeles, California. During the fourth quarter of fiscal 2012 we purchased our distribution facility in part to facilitate the migration of bebe.com in-house that occurred in the first quarter of 2013. Any serious disruption at these facilities whether due to construction, relocation, fire, earthquake, terrorist acts or otherwise could harm our operations and could negatively affect our business and results of operations. Furthermore, we have little experience operating essential functions away from our main corporate offices and are uncertain what effect operating such satellite facilities might have on business, personnel and results of operations.

**12. We are subject to risks associated with our on-line sales.** We operate on-line stores at [www.bebe.com](http://www.bebe.com) and [www.2bstores.com](http://www.2bstores.com) to sell our merchandise. Our on-line operations are subject to numerous risks, including unanticipated operating problems, reliance on third-party computer hardware and software providers and system failures. The on-line operations also involve other risks that could have an 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. In addition, with the migration to a third-party platform for our bebe.com store, we no longer have direct control of certain aspects of our on-line business. We cannot assure that our on-line stores will continue to achieve sales and profitability growth or even remain at their current level.

**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.** There is an increased dependence on digital technologies by public companies and an increasing frequency and severity of 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 online activities to connect with our customers. While we have implemented measures to prevent security breaches and cyber incidents, given the ever increasing abilities of those intent on breaching cyber-security measures and given our reliance on the security and other efforts of third-party vendors, the total security effort at any point in time may not be completely effective and any such security breaches and cyber incidents could adversely affect our business.

**14. Our business could be adversely impacted by unfavorable international political conditions.** Due to our international operations, 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. 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 financial condition and results of operations. 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.

**15. If we are not able to protect our intellectual property our ability to capitalize on the value of our brand name may be impaired.** Even though we take actions to establish, register and 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. 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, bbsp and 2b bebe 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. In some

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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.

**16. 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.** 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 control the actions or the public's perceptions of such manufacturers, nor can we assure that these manufacturers will conduct their businesses using ethical or legal labor practices. Apparel companies, in certain conditions, may be held jointly liable for the wrongdoings of the manufacturers of their products. While we do not control our manufacturers' employment conditions or business practices, and the manufacturers act in their own interest, they may act in a manner that results in negative public perceptions of us and/or employee allegations or court determinations that we are jointly liable.

**17. We may be required to record losses in future quarters as a result of the decline in value of our investments in auction rates securities or as a result of a change in our ability to hold our investments in auction rate securities.** We hold a variety of interest bearing ARS comprised of federally insured student loan backed securities and insured municipal authority bonds. 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 recent 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 failed to settle on their respective settlement dates. Consequently, \$39.3 million of our ARS are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful or securities are purchased or redeemed outside of the auction process. Maturity dates for these ARS investments range from 2018 to 2042, 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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The following table presents information with respect to purchases of our common stock made during the quarter ended December 29, 2012 by bebe Stores, inc. or any affiliated purchaser, as defined in Rule 10b-18(a)(3) under the Exchange Act.

	Total Number of Shares Purchased	Average Price Paid per Share (in thousands, except per share amounts)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or approximate dollar amount) of Shares that May Yet be Purchased Under the Plans or Programs (1)
Month #1 (September 30 – October 27)		\$		\$ 30,000
Month #2 (October 28 – November 24)	108	\$ 3.73	108	\$ 29,595
Month #3 (November 25 – December 29)	1,683	\$ 3.81	1,683	\$ 23,174
Total	1,791	\$ 3.81	1,791	

- (1) In November 2012, our Board of Directors approved \$30 million for share repurchases, which we announced on November 19, 2012. This authorization has no expiration date.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES****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
10.26	Third Amendment to Credit Agreement and Revolving Line of Credit Note between Registrant and Wells Fargo dated as of February 1, 2013
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.



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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 7, 2013

bebe stores, inc.

/s/ Walter Parks

Walter Parks, Chief Operating Officer and Chief Financial Officer

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