CLAIRES STORES INC
Form 10-Q
August 29, 2013

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 August 3, 2013

OR

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

For the transition period from ______ to ______

Commission File Nos. 1-8899, 333-148108 and 333-175171

Claire s Stores, Inc.

(Exact name of registrant as specified in its charter)

Florida	**59-0940416**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
2400 West Central Road,	
Hoffman Estates, Illinois	**60192**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (847) 765-1100

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 x

Explanatory Note: While registrant is not subject to the filing requirements of Section 13 or 15(d) of the Exchange Act, it has filed all reports pursuant to Section 13 or 15(d) of the Exchange Act during the preceding 12 months.

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x	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 x

As of August 1, 2013, 100 shares of the Registrant s common stock, $0.001 par value, were outstanding.

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CLAIRE S STORES, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

CLAIRE S STORES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	August 3, 2013	February 2, 2013
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 73,798	$ 166,956
Inventories	174,247	157,549
Prepaid expenses	21,050	19,701
Other current assets	27,109	29,621
Total current assets	296,204	373,827
Property and equipment:		
Furniture, fixtures and equipment	246,766	234,209
Leasehold improvements	328,036	312,789
	574,802	546,998
Less accumulated depreciation and amortization	(345,351)	(325,618)
	229,451	221,380
Leased property under capital lease:		
Land and building	18,055	18,055
Less accumulated depreciation and amortization	(3,160)	(2,708)
	14,895	15,347
Goodwill	1,550,056	1,550,056
Intangible assets, net of accumulated amortization of $61,340 and $57,672, respectively	542,877	547,433
Deferred financing costs, net of accumulated amortization of $34,980 and $27,156, respectively	43,402	41,381
Other assets	50,475	49,848
	2,186,810	2,188,718
Total assets	$ 2,727,360	$ 2,799,272
LIABILITIES AND STOCKHOLDER S DEFICIT		
Current liabilities:		
Trade accounts payable	$ 72,972	$ 73,445
Income taxes payable	2,134	10,508
Accrued interest payable	70,631	68,254
Accrued expenses and other current liabilities	85,355	99,529
Total current liabilities	231,092	251,736
Long-term debt	2,379,869	2,373,366
Obligation under capital lease	17,181	17,232

Deferred tax liability	119,795	120,968
Deferred rent expense	29,996	29,859
Unfavorable lease obligations and other long-term liabilities	17,644	20,551
	2,564,485	2,561,976
Commitments and contingencies		
Stockholder s deficit:		
Common stock par value $0.001 per share; authorized 1,000 shares; issued and outstanding 100 shares		
Additional paid-in capital	618,939	618,403
Accumulated other comprehensive (loss) income, net of tax	(3,784)	3,273
Accumulated deficit	(683,372)	(636,116)
	(68,217)	(14,440)
Total liabilities and stockholder s deficit	$ 2,727,360	$ 2,799,272

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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CLAIRE S STORES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND

COMPREHENSIVE LOSS

(in thousands)

	Three Months Ended August 3, 2013	Three Months Ended July 28, 2012	Six Months Ended August 3, 2013	Six Months Ended July 28, 2012
Net sales	$ 366,703	$ 359,617	$ 720,709	$ 700,234
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	180,973	177,866	359,539	351,869
Gross profit	185,730	181,751	361,170	348,365
Other expenses:				
Selling, general and administrative	126,448	120,329	251,835	238,911
Depreciation and amortization	16,153	15,475	31,778	32,190
Severance and transaction-related costs	889	1,144	1,804	1,197
Other (income) expense, net	(2,082)	149	(1,158)	580
	141,408	137,097	284,259	272,878
Operating income	44,322	44,654	76,911	75,487
Loss on early debt extinguishment	3,121		4,795	4,602
Interest expense, net	57,755	48,879	115,974	95,901
Loss before income tax expense	(16,554)	(4,225)	(43,858)	(25,016)
Income tax expense	4,118	3,048	3,398	2,178
Net loss	$ (20,672)	$ (7,273)	$ (47,256)	$ (27,194)
Net loss	$ (20,672)	$ (7,273)	$ (47,256)	$ (27,194)
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(36)	(3,297)	(1,811)	(2,797)
Net gain (loss) on intra-entity foreign currency transactions, net of tax (benefit) of $(33) $(755), $(333) and $(479)	205	(10,092)	(5,246)	(8,340)
Unrealized gain on interest rate swap, net of tax of $0, $0, $0 and $0		169		528
Other comprehensive income (loss)	169	(13,220)	(7,057)	(10,609)
Comprehensive loss	$ (20,503)	$ (20,493)	$ (54,313)	$ (37,803)

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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CLAIRE S STORES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended August 3, 2013	Six Months Ended July 28, 2012
Cash flows from operating activities:		
Net loss	$ (47,256)	$ (27,194)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	31,778	32,190
Amortization of lease rights and other assets	1,950	1,585
Amortization of debt issuance costs	4,228	5,367
Accretion of debt premium	(1,037)	
Net unfavorable accretion of lease obligations	(423)	(286)
Loss on sale/retirement of property and equipment, net	33	64
Loss on early debt extinguishment	4,795	4,602
Stock-based compensation expense (benefit)	536	(918)
(Increase) decrease in:		
Inventories	(18,534)	(25,091)
Prepaid expenses	(2,170)	148
Other assets	(1,441)	(5,711)
Increase (decrease) in:		
Trade accounts payable	849	1,909
Income taxes payable	(8,040)	(7,057)
Accrued interest payable	2,376	16,684
Accrued expenses and other liabilities	(12,904)	(8,093)
Deferred income taxes	(1,623)	(1,297)
Deferred rent expense	460	239
Net cash used in operating activities	(46,423)	(12,859)
Cash flows from investing activities:		
Acquisition of property and equipment	(40,718)	(30,688)
Acquisition of intangible assets/lease rights	(1,617)	(1,174)
Changes in restricted cash		250
Net cash used in investing activities	(42,335)	(31,612)
Cash flows from financing activities:		
Payments on credit facility		(489,750)
Proceeds from notes	530,000	501,500
Repurchases of notes, including tender premiums and fees	(523,660)	
Payment of debt issuance costs	(9,845)	(11,041)
Principal payments on capital lease	(24)	
Net cash (used in) provided by financing activities	(3,529)	709
Effect of foreign currency exchange rate changes on cash and cash equivalents	(871)	153
Net decrease in cash and cash equivalents	(93,158)	(43,609)

Cash and cash equivalents, at beginning of period		166,956		170,024
Cash and cash equivalents, at end of period		73,798		126,415
Restricted cash, at end of period				4,100
Cash and cash equivalents and restricted cash, at end of period	$	73,798	$	130,515
Supplemental disclosure of cash flow information:				
Interest paid	$	110,377	$	73,765
Income taxes paid		11,988		9,917

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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CLAIRE S STORES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying Unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair statement of the results for the interim periods presented have been included. These statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in the Annual Report on Form 10-K for the year ended February 2, 2013 filed with the Securities and Exchange Commission, including Note 2 to the Consolidated Financial Statements included therein, which discusses principles of consolidation and summary of significant accounting policies.

The Unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make certain estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures regarding contingent assets and liabilities and reported amounts of revenues and expenses. Such estimates include, but are not limited to, the value of inventories, goodwill, intangible assets and other long-lived assets, legal contingencies and assumptions used in the calculation of income taxes, stock-based compensation, derivative and hedging activities, residual values and other items. These estimates and assumptions are based on management s best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. Management adjusts such estimates and assumptions when facts and circumstances dictate. Illiquid credit markets, volatile equity, foreign currency, energy markets and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates will be reflected in the financial statements in those future periods when the changes occur.

Due to the seasonal nature of the retail industry and the Company s business, the results of operations for interim periods of the year are not necessarily indicative of the results of operations on an annualized basis.

2. Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists,* which clarifies guidance and eliminates diversity in practice on the presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments in this ASU are effective for interim and annual fiscal periods beginning after December 15, 2013 and early adoption is permitted. The Company does not expect adoption of ASU 2013-11 will have a material impact on the Company s financial position, results of operations or cash flows.

In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* which requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account instead of directly to income or expense in the same reporting period. The amendment is effective prospectively for interim and annual periods beginning after December 15, 2012. The Company adopted this guidance in the first quarter of fiscal 2013 and it did not have any impact on the Company s financial position, results of operations or cash flows.

In July 2012, the FASB issued ASU 2012-02, *Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment,* which permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit s fair value is less than its carrying amount. If an entity can support the conclusion that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then the entity is not required to take further action. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption is permitted. The Company adopted this guidance in the first quarter of fiscal 2013 and it did not have any impact on the Company s financial position, results of operations or cash flows.

3. Fair Value Measurements

ASC 820, *Fair Value Measurement Disclosures,* defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Disclosures of the fair value of certain financial instruments are required, whether or not recognized in the Unaudited Condensed Consolidated Balance Sheets. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. There is a three-level valuation hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs are inputs market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the factors market participants would use in valuing the asset or liability.

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

The Company does not have any assets (liabilities) measured at fair value on a recurring basis. The Company s former interest rate swap, which was previously measured at fair value on a recurring basis, was terminated on September 20, 2012.

Non-Financial Assets Measured at Fair Value on a Non-Recurring Basis

The Company s non-financial assets, which include goodwill, intangible assets, and long-lived tangible assets, are not adjusted to fair value on a recurring basis. Fair value measures of non-financial assets are primarily used in the impairment analysis of these assets. Any resulting asset impairment would require that the non-financial asset be recorded at its fair value. The Company reviews goodwill and indefinite-lived intangible assets for impairment annually, during the fourth quarter of each fiscal year, or as circumstances indicate the possibility of impairment. The Company monitors the carrying value of definite-lived intangible assets and long-lived tangible assets for impairment whenever events or changes in circumstances indicate its carrying amount may not be recoverable.

Financial Instruments Not Measured at Fair Value

The Company s financial instruments consist primarily of cash and cash equivalents, accounts receivable, current liabilities and long-term debt. Cash and cash equivalents, accounts receivable and current liabilities approximate fair market value due to the relatively short maturity of these financial instruments.

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The Company considers all investments with a maturity of three months or less when acquired to be cash equivalents. The Company s cash equivalent instruments are valued using quoted market prices and are primarily U.S. Treasury securities. The estimated fair value of the Company s long-term debt was approximately $2.56 billion as of August 3, 2013, compared to a carrying value of $2.38 billion at that date. The estimated fair value of the Company s long-term debt was approximately $2.41 billion as of February 2, 2013, compared to a carrying value of $2.37 billion at that date. For publicly-traded debt, the fair value (estimated market value) is based on quoted market prices in less active markets. For non-publicly-traded debt, fair value is estimated based on quoted prices for similar instruments. If measured at fair value in the financial statements, long-term debt would be classified as Level 2 in the fair value hierarchy.

4. Debt

Debt as of August 3, 2013 and February 2, 2013 included the following components (in thousands):

	August 3, 2013	February 2, 2013
Long-term debt:		
9.25% Senior fixed rate notes due 2015	$	$ 220,270
9.625%/10.375% Senior toggle notes due 2015		302,190
10.5% Senior subordinated notes due 2017	259,612	259,612
9.0% Senior secured first lien notes due 2019 (1)	1,140,257	1,141,294
8.875% Senior secured second lien notes due 2019	450,000	450,000
6.125% Senior secured first lien notes due 2020	210,000	
7.75% Senior notes due 2020	320,000	
Long-term debt	$ 2,379,869	$ 2,373,366
Obligation under capital lease (including current portion)	$ 17,262	$ 17,286

(1) Amounts include unamortized premium of $15,257 and $16,294 as of August 3, 2013 and February 2, 2013, respectively.

6.125 % Senior Secured First Lien Notes

On March 15, 2013, the Company issued $210.0 million aggregate principal amount of 6.125% senior secured first lien notes that mature on March 15, 2020 (the 6.125% Senior Secured First Lien Notes). The notes were issued at a price equal to 100.00% of the principal amount. Interest on the 6.125% Senior Secured First Lien Notes is payable semi-annually to holders of record at the close of business on March 1 and September 1 immediately preceding the interest payment date on March 15 and September 15 of each year, commencing on September 15, 2013. The 6.125% Senior Secured First Lien Notes are guaranteed on a first-priority senior secured basis by all of the Company s existing and future direct or indirect wholly-owned domestic subsidiaries. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. The 6.125% Senior Secured First Lien Notes and related guarantees are secured, subject to certain exceptions and permitted liens, by a first-priority lien on substantially all of the assets of the Company s material owned assets and the material owned assets of subsidiary guarantors, limited in the case of equity interests held by the Company or any subsidiary guarantor in a foreign subsidiary, to 100% of the non-voting equity interest and 65% of the voting equity interest of such foreign subsidiary held directly by the Company or a subsidiary guarantor. The liens rank equally with those securing the Company s secured revolving credit facility (the Credit Facility) and the Company s 9.0% senior secured first lien notes due 2019 (the 9.0% Senior Secured First Lien Notes), and senior to those securing the Company s 8.875% senior secured second lien notes due 2019 (the Senior Secured Second Lien Notes).The Company used the proceeds of the offering of the 6.125% Senior Secured First Lien Notes for note repurchases of $59.8 million pursuant to a tender offer to retire $39.0 million aggregate principal amount of 9.25% Senior Fixed Rate Notes due 2015 (the Senior Fixed Rate Notes) and $21.5 million aggregate principal amount of 9.625%/10.375% Senior Toggle Notes due 2015 (the Senior Toggle Notes), to pay $1.9 million in tender premiums and fees, and to pay $4.0 million in financing costs which have been recorded as Deferred financing costs, net in the accompanying

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Unaudited Condensed Consolidated Balance Sheets. The Company used the remaining net proceeds, together with cash on hand, to redeem an additional $149.5 million aggregate principal amount of Senior Fixed Rate Notes on June 3, 2013 pursuant to the redemption provisions applicable to such notes.

7.75 % Senior Notes

On May 14, 2013, the Company issued $320.0 million aggregate principal amount of 7.75% senior notes that mature on June 1, 2020 (the 7.75% Senior Notes). The 7.75% Senior Notes were issued at a price equal to 100.00% of the principal amount. Interest on the 7.75% Senior Notes is payable semi-annually to holders of record at the close of business on May 15 and November 15 immediately preceding the interest payment date on June 1 and December 1 of each year, commencing on December 1, 2013. The 7.75% Senior Notes are guaranteed by all of the Company s existing and future direct or indirect wholly-owned domestic subsidiaries. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. The 7.75% Senior Notes and related guarantees are unsecured and will: (i) rank equal in right of payment with all of our existing and future indebtedness, (ii) rank senior to any of our existing and future indebtedness that is expressly subordinated to the 7.75% Senior Notes, and (iii) rank junior in priority to our obligations under all of our secured indebtedness, including the Credit Facility, the Senior Secured Second Lien Notes, the 9.0% Senior Secured First Lien Notes and the 6.125% Senior Secured First Lien Notes, to the extent of the value of assets securing such indebtedness. The Company used the net proceeds of the offering of the 7.75% Senior Notes to redeem all outstanding $31.8 million aggregate principal amount of Senior Fixed Rate Notes and all outstanding $280.7 million aggregate principal amount of Senior Toggle Notes on June 13, 2013 pursuant to the redemption provisions applicable to such notes.

Note Repurchases

The following is a summary of the Company s debt repurchase activity for the three and six months ended August 3, 2013 (in thousands). All debt repurchases in the three and six months ended August 3, 2013, were pursuant to the tender offer and note redemptions. There was no debt repurchase activity for the three and six months ended July 28, 2012.

	Three Months Ended August 3, 2013			Six Months Ended August 3, 2013		
Notes Repurchased	**Principal Amount**	**Repurchase Price**	**Recognized Loss (1)**	**Principal Amount**	**Repurchase Price**	**Recognized Loss (2)**
Senior Fixed Rate Notes	$ 181,259	$ 181,259	$ 1,494	$ 220,270	$ 219,802	$ 2,597
Senior Toggle Notes	280,667	280,667	1,627	302,190	301,947	2,198
	$ 461,926	$ 461,926	$ 3,121	$ 522,460	$ 521,749	$ 4,795

(1) Net of deferred issuance cost write-offs of $1,476 for the Senior Fixed Rate Notes and $1,625 for the Senior Toggle Notes and tender premiums and fees of $18 for the Senior Fixed Rate Notes and $2 for the Senior Toggle Notes.

(2) Net of deferred issuance cost write-offs of $1,829 for the Senior Fixed Rate Notes and $1,766 for the Senior Toggle Notes and tender premiums and fees of $1,236 for the Senior Fixed Rate Notes and $675 for the Senior Toggle Notes.

During the six months ended July 28, 2012, the Company recognized a $4.6 million loss on early debt extinguishment attributed to the write-off of unamortized debt issuance costs associated with the early repayment of indebtedness under the former senior secured term loan credit facility.

Note Covenants

Our 10.5% Senior Subordinated Notes due 2017 (the Senior Subordinated Notes), Senior Secured Second Lien Notes, 9.0% Senior Secured First Lien Notes, 6.125% Senior Secured First Lien Notes and 7.75% Senior Notes (collectively, the Notes) and our Credit Facility contain certain covenants that, among other things, are subject to certain exceptions and other basket amounts, restrict our ability and the ability of our subsidiaries to:

incur additional indebtedness;

pay dividends or distributions on our capital stock, repurchase or retire our capital stock and redeem, repurchase or defease any subordinated indebtedness;

make certain investments;

create or incur certain liens;

create restrictions on the payment of dividends or other distributions to us from our subsidiaries;

transfer or sell assets;

engage in certain transactions with our affiliates; and

merge or consolidate with other companies or transfer all or substantially all of our assets.

The Credit Facility also contains customary provisions relating to mandatory prepayments, voluntary payments, affirmative and negative covenants, and events of default; however, it does not contain any covenants that require the Company to maintain any particular financial ratio or other measure of financial performance except that so long as the revolving loans and letters of credit outstanding exceed $15 million, the Company will be required to comply with a maximum Total Net Secured Leverage Ratio of 5.5 to 1.0 based upon the ratio of its net senior secured first lien debt to adjusted earnings before interest, taxes, depreciation and amortization for the period of four consecutive fiscal quarters most recently ended.

Certain of these covenants in the indentures governing the Notes, such as limitations on the Company s ability to make certain payments such as dividends, or incur debt, will no longer apply if the Notes have investment grade ratings from both of the rating agencies of Moody s Investor Services, Inc. (Moody s) and Standard & Poor s Ratings Group (S&P) and no event of default has occurred. Since the date of issuance of the Notes, the Notes have not received investment grade ratings from Moody s or S&P. Accordingly, all of the covenants under the Notes currently apply to the Company. None of these covenants, however, require the Company to maintain any particular financial ratio or other measure of financial performance except as previously disclosed herein for the Credit Facility.

See Note 3 Fair Value Measurements for related fair value disclosure on debt.

5. Derivatives and Hedging Activities

The Company does not have any derivative and hedging activity since September 20, 2012 when the Company terminated its former interest rate swap. During the periods when the Company had the interest rate swap, it followed the accounting treatment described below.

The Company formally designated and documented the financial instrument as a hedge of a specific underlying exposure, as well as the risk management objectives and strategies for undertaking the hedge transaction. The Company formally assessed both at inception and at least quarterly thereafter, whether the financial instruments that were used in hedging transactions were effective at offsetting changes in cash flows of the related underlying exposure. The Company measured the effectiveness of its cash flow hedges by evaluating the following criteria: (i) the re-pricing dates of the derivative instrument match those of the debt obligation; (ii) the interest rates of the derivative instrument and the debt obligation are based on the same interest rate index and tenor; (iii) the variable interest rate of the derivative instrument does not contain a floor or cap, or other provisions that cause a basis difference with the debt obligation; and (iv) the likelihood of the counterparty not defaulting is assessed as being probable.

The Company primarily employed derivative financial instruments to manage its exposure to interest rate changes and to limit the volatility and impact of interest rate changes on earnings and cash flows. The Company did not enter into derivative financial instruments for trading or speculative purposes. The Company faced credit risk if the counterparties to the financial instruments were unable to perform their obligations. However, the Company sought to mitigate derivative credit risk by entering into transactions with counterparties that were significant and creditworthy financial institutions. The Company monitored the credit ratings of the counterparties.

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For derivatives that qualify as cash flow hedges, the Company reported the effective portion of the change in fair value as a component of Accumulated other comprehensive income (loss), net of tax in the Unaudited Condensed Consolidated Balance Sheets and reclassified it into earnings in the same periods in which the hedged item affected earnings, and within the same income statement line item as the impact of the hedged item. The ineffective portion of the change in fair value of a cash flow hedge was recognized in income immediately. No ineffective portion was recorded to earnings during the three and six months ended July 28, 2012 and all components of the derivative gain or loss were included in the assessment of hedge effectiveness. For derivative financial instruments which do not qualify as cash flow hedges, any changes in fair value would be recorded in the Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss.

The Company may at its discretion change the designation of any such hedging instrument agreements prior to maturity. At that time, any gains or losses previously reported in Accumulated other comprehensive income (loss), net of tax on termination would amortize into interest expense or interest income to correspond to the recognition of interest expense or interest income on the hedged debt. If such debt instrument was also terminated, the gain or loss associated with the terminated derivative included in Accumulated other comprehensive income (loss), net of tax at the time of termination of the debt would be recognized in the Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss at that time.

The following tables provide a summary of the financial statement effect of the Company s derivative financial instrument designated as interest rate cash flow hedge during the three and six months ended July 28, 2012 (in thousands):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Three months ended July 28, 2012	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) (1) Three months ended July 28, 2012
Interest rate swap	$ 169	Interest expense, net	$ (383)

(1) Represents reclassification of amounts from accumulated other comprehensive income (loss) into earnings as interest expense was recognized on the former term loan. No ineffectiveness was associated with the interest rate cash flow hedge.

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Six months ended July 28, 2012	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) (1) Six months ended July 28, 2012
Interest rate swap	$ 528	Interest expense, net	$ (724)

(1)

Represents reclassification of amounts from accumulated other comprehensive income (loss) into earnings as interest expense was recognized on the former term loan. No ineffectiveness was associated with the interest rate cash flow hedge.

6. Commitments and Contingencies

The Company is, from time to time, involved in litigation incidental to the conduct of its business, including personal injury litigation, litigation regarding merchandise sold, including product and safety concerns regarding heavy metal and chemical content in merchandise, litigation with respect to various employment matters, including litigation with present and former employees, wage and hour litigation and litigation regarding intellectual property rights.

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The Company believes that current pending litigation will not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

7. Accumulated Other Comprehensive Income (Loss)

The following summary sets forth the components of accumulated other comprehensive income (loss), net of tax as follows: (in thousands, net of tax)

	Foreign Currency Items	Derivative Instrument	Total
Balance as of February 2, 2013	$ (2,459)	$ 5,732	$ 3,273
Other comprehensive loss before reclassifications	(7,057)		(7,057)
Net other comprehensive loss	(7,057)		(7,057)
Balance as of August 3, 2013	$ (9,516)	$ 5,732	$ (3,784)

8. Stock Options and Stock-Based Compensation

The following is a summary of activity in the Company s stock option plan for the six months ended August 3, 2013:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)
Outstanding as of February 2, 2013	5,027,665	$ 10.00	
Options granted	787,190	$ 10.00	
Options exercised			
Options forfeited	(169,176)	$ 10.00	
Options expired	(144,600)	$ 10.00	
Outstanding as of August 3, 2013	5,501,079	$ 10.00	4.7
Options vested and expected to vest as of August 3, 2013	4,893,222	$ 10.00	4.6
Exercisable as of August 3, 2013	1,928,226	$ 10.00	2.2

The weighted average grant date fair value of options granted during the six months ended August 3, 2013 and July 28, 2012 was $3.27 and $1.54, respectively.

During the three and six months ended August 3, 2013 and July 28, 2012, the Company recorded stock-based compensation expense (benefit) and additional paid-in capital relating to stock-based compensation of approximately $0.1 million, $(1.0) million, $0.5 million and ($0.9) million, respectively. During the three months ended July 28, 2012, the Company recorded a reversal of stock option expense of $1.6 million associated with the forfeitures of stock options, including $1.4 million for a former executive officer. Stock-based compensation expense (benefit) is recorded in Selling, general and administrative expenses in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss.

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9. Income Taxes

The effective income tax rate was (24.9)% and (7.7)% for the three and six months ended August 3, 2013. This effective income tax rate differed from the statutory federal income tax rate of 35% primarily from increases in the valuation allowance recorded for additional deferred tax assets generated primarily from operating losses in the three and six months ended August 3, 2013 by the Company s U.S. operations.

The effective income tax rate was (72.1)% and (8.7)% for the three and six months ended July 28, 2012. This effective income tax rate differed from the statutory federal income tax rate of 35% primarily from increases in the valuation allowance recorded for additional deferred tax assets generated primarily from operating losses in the three and six months ended July 28, 2012 by the Company s U.S. operations.

In April 2011, the Company received from the Canada Revenue Agency withholding tax assessments for 2003 through 2007 of approximately $5.5 million, including penalties and interest. In conjunction with these assessments, a security deposit will be required in the amount of approximately $5.5 million until such time a final decision is made by the tax authority. The Company is objecting to these assessments and believes it will prevail at the appeals level; therefore, an accrual has not been recorded for this item.

10. Related Party Transactions

We are controlled by investment funds affiliated with, and co-investment vehicles managed by, Apollo Management VI, L.P. (the Apollo Funds). The Apollo Funds are affiliates of Apollo Global Management, LLC (together with its subsidiaries, Apollo). The initial purchasers of the 6.125% Senior Secured First Lien Notes on March 15, 2013 included Apollo Global Securities, LLC. Apollo Global Securities, LLC is an affiliate of the Apollo Funds, which are the Company s controlling stockholders. In connection with the issuance of the 6.125% Senior Secured First Lien Notes, the Company paid a fee of approximately $0.2 million to Apollo Global Securities, LLC. The initial purchasers of the 7.75% Senior Notes on May 14, 2013 included Apollo Global Securities, LLC. In connection with the issuance of the 7.75% Senior Notes, the Company paid a fee of approximately $0.2 million to Apollo Global Securities, LLC.

The initial purchasers of the 9.0% Senior Secured First Lien Notes on February 28, 2012 included Apollo Global Securities, LLC and Morgan Joseph TriArtisan LLC. Apollo Management, LLC, an affiliate of Apollo Management VI, L.P., has a non-controlling interest in Morgan Joseph TriArtisan LLC and its affiliates. Additionally, a member of the Company s Board of Directors is an executive of Morgan Joseph TriArtisan Inc., an affiliate of Morgan Joseph TriArtisan LLC. In connection with the issuance of the 9.0% Senior Secured First Lien Notes, the Company paid fees of approximately $0.7 million to Apollo Global Securities, LLC and $0.1 million to Morgan Joseph TriArtisan LLC.

The Company paid store planning and retail design fees to a business owned by a family member of one of the Company s former executive officers. These fees are included in Furniture, fixtures and equipment in the Company s Unaudited Condensed Consolidated Balance Sheets and Selling, general and administrative expenses in the Company s Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss. For the three and six months ended July 28, 2012, the Company paid fees of approximately $0.3 million and $0.8 million, respectively. This former arrangement was approved by the Audit Committee of the Board of Directors.

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11. Segment Information

The Company is organized based on the geographic markets in which it operates. Under this structure, the Company currently has two reportable segments: North America and Europe. The Company accounts for the goods it sells to third parties under franchising and licensing agreements within Net sales and Cost of sales, occupancy and buying expenses in the Company s Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss within its North America segment. The franchise fees the Company charges under the franchising agreements are reported in Other (income) expense, net in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss within its Europe segment. Substantially all of the interest expense on the Company s outstanding debt is recorded in the Company s North America segment.

Net sales, depreciation and amortization and operating income (loss) for the three and six months ended August 3, 2013 and July 28, 2012 are as follows (in thousands):

	Three Months Ended August 3, 2013	Three Months Ended July 28, 2012	Six Months Ended August 3, 2013	Six Months Ended July 28, 2012
Net sales:				
North America	$ 219,317	$ 218,740	$ 445,274	$ 440,315
Europe	147,386	140,877	275,435	259,919
Total net sales	366,703	359,617	720,709	700,234
Depreciation and amortization:				
North America	9,935	10,150	19,464	20,009
Europe	6,218	5,325	12,314	12,181
Total depreciation and amortization	16,153	15,475	31,778	32,190
Operating income for reportable segments:				
North America	28,198	29,036	61,722	63,709
Europe	17,013	16,762	16,993	12,975
Total operating income for reportable segments	45,211	45,798	78,715	76,684
Severance and transaction-related costs	889	1,144	1,804	1,197
Consolidated operating income	44,322	44,654	76,911	75,487
Loss on early debt extinguishment	3,121		4,795	4,602
Interest expense, net	57,755	48,879	115,974	95,901
Consolidated loss before income tax expense	$ (16,554)	$ (4,225)	$ (43,858)	$ (25,016)

Excluded from operating income for the North America segment are severance and transaction-related costs of approximately $0.6 million and $1.3 million for the three months ended August 3, 2013 and July 28, 2012, respectively, and $1.2 million and $1.3 million for the six months ended August 3, 2013 and July 28, 2012, respectively.

Excluded from operating loss for the Europe segment are severance and transaction-related costs of approximately $0.3 million and $(0.2) million for the three months ended August 3, 2013 and July 28, 2012, respectively, and $0.6 million and $(0.1) million for the six months ended August 3, 2013 and July 28, 2012, respectively.

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12. Supplemental Financial Information

On May 29, 2007, Claire s Stores, Inc. (the Issuer), issued $935.0 million in Senior Fixed Rate Notes, Senior Toggle Notes and Senior Subordinated Notes, (collectively, the 2007 Notes). On March 4, 2011, the Issuer issued $450.0 million aggregate principal amount of Senior Secured Second Lien Notes, (collectively, the 2011 Notes). On February 28, 2012, March 12, 2012 and September 20, 2012, the Issuer issued $400.0 million, $100.0 million and $625.0 million, respectively, aggregate principal amount of the same series of 9.0% Senior Secured First Lien Notes (collectively, the 2012 Notes). On March 15, 2013, the Issuer issued $210.0 million aggregate principal amount of 6.125% Senior Secured First Lien Notes and on May 14, 2013, the Issuer issued $320.0 million aggregate principal amount of 7.75% Senior Notes (the 2013 Notes). The 2007 Notes and the 2011 Notes are irrevocably and unconditionally guaranteed, jointly and severally, by all wholly-owned domestic current and future subsidiaries of Claire s Stores, Inc. that guarantee the Company s Credit Facility. The 2012 Notes and the 2013 Notes are unconditionally guaranteed, jointly and severally, by all wholly-owned domestic current and future subsidiaries of Claire s Stores, Inc. As of August 3, 2013, Claire s Stores, Inc. owned 100% of its domestic subsidiaries that guarantee the 2007 Notes, 2011 Notes, 2012 Notes, and 2013 Notes. All guarantors are collectively referred to as the Guarantors. The Company s other subsidiaries, principally its international subsidiaries including its European, Canadian and Asian subsidiaries (the Non-Guarantors), are not guarantors of these Notes.

The tables in the following pages present the condensed consolidating financial information for the Issuer, the Guarantors and the Non-Guarantors, together with eliminations, as of and for the periods indicated. The consolidating financial information may not necessarily be indicative of the financial position, results of operations or cash flows had the Issuer, Guarantors and Non-Guarantors operated as independent entities.

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Condensed Consolidating Balance Sheet

August 3, 2013

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	(105)	$ 6,447	$ 67,456	$	$ 73,798
Inventories		95,627	78,620		174,247
Prepaid expenses	893	2,263	17,894		21,050
Other current assets	478	18,745	7,886		27,109
Total current assets	1,266	123,082	171,856		296,204
Property and equipment:					
Furniture, fixtures and equipment	6,979	150,645	89,142		246,766
Leasehold improvements	1,471	174,950	151,615		328,036
	8,450	325,595	240,757		574,802
Less accumulated depreciation and amortization	(4,338)	(211,644)	(129,369)		(345,351)
	4,112	113,951	111,388		229,451
Leased property under capital lease:					
Land and building		18,055			18,055
Less accumulated depreciation and amortization		(3,160)			(3,160)
		14,895			14,895
Intercompany receivables		282,453		(282,453)	
Investment in subsidiaries	2,270,463	(54,613)		(2,215,850)	
Goodwill		1,235,650	314,406		1,550,056
Intangible assets, net	286,000	3,223	253,654		542,877
Deferred financing costs, net	43,402				43,402
Other assets	149	4,045	46,298	(17)	50,475
	2,600,014	1,470,758	614,358	(2,498,320)	2,186,810
Total assets	$ 2,605,392	$ 1,722,686	$ 897,602	$ (2,498,320)	$ 2,727,360
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)					
Current liabilities:					
Trade accounts payable	$ 669	$ 30,511	$ 41,792	$	$ 72,972
Income taxes payable		(252)	2,386		2,134
Accrued interest payable	70,631				70,631
Accrued expenses and other current liabilities	9,541	33,641	42,173		85,355
Total current liabilities	80,841	63,900	86,351		231,092

Intercompany payables	212,899		69,572	(282,471)	
Long-term debt	2,379,869				2,379,869
Obligation under capital lease		17,181			17,181
Deferred tax liability		106,950	12,845		119,795
Deferred rent expense		19,269	10,727		29,996
Unfavorable lease obligations and other long-term liabilities		17,309	335		17,644
	2,592,768	160,709	93,479	(282,471)	2,564,485
Stockholder s equity (deficit):					
Common stock		367	2	(369)	
Additional paid in capital	618,939	1,435,909	797,830	(2,233,739)	618,939
Accumulated other comprehensive income (loss), net of tax	(3,784)	2,550	(11,346)	8,796	(3,784)
(Accumulated deficit) retained earnings	(683,372)	59,251	(68,714)	9,463	(683,372)
	(68,217)	1,498,077	717,772	(2,215,849)	(68,217)
Total liabilities and stockholder s equity (deficit)	$ 2,605,392	$ 1,722,686	$ 897,602	$ (2,498,320)	$ 2,727,360

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Condensed Consolidating Balance Sheet

February 2, 2013

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 56,392	$ 4,299	$ 106,265	$	$ 166,956
Inventories	36	88,127	69,386		157,549
Prepaid expenses	592	2,390	16,719		19,701
Other current assets	262	19,422	9,937		29,621
Total current assets	57,282	114,238	202,307		373,827
Property and equipment:					
Furniture, fixtures and equipment	6,079	141,232	86,898		234,209
Leasehold improvements	1,177	165,075	146,537		312,789
	7,256	306,307	233,435		546,998
Less accumulated depreciation and amortization	(3,686)	(199,402)	(122,530)		(325,618)
	3,570	106,905	110,905		221,380
Leased property under capital lease:					
Land and building		18,055			18,055
Less accumulated depreciation and amortization		(2,708)			(2,708)
		15,347			15,347
Intercompany receivables		252,709		(252,709)	
Investment in subsidiaries	2,205,303	(56,381)		(2,148,922)	
Goodwill		1,235,650	314,406		1,550,056
Intangible assets, net	286,000	4,054	257,379		547,433
Deferred financing costs, net	41,381				41,381
Other assets	129	3,867	45,845	7	49,848
	2,532,813	1,439,899	617,630	(2,401,624)	2,188,718
Total assets	$ 2,593,665	$ 1,676,389	$ 930,842	$ (2,401,624)	$ 2,799,272
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)					
Current liabilities:					
Trade accounts payable	$ 993	$ 31,584	$ 40,868	$	$ 73,445
Income taxes payable		(12)	10,520		10,508
Accrued interest payable	68,254				68,254
Accrued expenses and other current liabilities	11,420	39,274	48,835		99,529
Total current liabilities	80,667	70,846	100,223		251,736

Intercompany payables	154,072		98,631	(252,703)	
Long-term debt	2,373,366				2,373,366
Obligation under capital lease		17,232			17,232
Deferred tax liability		107,618	13,350		120,968
Deferred rent expense		18,481	11,378		29,859
Unfavorable lease obligations and other long-term liabilities		20,080	471		20,551
	2,527,438	163,411	123,830	(252,703)	2,561,976
Stockholder s equity (deficit):					
Common stock		367	2	(369)	
Additional paid in capital	618,403	1,435,909	797,819	(2,233,728)	618,403
Accumulated other comprehensive income (loss), net of tax	3,273	3,909	(6,731)	2,822	3,273
(Accumulated deficit) retained earnings	(636,116)	1,947	(84,301)	82,354	(636,116)
	(14,440)	1,442,132	706,789	(2,148,921)	(14,440)
Total liabilities and stockholder s equity (deficit)	$ 2,593,665	$ 1,676,389	$ 930,842	$ (2,401,624)	$ 2,799,272

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Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

For The Three Months Ended August 3, 2013

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	$	$ 200,481	$ 166,222	$	$ 366,703
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	65	97,124	83,784		180,973
Gross profit (deficit)	(65)	103,357	82,438		185,730
Other expenses:					
Selling, general and administrative	4,567	65,044	56,837		126,448
Depreciation and amortization	335	8,603	7,215		16,153
Severance and transaction-related costs	643		246		889
Other (income) expense	(2,989)	1,242	(335)		(2,082)
	2,556	74,889	63,963		141,408
Operating income (loss)	(2,621)	28,468	18,475		44,322
Loss on early debt extinguishment	3,121				3,121
Interest expense, net	57,207	555	(7)		57,755
Income (loss) before income taxes	(62,949)	27,913	18,482		(16,554)
Income tax expense		654	3,464		4,118
Income (loss) from continuing operations	(62,949)	27,259	15,018		(20,672)
Equity in earnings of subsidiaries	42,277	342		(42,619)	
Net income (loss)	(20,672)	27,601	15,018	(42,619)	(20,672)
Foreign currency translation adjustments	(36)	(48)	1,690	(1,642)	(36)
Net gain (loss) on intra-entity foreign currency transactions, net of tax	205	(906)	208	698	205
Other comprehensive income (loss)	169	(954)	1,898	(944)	169
Comprehensive income (loss)	$ (20,503)	$ 26,647	$ 16,916	$ (43,563)	$ (20,503)

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

For The Three Months Ended July 28, 2012

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	$	$ 201,681	$ 157,936	$	$ 359,617

Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	334	98,348	79,184		177,866
Gross profit (deficit)	(334)	103,333	78,752		181,751
Other expenses:					
Selling, general and administrative	3,975	62,787	53,567		120,329
Depreciation and amortization	249	9,104	6,122		15,475
Severance and transaction-related costs	1,326		(182)		1,144
Other (income) expense	(2,643)	463	2,329		149
	2,907	72,354	61,836		137,097
Operating income (loss)	(3,241)	30,979	16,916		44,654
Interest expense, net	48,299	551	29		48,879
Income (loss) before income taxes	(51,540)	30,428	16,887		(4,225)
Income tax expense		741	2,307		3,048
Income (loss) from continuing operations	(51,540)	29,687	14,580		(7,273)
Equity in earnings (loss) of subsidiaries	44,267	(187)		(44,080)	
Net income (loss)	(7,273)	29,500	14,580	(44,080)	(7,273)
Foreign currency translation adjustments	(3,297)	(210)	(1,690)	1,900	(3,297)
Net loss on intra-entity foreign currency transactions, net of tax	(10,092)	(485)	(10,310)	10,795	(10,092)
Unrealized gain on interest rate swap, net of tax	169				169
Other comprehensive income (loss)	(13,220)	(695)	(12,000)	12,695	(13,220)
Comprehensive income (loss)	$ (20,493)	$ 28,805	$ 2,580	$ (31,385)	$ (20,493)

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Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

For The Six Months Ended August 3, 2013

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	$	$ 408,842	$ 311,867	$	$ 720,709
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	107	198,320	161,112		359,539
Gross profit (deficit)	(107)	210,522	150,755		361,170
Other expenses:					
Selling, general and administrative	9,094	128,514	114,227		251,835
Depreciation and amortization	651	16,900	14,227		31,778
Severance and transaction-related costs	1,171		633		1,804
Other (income) expense	(5,078)	2,407	1,513		(1,158)
	5,838	147,821	130,600		284,259
Operating income (loss)	(5,945)	62,701	20,155		76,911
Loss on early debt extinguishment	4,795				4,795
Interest expense, net	114,894	1,103	(23)		115,974
Income (loss) before income taxes	(125,634)	61,598	20,178		(43,858)
Income tax expense (benefit)		(1,194)	4,592		3,398
Income (loss) from continuing operations	(125,634)	62,792	15,586		(47,256)
Equity in earnings of subsidiaries	78,378	675		(79,053)	
Net income (loss)	(47,256)	63,467	15,586	(79,053)	(47,256)
Foreign currency translation adjustments	(1,811)	(177)	694	(517)	(1,811)
Net loss on intra-entity foreign currency transactions, net of tax	(5,246)	(1,182)	(5,309)	6,491	(5,246)
Other comprehensive income (loss)	(7,057)	(1,359)	(4,615)	5,974	(7,057)
Comprehensive income (loss)	$ (54,313)	$ 62,108	$ 10,971	$ (73,079)	$ (54,313)

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

For The Six Months Ended July 28, 2012

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	$	$ 407,571	$ 292,663	$	$ 700,234
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	1,625	196,051	154,193		351,869

Gross profit (deficit)	(1,625)	211,520	138,470		348,365
Other expenses:					
Selling, general and administrative	8,362	123,662	106,887		238,911
Depreciation and amortization	501	17,847	13,842		32,190
Severance and transaction-related costs	1,331		(134)		1,197
Other (income) expense	(4,977)	(1,046)	6,603		580
	5,217	140,463	127,198		272,878
Operating income (loss)	(6,842)	71,057	11,272		75,487
Loss on early debt extinguishment	4,602				4,602
Interest expense, net	94,204	1,093	604		95,901
Income (loss) before income taxes	(105,648)	69,964	10,668		(25,016)
Income tax expense (benefit)		(911)	3,089		2,178
Income (loss) from continuing operations	(105,648)	70,875	7,579		(27,194)
Equity in earnings (loss) of subsidiaries	78,454	(1,360)		(77,094)	
Net income (loss)	(27,194)	69,515	7,579	(77,094)	(27,194)
Foreign currency translation adjustments	(2,797)	(66)	(2,652)	2,718	(2,797)
Net (loss) gain on intra-entity foreign currency transactions, net of tax	(8,340)	124	(8,506)	8,382	(8,340)
Unrealized gain on interest rate swap, net of tax	528				528
Other comprehensive income (loss)	(10,609)	58	(11,158)	11,100	(10,609)
Comprehensive income (loss)	$ (37,803)	$ 69,573	$ (3,579)	$ (65,994)	$ (37,803)

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Condensed Consolidating Statement of Cash Flows

Six Months Ended August 3, 2013

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
Net income (loss)	$ (47,256)	$ 63,467	$ 15,586	$ (79,053)	$ (47,256)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries	(78,378)	(675)		79,053	
Depreciation and amortization	651	16,900	14,227		31,778
Amortization of lease rights and other assets			1,950		1,950
Amortization of debt issuance costs	4,228				4,228
Accretion of debt premium	(1,037)				(1,037)
Net accretion of unfavorable lease obligations		(396)	(27)		(423)
Loss on sale/retirement of property and equipment, net		32	1		33
Loss on early debt extinguishment	4,795				4,795
Stock compensation expense	353	(82)	265		536
(Increase) decrease in:					
Inventories	36	(7,499)	(11,071)		(18,534)
Prepaid expenses	(301)	127	(1,996)		(2,170)
Other assets	(235)	(170)	(1,036)		(1,441)
Increase (decrease) in:					
Trade accounts payable	(364)	913	300		849
Income taxes payable		(239)	(7,801)		(8,040)
Accrued interest payable	2,376				2,376
Accrued expenses and other liabilities	(1,879)	(5,659)	(5,366)		(12,904)
Deferred income taxes		(1,503)	(120)		(1,623)
Deferred rent expense		788	(328)		460
Net cash provided by (used in) operating activities	(117,011)	66,004	4,584		(46,423)
Cash flows from investing activities:					
Acquisition of property and equipment	(1,153)	(25,449)	(14,116)		(40,718)
Acquisition of intangible assets/lease rights		(105)	(1,512)		(1,617)
Net cash used in investing activities	(1,153)	(25,554)	(15,628)		(42,335)
Cash flows from financing activities:					
Proceeds from notes	530,000				530,000
Repurchases of notes, including tender premium and fees	(523,660)				(523,660)
Payment of debt issuance costs	(9,845)				(9,845)
Principal payments on capital lease		(24)			(24)
Intercompany activity, net	65,173	(35,826)	(29,347)		
Net cash provided by (used in) financing activities	61,668	(35,850)	(29,347)		(3,529)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(1)	(2,452)	1,582		(871)
Net increase (decrease) in cash and cash equivalents	(56,497)	2,148	(38,809)		(93,158)

Cash and cash equivalents, at beginning of period	56,392	4,299	106,265	166,956
Cash and cash equivalents, at end of period	(105)	6,447	67,456	73,798

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Condensed Consolidating Statement of Cash Flows

Six Months Ended July 28, 2012

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
Net income (loss)	$ (27,194)	$ 69,515	$ 7,579	$ (77,094)	$ (27,194)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity in (earnings) loss of subsidiaries	(78,454)	1,360		77,094	
Depreciation and amortization	501	17,847	13,842		32,190
Amortization of lease rights and other assets			1,585		1,585
Amortization of debt issuance costs	4,773		594		5,367
Net accretion of favorable (unfavorable) lease obligations		(401)	115		(286)
Loss on sale/retirement of property and equipment, net		61	3		64
Loss on early debt extinguishment	4,602				4,602
Stock compensation expense (benefit)	(1,033)	(65)	180		(918)
(Increase) decrease in:					
Inventories		(13,163)	(11,928)		(25,091)
Prepaid expenses	(544)	(913)	1,605		148
Other assets		(3,348)	(2,363)		(5,711)
Increase (decrease) in:					
Trade accounts payable	(134)	3,240	(1,197)		1,909
Income taxes payable		(994)	(6,063)		(7,057)
Accrued interest payable	16,684				16,684
Accrued expenses and other liabilities	(3,214)	(1,085)	(3,794)		(8,093)
Deferred income taxes		(1,307)	10		(1,297)
Deferred rent expense		42	197		239
Net cash provided by (used in) operating activities	(84,013)	70,789	365		(12,859)
Cash flows from investing activities:					
Acquisition of property and equipment	(604)	(15,017)	(15,067)		(30,688)
Acquisition of intangible assets/lease rights		(12)	(1,162)		(1,174)
Changes in restricted cash	250				250
Net cash used in investing activities	(354)	(15,029)	(16,229)		(31,612)
Cash flows from financing activities:					
Payments on credit facility	(489,750)				(489,750)
Proceeds from notes	501,500				501,500
Payment of debt issuance costs	(11,041)				(11,041)
Intercompany activity, net	49,865	(54,678)	4,813		
Net cash provided by (used in) financing activities	50,574	(54,678)	4,813		709
Effect of foreign currency exchange rate changes on cash and cash equivalents		14	139		153
Net increase (decrease) in cash and cash equivalents	(33,793)	1,096	(10,912)		(43,609)
Cash and cash equivalents, at beginning of period	102,915	4,908	62,201		170,024

Cash and cash equivalents, at end of period	69,122	6,004	51,289		126,415
Restricted cash, at end of period	4,100				4,100
Cash and cash equivalents and restricted cash, at end of period	$ 73,222	$ 6,004	$ 51,289	$	$ 130,515

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Management s Discussion and Analysis of Financial Condition and Results of Operations is designed to provide the reader of the financial statements with a narrative on our results of operations, financial position and liquidity, risk management activities, and significant accounting policies and critical estimates. Management s Discussion and Analysis should be read in conjunction with the Unaudited Condensed Consolidated Financial Statements and related notes thereto contained elsewhere in this document.

We include a store in the calculation of same store sales once it has been in operation sixty weeks after its initial opening and, effective in the third quarter of Fiscal 2012, we include sales from e-commerce. A store which is temporarily closed, such as for remodeling, is removed from the same store sales computation if it is closed for nine consecutive weeks. The removal is effective prospectively upon the completion of the ninth consecutive week of closure. A store which is closed permanently, such as upon termination of the lease, is immediately removed from the same store sales computation. We compute same store sales on a local currency basis, which eliminates any impact for changes in foreign currency rates.

Business Overview

We are one of the world s leading specialty retailers of fashionable jewelry and accessories for young women, teens, tweens, and kids. Our vision is to inspire girls and women around the world to become their best selves by providing products and experiences that empower them to express their own unique individual styles. We are organized into two operating segments: North America and Europe. We identify our operating segments by how we manage and evaluate our business activities. As of August 3, 2013, we operated a total of 3,094 owned stores, of which 1,925 were located in all 50 states of the United States, Puerto Rico, Canada, the U.S. Virgin Islands, and China (North America segment) and 1,169 stores were located in the United Kingdom, Ireland, France, Spain, Portugal, Belgium, Switzerland, Austria, Netherlands, Germany, Poland, Czech Republic, Hungary, Italy and Luxembourg (Europe segment). We operate our stores under two brand names: Claire s® and Icing®.

As of August 3, 2013, we also franchised or licensed 414 stores in Japan, the Middle East, Turkey, Greece, Guatemala, Malta, Ukraine, Mexico, India, Dominican Republic, El Salvador, Venezuela, Panama, Honduras, Indonesia, Philippines, and Costa Rica. We account for the goods we sell to third parties under franchising agreements within Net sales and Cost of sales, occupancy and buying expenses in our Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss. The franchise fees we charge under the franchising agreements are reported in Other (income) expense, net in our Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss.

Claire s® is our primary global brand that we operate through company-owned or franchise stores. *Claire s*® offers a differentiated and fun store experience with a treasure hunt setting that encourages our customer to visit often to explore and find merchandise that appeals to her. We believe by maintaining a highly relevant merchandise assortment and offering a compelling value proposition, *Claire s*® has universal appeal to teens, pre-teens and kids. *Claire s*® target customer is a girl between 3-18 years old with a particular focus on a core demographic of girls between 10-14 years old.

Icing® is our other brand which we currently operate in North America through company-owned stores. *Icing*® offers an inspiring merchandise assortment of fashionable products that helps a young woman to say something about herself, whatever the occasion. Our *Icing*® brand targets a young woman in the 18-35 year age group with a focus on our core 21-25 year olds who have recently entered the workforce. This customer is independent, fashion-conscious, and has enhanced spending ability.

We provide our target customer groups with a significant selection of fashionable merchandise across a wide range of categories, all with a compelling value proposition. Our major categories of business are:

Jewelry: Includes earrings, necklaces, bracelets, body jewelry and rings, as well as our ear piercing service; and

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Accessories: Includes fashion and seasonal accessories, including headwear, legwear, hairgoods, handbags and small leather goods, attitude glasses, scarves, armwear and belts, sunglasses, hats, gloves, slippers and earmuffs; and our beauty product offerings.

In North America, our stores are located primarily in shopping malls. The differentiation of our *Claire s*® and *Icing*® brands allows us to operate multiple stores within a single location. In Europe, our stores are located primarily on high streets, in shopping malls and in high traffic urban areas.

Consolidated Results of Operations

A summary of our consolidated results of operations for the three and six months ended August 3, 2013 and July 28, 2012 are as follows (dollars in thousands):

	Three Months Ended August 3, 2013	Three Months Ended July 28, 2012
Net sales	$ 366,703	$ 359,617
(Decrease) increase in same store sales	(0.1)%	1.5%
Gross profit percentage	50.6%	50.5%
Selling, general and administrative expenses as a percentage of net sales	34.5%	33.5%
Depreciation and amortization as a percentage of net sales	4.4%	4.3%
Operating income	$ 44,322	$ 44,654
Loss on early debt extinguishment	$ 3,121	$
Net loss	$ (20,672)	$ (7,273)
Number of stores at the end of the period (1)	3,094	3,074

(1) Number of stores excludes stores operated under franchise agreements.

	Six Months Ended August 3, 2013	Six Months Ended July 28, 2012
Net sales	$ 720,709	$ 700,234
Increase (decrease) in same store sales	1.3%	(0.7)%
Gross profit percentage	50.1%	49.7%
Selling, general and administrative expenses as a percentage of net sales	34.9%	34.1%
Depreciation and amortization as a percentage of net sales	4.4%	4.6%
Operating income	$ 76,911	$ 75,487
Loss on early debt extinguishment	$ 4,795	$ 4,602
Net loss	$ (47,256)	$ (27,194)
Number of stores at the end of the period (1)	3,094	3,074

(1) Number of stores excludes stores operated under franchise agreements.

Net sales

Net sales for the three months ended August 3, 2013 increased $7.1 million, or 2.0%, from the three months ended July 28, 2012. The increase was attributable to new store sales of $14.8 million and a favorable foreign currency translation effect of our non-U.S. net sales of $2.2 million, partially offset by the effect of store closures of $8.6 million, decreased shipments to franchisees of $0.8 million, and a decrease in same store sales of $0.5 million. Net sales would have increased 1.3% excluding the impact from foreign currency exchange rate changes.

Net sales for the six months ended August 3, 2013 increased $20.5 million, or 2.9%, from the six months ended July 28, 2012. The increase was attributable to new store sales of $28.2 million and an increase in same store sales of $8.9 million, partially offset by the effect of store closures of $16.2 million, an unfavorable foreign currency translation effect of our non-U.S. net sales of $0.3 million, and decreased shipments to franchisees of $0.1 million. Net sales would have increased 3.0% excluding the impact from foreign currency exchange rate changes.

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For the three months ended August 3, 2013, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 0.3%, partially offset by an increase in average transaction value of 0.2%.

For the six months ended August 3, 2013, the increase in same store sales was primarily attributable to an increase in average transaction value of 0.9% and an increase in average number of transactions per store of 0.7%.

The following table compares our sales of each product category for each of the periods presented:

	Percentage of Total		Percentage of Total	
Product Category	**Three Months Ended August 3, 2013**	**Three Months Ended July 28, 2012**	**Six Months Ended August 3, 2013**	**Six Months Ended July 28, 2012**
Jewelry	51.8	50.6	51.5	50.2
Accessories	48.2	49.4	48.5	49.8
	100.0	100.0	100.0	100.0

Gross profit

In calculating gross profit and gross profit percentages, we exclude the costs related to our distribution center and depreciation and amortization expense. These costs are included instead in Selling, general and administrative expenses in our Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss. Other retail companies may include these costs in cost of sales, so our gross profit percentages may not be comparable to those retailers.

During the three months ended August 3, 2013, gross profit percentage increased 10 basis points to 50.6% compared to 50.5% during the three months ended July 28, 2012. The increase in gross profit percentage consisted of a 60 basis point increase in merchandise margin and a 10 basis point decrease in buying and buying-related costs, partially offset by a 60 basis point increase in occupancy costs. The increase in merchandise margin resulted primarily from a decrease in markdowns and lower inventory shrink. Markdowns fluctuate based upon many factors including the amount of inventory purchased versus the rate of sale and promotional activity. We do not anticipate a significant change in the level of markdowns or shrink that would materially affect our merchandise margin. The increase in occupancy costs, as a percentage of net sales, was primarily due to rent increases which were not offset by an increase in same store sales.

During the six months ended August 3, 2013, gross profit percentage increased 40 basis points to 50.1% compared to 49.7% during the six months ended July 28, 2012. The increase in gross profit percentage consisted of a 40 basis point increase in merchandise margin and a 10 basis point decrease in buying and buying-related costs, partially offset by a 10 basis point increase in occupancy costs. The increase in merchandise margin resulted primarily from a decrease in markdowns and lower inventory shrink. Markdowns fluctuate based upon many factors including the amount of inventory purchased versus the rate of sale and promotional activity. We do not anticipate a significant change in the level of markdowns or shrink that would materially affect our merchandise margin.

Selling, general and administrative expenses

During the three months ended August 3, 2013, selling, general and administrative expenses increased $6.1 million, or 5.1%, compared to the three months ended July 28, 2012. As a percentage of net sales, selling, general and administrative expenses increased 100 basis points compared to the three months ended July 28, 2012. Excluding an unfavorable $0.7 million foreign currency translation effect, selling, general and administrative expenses would have increased $5.4 million. Of this increase, approximately $3.7 million was primarily for compensation-related expenses, such as store payroll and stock-based compensation expense, and approximately $1.7 million were costs associated with our newly launched stores in China and e-commerce related expenses for our recently launched platforms in the United Kingdom, Icing in North America and Claire s in Canada.

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During the six months ended August 3, 2013, selling, general and administrative expenses increased $12.9 million, or 5.4%, compared to the six months ended July 28, 2012. As a percentage of net sales, selling, general and administrative expenses increased 80 basis points compared to the six months ended July 28, 2012. Excluding a favorable $0.3 million foreign currency translation effect, selling, general and administrative expenses would have increased $13.2 million. Of this increase, approximately $9.9 million was primarily for compensation-related expenses, such as store payroll and bonus and stock-based compensation expense and approximately $3.3 million were costs associated with our newly launched stores in China and e-commerce related expenses for our recently launched platforms in the United Kingdom, Icing in North America and Claire s in Canada.

Depreciation and amortization expense

During the three months ended August 3, 2013, depreciation and amortization expense increased $0.7 million to $16.2 million compared to $15.5 million for the three months ended July 28, 2012. Excluding an unfavorable $0.1 million foreign currency translation effect, the increase in depreciation and amortization expense would have been $0.6 million.

During the six months ended August 3, 2013, depreciation and amortization expense decreased $0.4 million to $31.8 million compared to $32.2 million for the six months ended July 28, 2012. During the six months ended August 3, 2013, depreciation and amortization expense remained unchanged on a foreign currency translated basis.

Other (income) expense, net

The following is a summary of other expense activity for the three and six months ended August 3, 2013 and July 28, 2012 (in thousands):

	Three Months Ended August 3, 2013	Three Months Ended July 28, 2012	Six Months Ended August 3, 2013	Six Months Ended July 28, 2012
Foreign currency exchange (gain) loss, net	$ (755)	$ 798	$ 1,274	$ 1,656
Royalty income	(1,327)	(649)	(2,432)	(1,076)
	$ (2,082)	$ 149	$ (1,158)	$ 580

During the three and six months ended August 3, 2013, royalty income increased primarily from fees received from the operation of our franchise stores in Japan.

Loss on early debt extinguishment

The following is a summary of the Company s debt repurchase activity for the three and six months ended August 3, 2013 (in thousands). All debt repurchases in the three and six months ended August 3, 2013, were pursuant to the tender offer and note redemptions. There was no debt repurchase activity for the three and six months ended July 28, 2012.

	Three Months Ended August 3, 2013			Six Months Ended August 3, 2013		
Notes Repurchased	**Principal Amount**	**Repurchase Price**	**Recognized Loss (1)**	**Principal Amount**	**Repurchase Price**	**Recognized Loss (2)**
Senior Fixed Rate Notes	$ 181,259	$ 181,259	$ 1,494	$ 220,270	$ 219,802	$ 2,597
Senior Toggle Notes	280,667	280,667	1,627	302,190	301,947	2,198
	$ 461,926	$ 461,926	$ 3,121	$ 522,460	$ 521,749	$ 4,795

(1) Net of deferred issuance cost write-offs of $1,476 for the Senior Fixed Rate Notes and $1,625 for the Senior Toggle Notes and tender premiums and fees of $18 for the Senior Fixed Rate Notes and $2 for the Senior Toggle Notes.

(2) Net of deferred issuance cost write-offs of $1,829 for the Senior Fixed Rate Notes and $1,766 for the Senior Toggle Notes and tender premiums and fees of $1,236 for the Senior Fixed Rate Notes and $675 for the Senior Toggle Notes.

During the six months ended July 28, 2012, the Company recognized a $4.6 million loss on early debt extinguishment attributed to the write-off of unamortized debt issuance costs associated with the early repayment of indebtedness under our former credit facility.

Interest expense, net

During the three months ended August 3, 2013, net interest expense aggregated $57.8 million compared to $48.9 million for the three months ended July 28, 2012. The increase of $8.9 million is primarily due to indebtedness incurred under the 9.0% senior secured first lien notes due 2019 (the 9.0% Senior Secured First Lien Notes) that bears a higher interest rate of interest than our former credit facility.

During the six months ended August 3, 2013, net interest expense aggregated $116.0 million compared to $95.9 million for the six months ended July 28, 2012. The increase of $20.1 million is primarily due to indebtedness incurred under the 9.0% Senior Secured First Lien Notes that bears a higher interest rate of interest than our former credit facility.

Income taxes

The effective income tax rate for the three and six months ended August 3, 2013 was (24.9)% and (7.7)% compared to (72.1)% and (8.7)% for the three and six months ended July 28, 2012. These effective income tax rates differed from the statutory federal income tax rate of 35% primarily from increases in the valuation allowance recorded for additional deferred tax assets generated primarily from operating losses in the three and six months ended August 3, 2013 and July 28, 2012, respectively, by our U.S. operations.

Segment Operations

We have two reportable segments North America and Europe. The following is a discussion of results of operations by reportable segment.

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North America

Key statistics and results of operations for our North America segment are as follows (dollars in thousands):

	Three Months Ended August 3, 2013	Three Months Ended July 28, 2012	Six Months Ended August 3, 2013	Six Months Ended July 28, 2012
Net sales	$ 219,317	$ 218,740	$ 445,274	$ 440,315
Increase (decrease) in same store sales	1.1%	0.3%	1.7%	(0.7)%
Gross profit percentage	51.7%	51.4%	51.7%	51.7%
Number of stores at the end of the period (1)	1,925	1,940	1,925	1,940

(1) Number of stores excludes stores operated under franchise agreements and includes 11 China stores as of August 3, 2013.

During the three months ended August 3, 2013, net sales in North America increased $0.6 million, or 0.3%, from the three months ended July 28, 2012. The increase was attributable to new store sales of $4.1 million and an increase in same store sales of $2.4 million, partially offset by the effect of store closures of $4.8 million, a decrease in shipments to franchisees of $0.8 million, and an unfavorable foreign currency translation effect of our non-U.S. net sales of $0.3 million. Sales would have increased 0.4% excluding the impact from foreign currency exchange rate changes.

During the six months ended August 3, 2013, net sales in North America increased $5.0 million, or 1.1%, from the six months ended July 28, 2012. The increase was attributable to new store sales of $8.0 million and an increase in same store sales of $7.2 million, partially offset by the effect of store closures of $9.5 million, an unfavorable foreign currency translation effect of our non-U.S. net sales of $0.6 million, and decreased shipments to franchisees of $0.1 million. Sales would have increased 1.3% excluding the impact from foreign currency exchange rate changes.

For the three months ended August 3, 2013, the increase in same store sales was primarily attributable to an increase in average number of transactions per store of 2.4%, partially offset by a decrease in average transaction value of 0.6%.

For the six months ended August 3, 2013, the increase in same store sales was primarily attributable to an increase in average number of transactions per store of 2.5%, partially offset by a decrease in average transaction value of 0.1%.

During the three months ended August 3, 2013, gross profit percentage increased 30 basis points to 51.7% compared to 51.4% during the three months ended July 28, 2012. The increase in gross profit percentage consisted of a 100 basis point increase in merchandise margin, partially offset by a 70 basis point increase in occupancy costs. The increase in merchandise margin resulted primarily from a decrease in markdowns and lower inventory shrink. Markdowns fluctuate based upon many factors including the amount of inventory purchased versus the rate of sale and promotional activity. We do not anticipate a significant change in the level of markdowns or shrink that would materially affect our merchandise margin. The increase in occupancy rate resulted primarily from occupancy costs, as a percentage of net sales, was primarily due to rent increases which were not offset by an increase in same store sales.

During the six months ended August 3, 2013, gross profit percentage remained unchanged at 51.7% compared to the six months ended July 28, 2012. The gross profit percentage consisted of a 30 basis point increase in merchandise margin and a 10 basis point decrease in buying and buying-related costs, offset by a 40 basis point increase in occupancy costs. The increase in merchandise margin resulted primarily from a decrease in markdowns and lower inventory shrink. Markdowns fluctuate based upon many factors including the amount of inventory purchased versus the rate of sale and promotional activity. We do not anticipate a significant change in the level of markdowns or shrink that would

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materially affect our merchandise margin. The increase in occupancy costs, as a percentage of net sales, was primarily due to rent increases which were not offset by an increase in same store sales. The following table compares our sales of each product category in North America for each of the periods presented:

	Percentage of Total		Percentage of Total	
Product Category	**Three Months Ended August 3, 2013**	**Three Months Ended July 28, 2012**	**Six Months Ended August 3, 2013**	**Six Months Ended July 28, 2012**
Jewelry	57.5	56.1	56.5	55.1
Accessories	42.5	43.9	43.5	44.9
	100.0	100.0	100.0	100.0

Europe

Key statistics and results of operations for our Europe segment are as follows (dollars in thousands):

	Three Months Ended August 3, 2013	**Three Months Ended July 28, 2012**	**Six Months Ended August 3, 2013**	**Six Months Ended July 28, 2012**
Net sales	$ 147,386	$ 140,877	$ 275,435	$ 259,919
(Decrease) increase in same store sales	(2.0)%	3.6%	0.7%	(0.7)%
Gross profit percentage	49.1%	49.2%	47.6%	46.5%
Number of stores at the end of the period (1)	1,169	1,134	1,169	1,134

(1) Number of stores excludes stores operated under franchise agreements.

During the three months ended August 3, 2013, net sales in Europe increased $6.5 million, or 4.6%, from the three months ended July 28, 2012. The increase was attributable to new store sales of $10.7 million and a favorable foreign currency translation effect of our non-U.S. net sales of $2.5 million, partially offset by the effect of store closures of $3.8 million and a decrease in same stores sales of $2.9 million. Sales would have increased 2.8% excluding the impact from foreign currency exchange rate changes.

During the six months ended August 3, 2013, net sales in Europe increased $15.5 million, or 6.0%, from the six months ended July 28, 2012. The increase was attributable to new store sales of $20.2 million, an increase in same store sales of $1.7 million, and a favorable foreign currency translation effect of our non-U.S. net sales of $0.3 million, partially offset by the effect of store closures of $6.7 million. Sales would have increased 5.9% excluding the impact from foreign currency exchange rate changes.

For the three months ended August 3, 2013, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 4.1%, partially offset by an increase in average transaction value of 0.9%.

For the six months ended August 3, 2013, the increase in same store sales was primarily attributable to an increase in average transaction value of 2.4%, partially offset by a decrease in average number of transactions per store of 2.1%.

During the three months ended August 3, 2013, gross profit percentage decreased 10 basis points to 49.1% compared to 49.2% during the three months ended July 28, 2012. The decrease in gross profit percentage consisted of a 40 basis point increase in occupancy costs, partially offset by a 20 basis point decrease in buying and buying-related costs and a 10 basis point increase in merchandise margin. The increase in occupancy costs, as a percentage of net sales, resulted primarily from the deleveraging effect of a decrease in same store sales. The increase in merchandise margin resulted primarily from lower inventory shrink, partially offset by an increase in markdowns. We do not anticipate a significant change in the level of shrink that would materially affect our merchandise margin.

During the six months ended August 3, 2013, gross profit percentage increased 110 basis points to 47.6% compared to 46.5% during the six months ended July 28, 2012. The increase in gross profit percentage consisted of a 60 basis point increase in merchandise margin and a 50 basis point decrease in occupancy

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costs. The increase in merchandise margin resulted primarily from a decrease in markdowns and lower inventory shrink. Markdowns fluctuate based upon many factors including the amount of inventory purchased versus the rate of sale and promotional activity. We do not anticipate a significant change in the level of markdowns or shrink that would materially affect our merchandise margin. The decrease in occupancy costs, as a percentage of net sales, resulted primarily from the leveraging effect of an increase in same store sales.

The following table compares our sales of each product category in Europe for each of the periods presented:

	Percentage of Total		Percentage of Total	
Product Category	**Three Months Ended August 3, 2013**	**Three Months Ended July 28, 2012**	**Six Months Ended August 3, 2013**	**Six Months Ended July 28, 2012**
Jewelry	43.6	42.4	43.7	42.3
Accessories	56.4	57.6	56.3	57.7
	100.0	100.0	100.0	100.0

Liquidity and Capital Resources

A summary of cash flows provided by (used in) operating, investing and financing activities for the six months ended August 3, 2013 and July 28, 2012 is outlined in the table below (in thousands):

	Six Months Ended August 3, 2013	**Six Months Ended July 28, 2012**
Operating activities	$ (46,423)	$ (12,859)
Investing activities	(42,335)	(31,612)
Financing activities	(3,529)	709

Cash flows from operating activities

For the six months ended August 3, 2013, cash used in operations increased $33.6 million compared to the prior year period. The primary reason for the increase was an increase in interest payments of $36.6 million, partially offset by a net increase in operating income and other items of $3.0 million.

Cash flows from investing activities

For the six months ended August 3, 2013, cash used in investing activities was $42.3 million and primarily consisted of $40.7 million for capital expenditures. For the six months ended July 28, 2012, cash used in investing activities was $31.6 million and primarily consisted of $30.7 million for capital expenditures. During the remainder of Fiscal 2013, we expect to fund approximately $45.0 million of capital expenditures.

Cash flows from financing activities

For the six months ended August 3, 2013, cash used in financing activities was $3.5 million, which consisted primarily of proceeds of $530.0 million from the issuance of $210.0 million aggregate principal amount of 6.125% Senior Secured First Lien Notes and $320.0 million aggregate principal amount of 7.75% Senior Notes, note repurchases of $521.7 million to retire $220.3 million aggregate principal amount of Senior Fixed Rate Notes and $302.2 million aggregate principal amount of Senior Toggle Notes pursuant to a tender offer and note redemptions, to pay $1.9 million in tender premiums and fees, and to pay $9.8 million in financing costs. For the six months ended July 28, 2012, cash provided from financing was $0.7 million which consisted primarily of proceeds of $501.5 million from the issuance of $500.0 million aggregate principal amount of 9.0% Senior Secured First Lien Notes used to repay $489.8 million of indebtedness under the former senior secured term loan credit facility and to pay $11.0 million in financing costs.

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We or our affiliates have purchased and may, from time to time, purchase portions of our indebtedness in privately-negotiated, open market transactions.

Cash Position

As of August 3, 2013, we had cash and cash equivalents of $73.8 million and all cash equivalents were maintained in one money market fund invested exclusively in U.S. Treasury Securities.

As of August 3, 2013, our foreign subsidiaries held cash and cash equivalents of $67.5 million. During the six months ended August 3, 2013, we did not repatriate any cash held by foreign subsidiaries, but we expect a portion of our foreign subsidiaries future cash flow generation to be repatriated to the U.S. to meet certain liquidity needs. Based upon the amount of our remaining U.S. net operating loss carryforwards as of August 3, 2013, we do not expect to pay U.S. income tax on fiscal 2013 repatriations. When our U.S. net operating loss carryforwards are no longer available, we would be required to accrue and pay U.S. income taxes, net of any foreign tax credit benefit, on any such repatriation.

We anticipate that cash generated from operations will be sufficient to meet our debt service requirements as they become due, new store expenditures, and future working capital requirements in both the next twelve months and over the longer term. However, our ability to make scheduled payments of interest on, to pay principal on, or refinance indebtedness, to satisfy any other present or future debt obligations and our ability to fund future capital expenditures and operating expenses will depend on future operating performance. Our future operating performance and liquidity may also be adversely affected by general economic, financial, and other factors beyond our control, including those disclosed in Risk Factors in our Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

Credit Facility

On September 20, 2012, we entered into an Amended and Restated Credit Agreement by and among Claire s Inc. (Parent), the Company, Credit Suisse AG, as Administrative Agent, and the other Lenders named therein (the Credit Facility), pursuant to which we replaced our existing $200.0 million senior secured former revolver maturing May 29, 2013 with a $115.0 million five-year senior secured revolving credit facility.

Borrowings under the Credit Facility bear interest at a rate equal to, at our option, either (a) an alternate base rate determined by reference to the higher of (1) the prime rate in effect on such day, (2) the federal funds effective rate plus 0.50% and (3) the one-month LIBOR rate plus 1.00%, or (b) a LIBOR rate with respect to any Eurodollar borrowing, determined by reference to the costs of funds for U.S. dollar deposits in the London Interbank Market for the interest period relevant to such borrowing, adjusted for certain additional costs, in each case plus an applicable margin of 4.50% for LIBOR rate loans and 3.50% for alternate base rate loans. We also pay a facility fee of 0.50% per annum of the committed amount of the Credit Facility whether or not utilized.

All obligations under the Credit Facility are unconditionally guaranteed by (i) Parent, prior to an initial public offering of our stock, and (ii) our existing and future direct or indirect wholly-owned domestic subsidiaries, subject to certain exceptions.

All obligations under the Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions and permitted liens, by a first priority lien on, (i) all of our capital stock, prior to an initial public offering of our stock, and (ii) substantially all of our material owned assets and the material owned assets of subsidiary guarantors, limited in the case of equity interests held by us or any subsidiary guarantor in a foreign subsidiary, to 100% of the non-voting equity interests and 65% of the voting equity interests of such foreign subsidiary held directly by us or a subsidiary guarantor. The liens securing the Credit Facility rank equally to the liens securing the 9.0% Senior Secured First Lien Notes and the 6.125% Senior Secured First Lien Notes.

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The Credit Facility also contains customary provisions relating to mandatory prepayments, voluntary payments, affirmative and negative covenants, and events of default; however, it does not contain any covenants that require us to maintain any particular financial ratio or other measure of financial performance except that so long as the revolving loans and letters of credit outstanding exceed $15 million, we will be required to comply with a maximum Total Net Secured Leverage Ratio of 5.5 to 1.0 based upon our ratio of its net senior secured first lien debt to adjusted earnings before interest, taxes, depreciation and amortization for the period of four consecutive fiscal quarters most recently ended. As of August 3, 2013, our Total Net Secured Leverage Ratio was 4.1 to 1.0.

The Credit Facility does contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit our Parent s and our restricted subsidiaries ability to, among other things:

- incur additional indebtedness or issue certain preferred shares;
- pay dividends on, repurchase or make distributions in respect of our capital stock or make other restricted payments;
- make certain investments;
- sell certain assets;
- create liens;
- consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; and
- enter into certain transactions with our affiliates.

A breach of any of these covenants could result in an event of default. Upon the occurrence of an event of default, the Lenders could elect to declare all amounts outstanding under the Credit Facility to be immediately due and payable and terminate all commitments to extend further credit. Such actions by those Lenders could cause cross defaults under our other indebtedness. If we were unable to repay those amounts, the Lenders under the Credit Facility could proceed against the collateral granted to them to secure that indebtedness. As of August 3, 2013, we were in compliance with the covenants.

As of August 3, 2013, we had $5.7 million of letters of credit outstanding, which reduces the borrowing availability under the Credit Facility to $109.3 million as of that date.

6.125% Senior Secured First Lien Notes

On March 15, 2013, we issued $210.0 million aggregate principal amount of 6.125% senior secured first lien notes that mature on March 15, 2020 (the 6.125% Senior Secured First Lien Notes). See Note 4 Debt in the Notes to Unaudited Condensed Consolidated Financial Statements for further description of the 6.125% Senior Secured First Lien Notes.

7.75% Senior Notes

On May 14, 2013, we issued $320.0 million aggregate principal amount of 7.75% senior notes due June 1, 2020 (the 7.75% Senior Notes). See Note 4 Debt in the Notes to Unaudited Condensed Consolidated Financial Statements for further description of the 7.75% Senior Notes.

Note Covenants

Our 10.5% Senior Subordinated Notes due 2017, 8.875% Senior Secured Second Lien Notes due 2019, 9.0% Senior Secured First Lien Notes, 6.125% Senior Secured First Lien Notes and 7.75% Senior Notes (collectively, the Notes) contain certain covenants that, among other things, and subject to certain exceptions and other basket amounts, restrict our ability and the ability of our subsidiaries to:

incur additional indebtedness;

pay dividends or distributions on our capital stock, repurchase or retire our capital stock and redeem, repurchase or defease any subordinated indebtedness;

make certain investments;

create or incur certain liens;

create restrictions on the payment of dividends or other distributions to us from our subsidiaries;

transfer or sell assets;

engage in certain transactions with our affiliates; and

merge or consolidate with other companies or transfer all or substantially all of our assets.

Certain of these covenants, such as limitations on our ability to make certain payments such as dividends, or incur debt, will no longer apply if the Notes have investment grade ratings from both of the rating agencies of Moody s Investor Services, Inc. (Moody s) and Standard & Poor s Ratings Group (S&P) and no event of default has occurred. Since the date of issuance of the Notes, the Notes have not received investment grade ratings from Moody s or S&P. Accordingly, all of the covenants under the Notes currently apply to us. None of these Note covenants, however, require us to maintain any particular financial ratio or other measure of financial performance. As of August 3, 2013, we were in compliance with the covenants under the Notes.

Europe Credit Facilities

Our non-U.S. subsidiaries have bank credit facilities totaling $2.4 million. These facilities are used for working capital requirements, letters of credit and various guarantees. These credit facilities have been arranged in accordance with customary lending practices in their respective countries of operation. As of August 3, 2013, the entire amount of $2.4 million was available for borrowing by us, subject to a reduction of $2.3 million for outstanding bank guarantees.

Parent Company Registration Statement Filing

On May 3, 2013, Claire s Inc., our Parent, filed a registration statement with the Securities and Exchange Commission for an initial public offering of Claire s Inc. s common stock.

Critical Accounting Policies and Estimates

Our Unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles. Preparation of these statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these financial statements. A summary of significant accounting policies and a description of accounting policies that are considered critical may be found in our Fiscal 2012 Annual Report on Form 10-K, filed on April 3, 2013, in the Notes to Consolidated Financial Statements, Note 2 Summary of Significant Accounting Policies, and the Critical Accounting Policies and Estimates section contained in the Management s Discussion and Analysis of Financial Condition and Results of Operations therein.

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Recent Accounting Pronouncements

See Note 2 Recent Accounting Pronouncements, in the Notes to the Unaudited Condensed Consolidated Financial Statements.

Cautionary Note Regarding Forward-Looking Statements and Risk Factors

We and our representatives may from time to time make written or oral forward-looking statements, including statements contained in this and other filings with the Securities and Exchange Commission and in our press releases and reports we issue publicly. All statements which address operating performance, events or developments that we expect or anticipate will occur in the future, including statements relating to our future financial performance, business strategy, planned capital expenditures, ability to service our debt, and new store openings for future periods, are forward-looking statements. The forward-looking statements are and will be based on management s then current views and assumptions regarding future events and operating performance, and we assume no obligation to update any forward-looking statement. Forward-looking statements involve known or unknown risks, uncertainties and other factors, including changes in estimates and judgments discussed under Critical Accounting Policies and Estimates which may cause our actual results, performance or achievements, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements may use the words expect, anticipate, plan, intend, project, may, believe, forecasts and similar expressions. Some of thes uncertainties and other factors are as follows: our level of indebtedness; general economic conditions; changes in consumer preferences and consumer spending; competition; general political and social conditions such as war, political unrest and terrorism; natural disasters or severe weather events; currency fluctuations and exchange rate adjustments; failure to maintain our favorable brand recognition; failure to successfully market our products through new channels, such as e-commerce; uncertainties generally associated with the specialty retailing business, such as decreases in mall traffic; disruptions in our supply of inventory; inability to increase same store sales; inability to renew, replace or enter into new store leases on favorable terms; significant increases in our merchandise markdowns; inability to grow our store base in North America, Europe, China, or expand to grow our international store base through franchise or similar licensing arrangements; inability to design and implement new information systems; data security breaches of confidential information or other cyber attacks; delays in anticipated store openings or renovations; changes in applicable laws, rules and regulations, including changes in North America, Europe, or China or other international laws and regulations governing the sale of our products, particularly regulations relating to heavy metal and chemical content in our products; changes in employment laws relating to overtime pay, tax laws and import laws; product recalls; loss of key members of management; increase in the costs of healthcare for our employees; increases in the cost of labor; labor disputes; unwillingness of vendors and service providers to supply goods or services pursuant to historical customary credit arrangements; increases in the cost of borrowings; unavailability of additional debt or equity capital; and the impact of our substantial indebtedness on our operating income and our ability to grow. The Company undertakes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances. In addition, we typically earn a disproportionate share of our operating income in the fourth quarter due to seasonal buying patterns, which are difficult to forecast with certainty. Additional discussion of these and other risks and uncertainties is contained elsewhere in this Item 2, in Item 3, Quantitative and Qualitative Disclosures About Market Risk and in our Form 10-K for Fiscal 2012 under Statement Regarding Forward-Looking Disclosures and Risk Factors.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Cash and Cash Equivalents

We have significant amounts of cash and cash equivalents at financial institutions that are in excess of federally insured limits. With the current financial environment and the instability of financial institutions, we cannot be assured that we will not experience losses on our deposits. We mitigate this risk by investing in money market funds that are invested exclusively in U.S. Treasury securities and by maintaining bank accounts with a group of credit worthy financial institutions. As of August 3, 2013, all cash equivalents were maintained in one money market fund that was invested exclusively in U.S. Treasury securities.

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Interest Rates

We no longer have exposure to interest rate risk associated with derivative instruments. On September 20, 2012, we terminated the interest rate swap agreement entered into on July 28, 2010, settled the contract at fair value of the liability and also extinguished the associated hedged debt instrument.

Foreign Currency

We are exposed to market risk from foreign currency exchange rate fluctuations on the United States dollar (USD or dollar) value of foreign currency denominated transactions and our investments in foreign subsidiaries. We manage this exposure to market risk through our regular operating and financing activities, and may from time to time, use foreign currency options. Exposure to market risk for changes in foreign currency exchange rates relates primarily to our foreign operations buying, selling, and financing activities in currencies other than local currencies and to the carrying value of our net investments in foreign subsidiaries. At August 3, 2013, we maintained no foreign currency options. We generally do not hedge the translation exposure related to our net investment in foreign subsidiaries. Included in Comprehensive loss are $(7.1) million and $(11.1) million, net of tax, reflecting the unrealized gain (loss) on foreign currency translations and intra-entity foreign currency transactions during the six months ended August 3, 2013 and July 28, 2012, respectively.

Certain of our subsidiaries make significant USD purchases from Asian suppliers, particularly in China. Until July 2005, the Chinese government pegged its currency, the yuan renminbi (RMB), to the USD, adjusting the relative value only slightly and on infrequent occasion. Many people viewed this practice as leading to a substantial undervaluation of the RMB relative to the USD and other major currencies, providing China with a competitive advantage in international trade. China now allows the RMB to float to a limited degree against a basket of major international currencies, including the USD, the euro and the Japanese yen. The official exchange rate has historically remained stable; however, there are no assurances that this currency exchange rate will continue to be as stable in the future due to the Chinese government s adoption of a floating rate with respect to the value of the RMB against foreign currencies. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on China to adopt an even more flexible and more market-oriented currency policy that allows a greater fluctuation in the exchange rate between the RMB and the USD. This floating exchange rate, and any appreciation of the RMB that may result from such rate, could have various effects on our business, which include making our purchases of Chinese products more expensive. If we are unable to negotiate commensurate price decreases from our Chinese suppliers, these higher prices would eventually translate into higher costs of sales, which could have a material adverse effect on our results of operations.

The results of operations of our foreign subsidiaries, when translated into U.S. dollars, reflect the average foreign currency exchange rates for the months that comprise the periods presented. As a result, if foreign currency exchange rates fluctuate significantly from one period to the next, results in local currency can vary significantly upon translation into U.S. dollars. Accordingly, fluctuations in foreign currency exchange rates, most notably the strengthening of the dollar against the euro, could have a material impact on our revenue growth in future periods.

General Market Risk

Our competitors include department stores, specialty stores, mass merchandisers, discount stores and other retail and internet channels. Our operations are impacted by consumer spending levels, which are affected by general economic conditions, consumer confidence, employment levels, availability of consumer credit and interest rates on credit, consumer debt levels, consumption of consumer staples including food and energy, consumption of other goods, adverse weather conditions and other factors over which we have little or no control. The increase in costs of such staple items has reduced the amount

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of discretionary funds that consumers are willing and able to spend for other goods, including our merchandise. Should there be continued volatility in food and energy costs, sustained recession in the U.S. and Europe, rising unemployment and continued declines in discretionary income, our revenue and margins could be significantly affected in the future. We can not predict whether, when or the manner in which the economic conditions described above will change.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934), as of the end of the period covered by this Quarterly Report. 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 to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities Exchange Commission s rules and forms, and that such information is accumulated and communicated to our management, including each of such officers as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

No changes in our internal control over financial reporting have been made during the quarter ended August 3, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are, from time to time, involved in routine litigation incidental to the conduct of our business, including litigation instituted by persons injured upon premises under our control; litigation regarding the merchandise that we sell, including product and safety concerns regarding content in our merchandise; litigation with respect to various employment matters, including wage and hour litigation; litigation with present and former employees; and litigation regarding intellectual property rights. Although litigation is routine and incidental to the conduct of our business, like any business of our size which employs a significant number of employees and sells a significant amount of merchandise, such litigation can result in large monetary awards when judges, juries or other finders of facts do not agree with management s evaluation of possible liability or outcome of litigation. Accordingly, the consequences of these matters cannot be finally determined by management. However, in the opinion of management, we believe that current pending litigation will not have a material adverse effect on our financial results.

Item 1A. Risk Factors

There have been no material changes in our risk factors disclosed in our Annual Report on Form 10-K for the year ended February 2, 2013.

Item 6. Exhibits

10.32	Employment Agreement date June 28, 2013, between Claire s Stores, Inc. and J.Per Brodin[2]
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a). [1]
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a). [1]
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. [1]
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. [1]
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Filed herewith.

(2) Filed previously as exhibit to Form 8-K by the Company on July 2, 2013.

Items 2, 3, 4 and 5 of Part II are not applicable and have been omitted.

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SIGNATURES

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

	CLAIRE S STORES, INC.
August 29, 2013	By: /s/ James D. Fielding James D. Fielding, Chief Executive Officer (principal executive officer)
August 29, 2013	By: /s/ J. Per Brodin J. Per Brodin, Executive Vice President and Chief Financial Officer (principal financial and accounting officer)

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INDEX TO EXHIBITS

EXHIBIT NO.	DESCRIPTION
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