

CLAIRE'S STORES INC  
Form 10-Q  
August 29, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the Quarterly Period Ended August 2, 2014**

**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**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**59-0940416**  
**(I.R.S. Employer**  
**Identification No.)**

**2400 West Central Road,**  
**Hoffman Estates, Illinois**  
**(Address of principal executive offices)**  
**Registrant's telephone number, including area code: (847) 765-1100**

**60192**  
**(Zip Code)**

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 ☒

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 ☒ 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 ☒

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 ☒

As of August 1, 2014, 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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**Table of Contents****PART I. FINANCIAL INFORMATION****CLAIRE S STORES, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>August 2, 2014</b>	<b>February 1, 2014</b>
	(In thousands, except share and per share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 27,126	\$ 58,343
Inventories	170,673	178,882
Prepaid expenses	22,665	19,471
Other current assets	28,036	26,305
Total current assets	248,500	283,001
Property and equipment:		
Furniture, fixtures and equipment	256,301	260,709
Leasehold improvements	341,669	335,858
	597,970	596,567
Less accumulated depreciation and amortization	(362,062)	(347,408)
	235,908	249,159
Leased property under capital lease:		
Land and building	18,055	18,055
Less accumulated depreciation and amortization	(4,062)	(3,611)
	13,993	14,444
Goodwill	1,550,056	1,550,056
Intangible assets, net of accumulated amortization of \$68,898 and \$65,194, respectively	537,035	541,095
Deferred financing costs, net of accumulated amortization of \$21,437 and \$38,917, respectively	35,649	39,481
Restricted cash	2,417	
Other assets	53,283	54,396
	2,178,440	2,185,028
Total assets	\$ 2,676,841	\$ 2,731,632

**LIABILITIES AND STOCKHOLDER'S DEFICIT**

## Current liabilities:

Revolving credit facility	\$	19,500	\$	
Trade accounts payable		69,278		84,364
Income taxes payable		1,510		3,729
Accrued interest payable		68,862		68,338
Accrued expenses and other current liabilities		97,519		94,727

Total current liabilities		256,669		251,158
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Long-term debt		2,377,657		2,378,786
Obligation under capital lease		17,043		17,124
Deferred tax liability		119,347		119,564
Deferred rent expense		33,541		32,000
Unfavorable lease obligations and other long-term liabilities		13,738		16,033
		2,561,326		2,563,507

## 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		619,126		619,499
Accumulated other comprehensive loss, net of tax		(146)		(1,109)
Accumulated deficit		(760,134)		(701,423)
		(141,154)		(83,033)

Total liabilities and stockholder's deficit	\$	2,676,841	\$	2,731,632
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See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

**Table of Contents****CLAIRE S STORES, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND  
COMPREHENSIVE LOSS**

(in thousands)

	<b>Three Months Ended August 2, 2014</b>	<b>Three Months Ended August 3, 2013</b>	<b>Six Months Ended August 2, 2014</b>	<b>Six Months Ended August 3, 2013</b>
Net sales	\$ 377,829	\$ 366,703	\$ 731,172	\$ 720,709
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	189,735	180,973	376,805	359,539
Gross profit	188,094	185,730	354,367	361,170
Other expenses:				
Selling, general and administrative	129,214	126,448	255,172	251,835
Depreciation and amortization	17,800	16,153	41,264	31,778
Severance and transaction-related costs	2,182	889	3,764	1,804
Other (income) expense, net	671	(2,082)	(815)	(1,158)
	149,867	141,408	299,385	284,259
Operating income	38,227	44,322	54,982	76,911
Loss on early debt extinguishment		3,121		4,795
Interest expense, net	54,557	57,755	109,316	115,974
Loss before income tax expense	(16,330)	(16,554)	(54,334)	(43,858)
Income tax expense	4,244	4,118	4,377	3,398
Net loss	\$ (20,574)	\$ (20,672)	\$ (58,711)	\$ (47,256)
Net loss	\$ (20,574)	\$ (20,672)	\$ (58,711)	\$ (47,256)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(1,606)	(36)	181	(1,811)
Net gain (loss) on intra-entity foreign currency transactions, net of tax expense (benefit) of \$(205) \$(33), \$104 and \$(333)	(3,841)	205	782	(5,246)
Other comprehensive income (loss)	(5,447)	169	963	(7,057)
Comprehensive loss	\$ (26,021)	\$ (20,503)	\$ (57,748)	\$ (54,313)

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

**Table of Contents****CLAIRE S STORES, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	<b>Six Months Ended August 2, 2014</b>	<b>Six Months Ended August 3, 2013</b>
Cash flows from operating activities:		
Net loss	\$ (58,711)	\$ (47,256)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	41,264	31,778
Amortization of lease rights and other assets	2,021	1,950
Amortization of debt issuance costs	3,998	4,228
Accretion of debt premium	(1,129)	(1,037)
Net unfavorable accretion of lease obligations	(264)	(423)
Loss on sale/retirement of property and equipment, net	92	33
Loss on early debt extinguishment		4,795
Loss on sale of intangible assets/lease rights	216	
Stock-based compensation (benefit) expense	(373)	536
(Increase) decrease in:		
Inventories	8,594	(18,534)
Prepaid expenses	(2,975)	(2,170)
Other assets	(2,203)	(1,441)
Increase (decrease) in:		
Trade accounts payable	(9,005)	849
Income taxes payable	(2,251)	(8,040)
Accrued interest payable	524	2,376
Accrued expenses and other liabilities	(1,145)	(14,407)
Deferred income taxes	194	(120)
Deferred rent expense	1,414	460
Net cash used in operating activities	(19,739)	(46,423)
Cash flows from investing activities:		
Acquisition of property and equipment	(30,947)	(40,718)
Acquisition of intangible assets/lease rights	(490)	(1,617)
Net cash used in investing activities	(31,437)	(42,335)
Cash flows from financing activities:		
Proceeds from revolving credit facility	122,500	
Payments on revolving credit facility	(103,000)	
Proceeds from notes		530,000
Repurchases of notes, including tender premiums and fees		(523,660)



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Payment of debt issuance costs	(165)	(9,845)
Principal payments on capital lease	(50)	(24)
Net cash provided by (used in) financing activities	19,285	(3,529)
Effect of foreign currency exchange rate changes on cash and cash equivalents	674	(871)
Net decrease in cash and cash equivalents	(31,217)	(93,158)
Cash and cash equivalents, at beginning of period	58,343	166,956
Cash and cash equivalents, at end of period	\$ 27,126	\$ 73,798

Supplemental disclosure of cash flow information:

Interest paid	\$ 105,801	\$ 110,377
Income taxes paid	7,079	11,988

Non-cash investing activities:

Restricted cash in escrow	2,497
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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 1, 2014 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, 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.

The Unaudited Condensed Consolidated Financial Statements include certain reclassifications of prior period amounts in order to conform to current period presentation.

**2. Recent Accounting Pronouncements**

In June 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*, which updates guidance on performance stock awards. The new standard requires that a performance target that affects vesting and that could be achieved after the requisite service period is treated as a performance condition. This standard is effective for fiscal years beginning after December 15, 2015. Earlier adoption is permitted. The Company does not expect adoption of ASU 2014-12 to have a material impact on the Company's financial position, results of operations or cash flows.

In May 2014, FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

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In April 2014, the FASB issued ASU 2014-08, *Presentation of Financial Statements (Topic 250) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposal of Components of an Entity*. ASU 2014-08 provides a narrower definition of discontinued operations than under existing U.S. GAAP. ASU 2014-08 requires that only disposal of components of an entity (or groups of components) that represent a strategic shift that has or will have a major effect on the reporting entity's operations are reported in the financial statements as discontinued operations. ASU 2014-08 also provides guidance on the financial statement presentations and disclosures of discontinued operations. ASU 2014-08 is effective prospectively for disposals of components of an entity that occur in annual or interim periods beginning after December 15, 2014. Early adoption is permitted only for disposals that have not been previously reported. The Company early adopted ASU 2014-08 which did not have a material 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 financial assets (liabilities) measured at fair value on a recurring basis.

**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, restricted cash, accounts receivable, current liabilities, revolving credit facility and long-term debt. Cash and cash equivalents, restricted cash, accounts receivable and current liabilities approximate fair market value due to the relatively short maturity of these financial instruments.

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 revolving credit facility approximates fair value due to the variable component of its interest rate. The estimated fair value of the Company's long-term debt was approximately \$2.15 billion as of August 2, 2014, 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 \$2.36 billion as of February 1, 2014, compared to a carrying value of \$2.38 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.

**Table of Contents****4. Debt**

Debt as of August 2, 2014 and February 1, 2014 included the following components (in thousands):

	<b>August 2, 2014</b>	<b>February 1, 2014</b>
Senior secured revolving credit facility due 2017	\$ 19,500	\$
Long-term debt:		
10.5% Senior subordinated notes due 2017	\$ 259,612	\$ 259,612
9.0% Senior secured first lien notes due 2019		
(1)	1,138,045	1,139,174
8.875% Senior secured second lien notes due 2019	450,000	450,000
6.125% Senior secured first lien notes due 2020	210,000	210,000
7.75% Senior notes due 2020	320,000	320,000
Long-term debt	\$ 2,377,657	\$ 2,378,786
Obligation under capital lease (including current portion)	\$ 17,181	\$ 17,232

(1) Amounts include unamortized premium of \$13,045 and \$14,174 as of August 2, 2014 and February 1, 2014, respectively.

**Credit Facility**

On April 30, 2014, the Company entered into Amendment No. 1 to its Amended and Restated Credit Agreement (as amended, the "Credit Facility"), dated as of September 20, 2012, among the Company, Claire's, Inc., the Administrative Agent and Issuing Agent named therein and the Lenders party thereto (the "Amendment"). The Amendment increased the maximum permitted Total Net Secured Leverage Ratio from 5.50:1.00 to 6.00:1.00 for purposes of the covenant described below under "Credit Facility and Note Covenants."

**Note Repurchases**

There was no debt repurchase activity for the three and six months ended August 2, 2014. 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.

**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)
9.25% Senior Fixed Rate Notes due 2015 (the Senior Fixed Rate Notes )	\$ 181,259	\$ 181,259	\$ 1,494	\$ 220,270	\$ 219,802	\$ 2,597
9.625%/10.375% Senior Toggle Notes due 2015 (the 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.

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### Credit Facility and Note Covenants

Our Credit Facility and our 10.5% Senior Subordinated Notes due 2017 (the "Senior Subordinated Notes"), 8.875% Senior Secured Second Lien Notes due 2019 (the "Senior Secured Lien Notes"), 9.0% Senior Secured First Lien Notes due 2019 (the "9.0% Senior Secured First Lien Notes"), 6.125% Senior Secured First Lien Notes due 2020 (the "6.125% Senior Secured First Lien Notes") and 7.75% Senior Notes due 2020 (the "7.75% Senior Notes") (collectively, the "Notes") contain certain covenants that, among other things, 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 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 the covenants under the Notes, however, require the Company to maintain any particular financial ratio or other measure of financial performance.

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 \$15.0 million, the Company is required to maintain, at each borrowing date measured at the end of the prior fiscal quarter (but reflecting borrowings and repayments under the Credit Facility through the measurement date) and at the end of each quarter, a maximum Total Net Secured



Leverage Ratio of 6.0:1.0 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.

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

## **5. 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.

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.

**Table of Contents****6. 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):

	<b>Foreign Currency Items</b>	<b>Derivative Instrument</b>	<b>Total</b>
Balance as of February 1, 2014	\$ (6,841)	\$ 5,732	\$ (1,109)
Other comprehensive income	963		963
Net other comprehensive income	963		963
Balance as of August 2, 2014	\$ (5,878)	\$ 5,732	\$ (146)

**7. 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 2, 2014:

	<b>Number of Shares</b>	<b>Weighted- Average Exercise Price</b>	<b>Weighted- Average Remaining Contractual Term (Years)</b>
Outstanding as of February 1, 2014	5,166,566	\$ 10.00	
Options granted	2,005,850	\$ 10.00	
Options exercised			
Options forfeited	(2,629,593)	\$ 10.00	
Options expired	(400,845)	\$ 10.00	
Outstanding as of August 2, 2014	4,141,978	\$ 10.00	5.2
Options vested and expected to vest as of August 2, 2014	3,763,102	\$ 10.00	5.1
Exercisable as of August 2, 2014	1,901,934	\$ 10.00	4.6

The weighted average grant date fair value of options granted during the six months ended August 2, 2014 and August 3, 2013 was \$0.04 and \$3.27, respectively.

During the three and six months ended August 2, 2014 and August 3, 2013, the Company recorded stock-based compensation expense (benefit) and additional paid-in capital relating to stock-based compensation of approximately \$(0.1) million, \$0.1 million, \$(0.4) million and \$0.5 million, respectively. During the three and six months ended

August 2, 2014, the Company recorded reversals of stock option expense of \$0.5 million and \$1.0 million, respectively, associated with the forfeitures of stock options, including \$0.2 million and \$0.6 million, respectively, for former executive officers. 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.

## **8. Income Taxes**

The effective income tax rate was (26.0)% and (8.1)% for the three and six months ended August 2, 2014. 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 (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.

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In April 2011, the Company received from the Canada Revenue Agency withholding tax assessments for 2003 through 2007 of approximately \$5.3 million, including penalties and interest. In July 2014, the Company received notice from the Canada Revenue Agency that the withholding tax assessments for 2003 through 2007, including penalties and interest have been reversed.

**9. 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 and the 7.75% Senior Notes on May 14, 2013 included Apollo Global Securities, LLC, 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 and the 7.75% Senior Notes, the Company paid fees in the aggregate amount of approximately \$0.2 million and \$0.4 million to Apollo Global Securities, LLC for the three and six months ended August 2, 2014.

**10. 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 for the three and six months ended August 2, 2014 and August 3, 2013 are as follows (in thousands):

	Three Months Ended August 2, 2014	Three Months Ended August 3, 2013	Six Months Ended August 2, 2014	Six Months Ended August 3, 2013
Net sales:				
North America	\$ 212,458	\$ 219,317	\$ 426,656	\$ 445,274
Europe	165,371	147,386	304,516	275,435
Total net sales	377,829	366,703	731,172	720,709
Depreciation and amortization:				
North America	10,838	9,935	28,022	19,464
Europe	6,962	6,218	13,242	12,314
Total depreciation and amortization	17,800	16,153	41,264	31,778

Operating income for reportable segments:				
North America	20,071	28,198	31,865	61,722
Europe	20,338	17,013	26,881	16,993
Total operating income for reportable segments				
	40,409	45,211	58,746	78,715
Severance and transaction-related costs	2,182	889	3,764	1,804
Consolidated operating income				
	38,227	44,322	54,982	76,911
Loss on early debt extinguishment		3,121		4,795
Interest expense, net	54,557	57,755	109,316	115,974
Consolidated loss before income tax expense				
	\$ (16,330)	\$ (16,554)	\$ (54,334)	\$ (43,858)

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Excluded from operating income for the North America segment are severance and transaction-related costs of approximately \$1.1 million and \$0.6 million for the three months ended August 2, 2014 and August 3, 2013, respectively, and \$1.9 million and \$1.2 million for the six months ended August 2, 2014 and August 3, 2013, respectively.

Excluded from operating loss for the Europe segment are severance and transaction-related costs of approximately \$1.1 million and \$0.3 million for the three months ended August 2, 2014 and August 3, 2013, respectively, and \$1.9 million and \$0.6 million for the six months ended August 2, 2014 and August 3, 2013, respectively.

**11. Supplemental Financial Information**

On May 29, 2007, the Issuer issued \$335.0 million of 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, (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 (collectively, 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 2, 2014 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.

**Table of Contents****Condensed Consolidating Balance Sheet****August 2, 2014****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ 1,367	\$ 6,486	\$ 19,273	\$	\$ 27,126
Inventories		96,906	73,767		170,673
Prepaid expenses	848	2,092	19,725		22,665
Other current assets		20,543	7,493		28,036
Total current assets	2,215	126,027	120,258		248,500
Property and equipment:					
Furniture, fixtures and equipment	4,250	160,116	91,935		256,301
Leasehold improvements	1,335	193,302	147,032		341,669
	5,585	353,418	238,967		597,970
Less accumulated depreciation and amortization	(3,260)	(226,026)	(132,776)		(362,062)
	2,325	127,392	106,191		235,908
Leased property under capital lease:					
Land and building		18,055			18,055
Less accumulated depreciation and amortization		(4,062)			(4,062)
		13,993			13,993
Intercompany receivables		194,054		(194,054)	
Investment in subsidiaries	2,197,415	(51,515)		(2,145,900)	
Goodwill		1,235,650	314,406		1,550,056
Intangible assets, net	286,000	1,871	249,164		537,035
Deferred financing costs, net	35,649				35,649
Restricted cash			2,417		2,417
Other assets	412	4,096	48,775		53,283
	2,519,476	1,384,156	614,762	(2,339,954)	2,178,440

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Total assets	\$ 2,524,016	\$ 1,651,568	\$ 841,211	\$ (2,339,954)	\$ 2,676,841
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**LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)**

Current liabilities:

Revolving credit facility	\$ 19,500	\$	\$	\$	\$ 19,500
Trade accounts payable	1,057	24,684	43,537		69,278
Income taxes payable		(118)	1,628		1,510
Accrued interest payable	68,862				68,862
Accrued expenses and other current liabilities	6,432	39,071	52,016		97,519
Total current liabilities	95,851	63,637	97,181		256,669
Intercompany payables	191,662		2,393	(194,055)	
Long-term debt	2,377,657				2,377,657
Obligation under capital lease		17,043			17,043
Deferred tax liability		107,131	12,216		119,347
Deferred rent expense		22,196	11,345		33,541
Unfavorable lease obligations and other long-term liabilities		13,590	148		13,738
	2,569,319	159,960	26,102	(194,055)	2,561,326

Stockholder's equity (deficit):

Common stock		367	2	(369)	
Additional paid in capital	619,126	1,435,909	797,655	(2,233,564)	619,126
Accumulated other comprehensive income (loss), net of tax	(146)	1,024	(4,981)	3,957	(146)
Accumulated deficit	(760,134)	(9,329)	(74,748)	84,077	(760,134)
	(141,154)	1,427,971	717,928	(2,145,899)	(141,154)

Total liabilities and stockholder's equity (deficit)	\$ 2,524,016	\$ 1,651,568	\$ 841,211	\$ (2,339,954)	\$ 2,676,841
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**Table of Contents****Condensed Consolidating Balance Sheet****February 1, 2014****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ 9,911	\$ 4,055	\$ 44,377	\$	\$ 58,343
Inventories		100,292	78,590		178,882
Prepaid expenses	443	2,023	17,005		19,471
Other current assets	644	16,953	8,708		26,305
Total current assets	10,998	123,323	148,680		283,001
Property and equipment:					
Furniture, fixtures and equipment	6,956	164,902	88,851		260,709
Leasehold improvements	1,471	189,407	144,980		335,858
	8,427	354,309	233,831		596,567
Less accumulated depreciation and amortization	(4,625)	(220,617)	(122,166)		(347,408)
	3,802	133,692	111,665		249,159
Leased property under capital lease:					
Land and building		18,055			18,055
Less accumulated depreciation and amortization		(3,611)			(3,611)
		14,444			14,444
Intercompany receivables		158,450		(158,450)	
Investment in subsidiaries	2,199,771	(49,924)		(2,149,847)	
Goodwill		1,235,650	314,406		1,550,056
Intangible assets, net	286,000	2,471	252,624		541,095
Deferred financing costs, net	39,481				39,481
Other assets	74	3,890	50,433	(1)	54,396
	2,525,326	1,350,537	617,463	(2,308,298)	2,185,028
Total assets	\$ 2,540,126	\$ 1,621,996	\$ 877,808	\$ (2,308,298)	\$ 2,731,632

**LIABILITIES AND  
STOCKHOLDER'S EQUITY  
(DEFICIT)**

Current liabilities:					
Trade accounts payable	\$ 10,630	\$ 33,800	\$ 39,934	\$	\$ 84,364
Income taxes payable		33	3,696		3,729
Accrued interest payable	68,338				68,338
Accrued expenses and other current liabilities	7,405	36,669	50,653		94,727
Total current liabilities	86,373	70,502	94,283		251,158
Intercompany payables	158,000		451	(158,451)	
Long-term debt	2,378,786				2,378,786
Obligation under capital lease		17,124			17,124
Deferred tax liability		106,890	12,674		119,564
Deferred rent expense		20,609	11,391		32,000
Unfavorable lease obligations and other long-term liabilities		15,812	221		16,033
	2,536,786	160,435	24,737	(158,451)	2,563,507
Stockholder's equity (deficit):					
Common stock		367	2	(369)	
Additional paid in capital	619,499	1,435,909	797,836	(2,233,745)	619,499
Accumulated other comprehensive income (loss), net of tax	(1,109)	205	(4,779)	4,574	(1,109)
Accumulated deficit	(701,423)	(45,422)	(34,271)	79,693	(701,423)
	(83,033)	1,391,059	758,788	(2,149,847)	(83,033)
Total liabilities and stockholder's equity (deficit)	\$ 2,540,126	\$ 1,621,996	\$ 877,808	\$ (2,308,298)	\$ 2,731,632

**Table of Contents****Condensed Consolidating Statement of Operations and Comprehensive Loss****For The Three Months Ended August 2, 2014****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$	\$ 195,933	\$ 181,896	\$	\$ 377,829
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	(1,269)	100,785	90,219		189,735
Gross profit	1,269	95,148	91,677		188,094
Other expenses:					
Selling, general and administrative	3,549	64,103	61,562		129,214
Depreciation and amortization	714	9,247	7,839		17,800
Severance and transaction-related costs	1,073	0	1,109		2,182
Other (income) expense	(1,968)	(4)	2,643		671
	3,368	73,346	73,153		149,867
Operating income (loss)	(2,099)	21,802	18,524		38,227
Interest expense, net	54,006	558	(7)		54,557
Income (loss) before income taxes	(56,105)	21,244	18,531		(16,330)
Income tax expense		706	3,538		4,244
Income (loss) from continuing operations	(56,105)	20,538	14,993		(20,574)
Equity in earnings (loss) of subsidiaries	35,531	(98)		(35,433)	
Net income (loss)	(20,574)	20,440	14,993	(35,433)	(20,574)
Foreign currency translation adjustments	(1,606)	170	(1,963)	1,793	(1,606)
Net gain (loss) on intra-entity foreign currency transactions, net of tax	(3,841)	166	(3,860)	3,694	(3,841)
Other comprehensive income (loss)	(5,447)	336	(5,823)	5,487	(5,447)
Comprehensive income (loss)	\$ (26,021)	\$ 20,776	\$ 9,170	\$ (29,946)	\$ (26,021)

**Condensed Consolidating Statement of Operations and Comprehensive 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)

**Table of Contents****Condensed Consolidating Statement of Operations and Comprehensive Loss****For The Six Months Ended August 2, 2014****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$	\$ 394,364	\$ 336,808	\$	\$ 731,172
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	515	203,797	172,493		376,805
Gross profit (deficit)	(515)	190,567	164,315		354,367
Other expenses:					
Selling, general and administrative	7,516	125,801	121,855		255,172
Depreciation and amortization	1,999	21,558	17,707		41,264
Severance and transaction-related costs	1,697	1	2,066		3,764
Other (income) expense	(4,141)	(26)	3,352		(815)
	7,071	147,334	144,980		299,385
Operating income (loss)	(7,586)	43,233	19,335		54,982
Interest expense, net	108,226	1,097	(7)		109,316
Income (loss) before income taxes	(115,812)	42,136	19,342		(54,334)
Income tax expense (benefit)		(1,041)	5,418		4,377
Income (loss) from continuing operations	(115,812)	43,177	13,924		(58,711)
Equity in earnings (loss) of subsidiaries	57,101	(1,171)		(55,930)	
Net income (loss)	(58,711)	42,006	13,924	(55,930)	(58,711)
Foreign currency translation adjustments	181	295	(994)	699	181
Net gain on intra-entity foreign currency transactions, net of tax	782	524	792	(1,316)	782
Other comprehensive income (loss)	963	819	(202)	(617)	963
Comprehensive income (loss)	\$ (57,748)	\$ 42,825	\$ 13,722	\$ (56,547)	\$ (57,748)

**Condensed Consolidating Statement of Operations and Comprehensive 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 loss	(7,057)	(1,359)	(4,615)	5,974	(7,057)
Comprehensive income (loss)	\$ (54,313)	\$ 62,108	\$ 10,971	\$ (73,079)	\$ (54,313)

**Table of Contents****Condensed Consolidating Statement of Cash Flows****Six Months Ended August 2, 2014****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Cash flows from operating activities:</b>					
Net income (loss)	\$ (58,711)	\$ 42,006	\$ 13,924	\$ (55,930)	\$ (58,711)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity in earnings (loss) of subsidiaries	(57,101)	1,171		55,930	
Depreciation and amortization	1,999	21,558	17,707		41,264
Amortization of lease rights and other assets			2,021		2,021
Amortization of debt issuance costs	3,998				3,998
Accretion of debt premium	(1,129)				(1,129)
Net accretion of unfavorable lease obligations		(242)	(22)		(264)
Loss on sale/retirement of property and equipment, net		90	2		92
Loss on sale of intangible assets/lease rights			216		216
Stock-based compensation (benefit) expense	(620)	115	132		(373)
<b>(Increase) decrease in:</b>					
Inventories		3,386	5,208		8,594
Prepaid expenses	(405)	(69)	(2,501)		(2,975)
Other assets	306	(3,559)	1,050		(2,203)
<b>Increase (decrease) in:</b>					
Trade accounts payable	(9,572)	(3,492)	4,059		(9,005)
Income taxes payable		(148)	(2,103)		(2,251)
Accrued interest payable	524				524
Accrued expenses and other liabilities	(974)	989	(1,160)		(1,145)
Deferred income taxes			194		194
Deferred rent expense		1,587	(173)		1,414
Net cash provided by (used in) operating activities	(121,685)	63,392	38,554		(19,739)
<b>Cash flows from investing activities:</b>					
Acquisition of property and equipment	(522)	(20,459)	(9,966)		(30,947)

Acquisition of intangible assets/lease rights		(59)	(431)	(490)
Net cash used in investing activities	(522)	(20,518)	(10,397)	(31,437)
Cash flows from financing activities:				
Proceeds from revolving credit facility	122,500			122,500
Payments on revolving credit facility	(103,000)			(103,000)
Payment of debt issuance costs	(165)			(165)
Principal payments on capital lease		(50)		(50)
Intercompany activity, net	94,329	(41,514)	(52,815)	
Net cash provided by (used in) financing activities	113,664	(41,564)	(52,815)	19,285
Effect of foreign currency exchange rate changes on cash and cash equivalents	(1)	1,121	(446)	674
Net increase (decrease) in cash and cash equivalents	(8,544)	2,431	(25,104)	(31,217)
Cash and cash equivalents, at beginning of period	9,911	4,055	44,377	58,343
Cash and cash equivalents, at end of period	1,367	6,486	19,273	27,126



**Table of Contents****Condensed Consolidating Statement of Cash Flows****Six Months Ended August 3, 2013****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
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 (benefit) 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)	(7,162)	(5,366)		(14,407)
Deferred income taxes			(120)		(120)
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)

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Net cash used in investing activities	(1,153)	(25,554)	(15,628)	(42,335)
<b>Cash flows from financing activities:</b>				
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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### **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, 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 one week or more. The removal is effective prospectively upon the completion of the first fiscal 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.

### **Results of Consolidated Operations**

#### **Management 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 2, 2014, we operated a total of 3,052 owned stores, of which 1,880 were located in all 50 states of the United States, Puerto Rico, Canada, and the U.S. Virgin Islands (North America segment) and 1,172 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*®. In January 2014, we made a decision to close our China stores and closed all of our 17 company-operated stores by May 4, 2014.

As of August 2, 2014 we also franchised or licensed 436 stores in Japan, the Middle East, Turkey, Greece, Guatemala, Malta, Ukraine, Mexico, India, Dominican Republic, El Salvador, Venezuela, Panama, Honduras, Indonesia, Philippines, Costa Rica, Colombia, Serbia, Sweden, Romania and Bulgaria. 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-operated 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-operated 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.

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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 as well as our ear piercing service, necklaces, bracelets, body jewelry and rings; and

**Accessories:** Includes hairgoods; beauty products; personal, fashion, and seasonal accessories, including tech accessories, holders, phone cases, stationery, key rings, DIY kits, attitude glasses, headwear, legwear, armwear, and sunglasses; and handbags and small leather goods.

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.

Financial activity for the three and six months ended August 2, 2014 includes the following:

Net sales increase of 3.0% and 1.5%, respectively.

Same store sales percentages:

	<b>Three Months Ended August 2, 2014</b>	<b>Six Months Ended August 2, 2014</b>
Consolidated	(0.6)%	(2.5)%
North America	(2.9)%	(4.3)%
Europe	2.5%	0.2%

Operating income margin of 10.1% and 7.5%, respectively.

Operational activity for the three and six months ended August 2, 2014 includes the following:

Opened 11 and 26, respectively, new company-operated stores.

Closed 30 and 88, respectively, company-operated stores due to underperformance or lease renewal terms that did not meet our criteria, including 3 and 17 stores, respectively, in China.

A summary of our consolidated results of operations for the three and six months ended August 2, 2014 and August 3, 2013 are as follows (dollars in thousands):

<b>Three Months Ended</b>	<b>Three Months Ended</b>
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	<b>August 2, 2014</b>	<b>August 3, 2013</b>
Net sales	\$ 377,829	\$ 366,703
Decrease in same store sales	(0.6)%	(0.1)%
Gross profit percentage	49.8%	50.6%
Selling, general and administrative expenses as a percentage of net sales	34.2%	34.5%
Depreciation and amortization as a percentage of net sales	4.7%	4.4%
Operating income	\$ 38,227	\$ 44,322
Loss on early debt extinguishment	\$	\$ 3,121
Net loss	\$ (20,574)	\$ (20,672)
Number of stores at the end of the period (1)	3,052	3,094

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

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	<b>Six Months Ended August 2, 2014</b>	<b>Six Months Ended August 3, 2013</b>
Net sales	\$ 731,172	\$ 720,709
(Decrease) increase in same store sales	(2.5)%	1.3%
Gross profit percentage	48.5%	50.1%
Selling, general and administrative expenses as a percentage of net sales	34.9%	34.9%
Depreciation and amortization as a percentage of net sales	5.6%	4.4%
Operating income	\$ 54,982	\$ 76,911
Loss on early debt extinguishment	\$	\$ 4,795
Net loss	\$ (58,711)	\$ (47,256)
Number of stores at the end of the period (1)	3,052	3,094

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

*Net sales*

Net sales for the three months ended August 2, 2014 increased \$11.1 million, or 3.0%, from the three months ended August 3, 2013. The increase was attributable to new store sales of \$15.9 million, a favorable foreign currency translation effect of our non-U.S. net sales of \$8.1 million and an increase in shipments to franchisees of \$1.0 million, partially offset by the effect of store closures of \$11.7 million and a decrease in same store sales of \$2.2 million. Net sales would have increased 0.8% excluding the impact from foreign currency exchange rate changes.

Net sales for the six months ended August 2, 2014 increased \$10.5 million, or 1.5%, from the six months ended August 3, 2013. The increase was attributable to new store sales of \$32.6 million, a favorable foreign currency translation effect of our non-U.S. net sales of \$14.7 million and an increase in shipments to franchisees of \$1.7 million, partially offset by the effect of store closures of \$21.2 million and a decrease in same store sales of \$17.3 million. Net sales would have decreased 0.6% excluding the impact from foreign currency exchange rate changes.

For the three months ended August 2, 2014, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 0.6%, partially offset by an increase in average transaction value of 1.4%.

For the six months ended August 2, 2014, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 2.0%, partially offset by an increase in average transaction value of 0.6%.

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

<b>Product Category</b>	<b>Percentage of Total</b>		<b>Percentage of Total</b>	
	<b>Three Months</b>	<b>Three Months</b>	<b>Six Months</b>	<b>Six Months</b>
	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>
	<b>August 2, 2014</b>	<b>August 3, 2013</b>	<b>August 2, 2014</b>	<b>August 3, 2013</b>
Jewelry	50.3	51.8	50.3	51.5
Accessories	49.7	48.2	49.7	48.5

100.0	100.0	100.0	100.0
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**Table of Contents***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 2, 2014, gross profit percentage decreased 80 basis points to 49.8% compared to 50.6% during the three months ended August 3, 2013. The decrease in gross profit percentage consisted of a 40 basis point decrease in merchandise margin, a 30 basis point increase in occupancy costs and a 10 basis point increase in buying and buying-related costs. The decrease in merchandise margin resulted primarily from an increase in markdowns. 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 that would materially affect our merchandise margin. The increase in occupancy costs, as a percentage of net sales, was primarily caused by the deleveraging effect of a decrease in same store sales.

During the six months ended August 2, 2014, gross profit percentage decreased 160 basis points to 48.5% compared to 50.1% during the six months ended August 3, 2013. The decrease in gross profit percentage consisted of a 120 basis point increase in occupancy costs and a 40 basis point decrease in merchandise margin. The increase in occupancy costs, as a percentage of net sales, was primarily caused by the deleveraging effect of a decrease in same store sales. The decrease in merchandise margin resulted primarily from an increase in markdowns. 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 that would materially affect our merchandise margin.

*Selling, general and administrative expenses*

During the three months ended August 2, 2014, selling, general and administrative expenses increased \$2.8 million, or 2.2%, compared to the three months ended August 3, 2013. As a percentage of net sales, selling, general and administrative expenses decreased 30 basis points compared to the three months ended August 3, 2013. Excluding an unfavorable \$2.9 million foreign currency translation effect, selling, general and administrative expenses would have decreased \$0.1 million.

During the six months ended August 2, 2014, selling, general and administrative expenses increased \$3.3 million, or 1.3%, compared to the six months ended August 3, 2013. As a percentage of net sales, selling, general and administrative expenses remained unchanged compared to the six months ended August 3, 2013. Excluding an unfavorable \$5.6 million foreign currency translation effect, selling, general and administrative expenses would have decreased \$2.3 million. This decrease primarily resulted from reductions in compensation-related expenses, such as store payroll and bonus and previously recorded non-cash stock-based compensation expense.

*Depreciation and amortization expense*

During the three months ended August 2, 2014, depreciation and amortization expense increased \$1.6 million to \$17.8 million compared to \$16.2 million for the three months ended August 3, 2013. Excluding an unfavorable \$0.3 million foreign currency translation effect, the increase in depreciation and amortization expense would have been \$1.3 million.

During the six months ended August 2, 2014, depreciation and amortization expense increased \$9.5 million to \$41.3 million compared to \$31.8 million for the six months ended August 3, 2013. Excluding an unfavorable \$0.6 million foreign currency translation effect, the increase in depreciation and amortization would have been \$8.9 million.

**Table of Contents***Other (income) expense, net*

The following is a summary of other (income) expense activity for the three and six months ended August 2, 2014 and August 3, 2013 (in thousands):

	<b>Three Months Ended August 2, 2014</b>	<b>Three Months Ended August 3, 2013</b>	<b>Six Months Ended August 2, 2014</b>	<b>Six Months Ended August 3, 2013</b>
Foreign currency exchange (gain) loss, net	\$ 2,026	\$ (755)	\$ 1,769	\$ 1,274
Royalty income	(1,355)	(1,327)	(2,541)	(2,432)
Other income			(43)	
	\$ 671	\$ (2,082)	\$ (815)	\$ (1,158)

*Loss on early debt extinguishment*

There was no debt repurchase activity for the three and six months ended August 2, 2014. 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.

<b>Notes Repurchased</b>	<b>Three Months Ended August 3, 2013</b>			<b>Six Months Ended August 3, 2013</b>		
	<b>Principal Amount</b>	<b>Repurchase Price</b>	<b>Recognized Loss (1)</b>	<b>Principal Amount</b>	<b>Repurchase Price</b>	<b>Recognized Loss (2)</b>
9.25% Senior Fixed Rate Notes due 2015 (the Senior Fixed Rate Notes )	\$ 181,259	\$ 181,259	\$ 1,494	\$ 220,270	\$ 219,802	\$ 2,597
9.625%/10.375% Senior Toggle Notes due 2015 (the 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.

*Interest expense, net*

During the three months ended August 2, 2014, net interest expense aggregated \$54.6 million compared to \$57.8 million for the three months ended August 3, 2013. The decrease of \$3.2 million is primarily due to a lower rate of

interest on the indebtedness used to refinance our former Senior Fixed Rate Notes and Senior Toggle Notes.

During the six months ended August 2, 2014, net interest expense aggregated \$109.3 million compared to \$116.0 million for the six months ended August 3, 2013. The decrease of \$6.7 million is primarily due to a lower rate of interest on the indebtedness used to refinance our former Senior Fixed Rate Notes and Senior Toggle Notes.

#### *Income taxes*

The effective income tax rate for the three and six months ended August 2, 2014 was (26.0)% and (8.1)% compared to (24.9)% and (7.7)% for the three and six months ended August 3, 2013. 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 2, 2014 and August 3, 2013, 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.

**Table of Contents***North America*

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

	<b>Three Months Ended August 2, 2014</b>	<b>Three Months Ended August 3, 2013</b>	<b>Six Months Ended August 2, 2014</b>	<b>Six Months Ended August 3, 2013</b>
Net sales	\$ 212,458	\$ 219,317	\$ 426,656	\$ 445,274
(Decrease) increase in same store sales	(2.9)%	1.1%	(4.3)%	1.7%
Gross profit percentage	49.1%	51.7%	48.0%	51.7%
Number of stores at the end of the period (1)	1,880	1,925	1,880	1,925

(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 2, 2014, net sales in North America decreased \$6.9 million, or 3.1%, from the three months ended August 3, 2013. The decrease was attributable to the effect of store closures of \$6.5 million, a decrease in same store sales of \$5.9 million and an unfavorable foreign currency translation effect of our non-U.S. net sales of \$0.8 million, partially offset by new store sales of \$5.3 million and an increase in shipments to franchisees of \$1.0 million. Sales would have decreased 2.8% excluding the impact from foreign currency exchange rate changes.

During the six months ended August 2, 2014, net sales in North America decreased \$18.6 million, or 4.2%, from the six months ended August 3, 2013. The decrease was attributable to a decrease in same store sales of \$17.9 million, the effect of store closures of \$12.0 million and an unfavorable foreign currency translation effect of our non-U.S. net sales of \$2.2 million, partially offset by new store sales of \$11.8 million and increased shipments to franchisees of \$1.7 million. Sales would have decreased 3.7% excluding the impact from foreign currency exchange rate changes.

For the three months ended August 2, 2014, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 0.9% and a decrease in average transaction value of 0.8%.

For the six months ended August 2, 2014, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 2.8% and a decrease in average transaction value of 0.6%.

During the three months ended August 2, 2014, gross profit percentage decreased 260 basis points to 49.1% compared to 51.7% during the three months ended August 3, 2013. The decrease in gross profit percentage consisted of a 150 basis point decrease in merchandise margin and a 110 basis point increase in occupancy costs. The decrease in merchandise margin resulted primarily from an increase in markdowns and lower initial markups. 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 that would materially affect our merchandise margin. The increase in occupancy costs, as a percentage of net sales, was primarily caused by the deleveraging effect of a decrease in same store sales.

During the six months ended August 2, 2014, gross profit percentage decreased 370 basis points to 48.0% compared to 51.7% during the six months ended August 3, 2013. The gross profit percentage consisted of a 200 basis point

increase in occupancy costs and a 170 basis point decrease in merchandise margin. The increase in occupancy costs, as a percentage of net sales, was primarily caused by the deleveraging effect of a decrease in same store sales. The decrease in merchandise margin resulted primarily from an increase in markdowns. 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 that would materially affect our merchandise margin.

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

<b>Product Category</b>	<b>Percentage of Total Three Months Ended August 2, 2014</b>	<b>Percentage of Total Three Months Ended August 3, 2013</b>	<b>Percentage of Total Six Months Ended August 2, 2014</b>	<b>Percentage of Total Six Months Ended August 3, 2013</b>
Jewelry	55.4	57.5	55.5	56.5
Accessories	44.6	42.5	44.5	43.5
	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):

	<b>Three Months Ended August 2, 2014</b>	<b>Three Months Ended August 3, 2013</b>	<b>Six Months Ended August 2, 2014</b>	<b>Six Months Ended August 3, 2013</b>
Net sales	\$ 165,371	\$ 147,386	\$ 304,516	\$ 275,435
Increase (decrease) in same store sales	2.5%	(2.0)%	0.2%	0.7%
Gross profit percentage	50.6%	49.1%	49.1%	47.6%
Number of stores at the end of the period (1)	1,172	1,169	1,172	1,169

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

During the three months ended August 2, 2014, net sales in Europe increased \$18.0 million, or 12.2%, from the three months ended August 3, 2013. The increase was attributable to new store sales of \$10.6 million, a favorable foreign currency translation effect of our non-U.S. net sales of \$8.9 million and an increase of same store sales of \$3.7 million, partially offset by the effect of store closures of \$5.2. Sales would have increased 5.8% excluding the impact from foreign currency exchange rate changes.

During the six months ended August 2, 2014, net sales in Europe increased \$29.1 million, or 10.6%, from the six months ended August 3, 2013. The increase was attributable to new store sales of \$20.8 million, a favorable foreign currency translation effect of our non-U.S. net sales of \$16.9 million and an increase in same store sales of \$0.6 million, partially offset by the effect of store closures of \$9.2 million. Sales would have increased 4.2% excluding the impact from foreign currency exchange rate changes.

For the three months ended August 2, 2014, the increase in same store sales was primarily attributable to an increase in average transaction value of 4.7%, partially offset by a decrease in average number of transactions per store of 1.0%.

For the six months ended August 2, 2014, the increase in same store sales was primarily attributable to an increase in average transaction value of 3.1%, partially offset by a decrease in average number of transactions per store of 1.8%.

During the three months ended August 2, 2014, gross profit percentage increased 150 basis points to 50.6% compared to 49.1% during the three months ended August 3, 2013. The increase in gross profit percentage consisted of a 90 basis point increase in merchandise margin and a decrease of 80 basis points in occupancy costs, partially offset by a 20 basis point increase in buying and buying-related costs. The increase in merchandise margin resulted primarily from a decrease in markdowns partially offset by higher 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 increase in occupancy costs, as a percentage of net sales, was primarily caused by the leveraging effect of an increase in same store sales.

During the six months ended August 2, 2014, gross profit percentage increased 150 basis points to 49.1% compared to 47.6% during the six months ended August 3, 2013. The increase in gross profit percentage consisted of a 140 basis point increase in merchandise margin and a 20 basis point decrease in occupancy costs, partially offset by a 10 basis point increase in buying and buying-related costs. The increase in merchandise margin resulted primarily from a decrease in markdowns and higher initial markups.



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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 that would materially affect our merchandise margin. The decrease increase in occupancy costs, as a percentage of net sales, was primarily caused by 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:

Product Category	Percentage of Total		Percentage of Total	
	Three Months	Three Months	Six Months	Six Months
	Ended	Ended	Ended	Ended
	August 2, 2014	August 3, 2013	August 2, 2014	August 3, 2013
Jewelry	43.8	43.6	43.2	43.7
Accessories	56.2	56.4	56.8	56.3
	100.0	100.0	100.0	100.0

**Liquidity and Capital Resources**

We anticipate that cash generated from operations, borrowings under our \$115.0 million Credit Facility (as described below) and future refinancings of our indebtedness will be sufficient to allow us to satisfy payments of interest and principal on our indebtedness as they become due, to fund new store expenditures, and future working capital requirements in both the next twelve months and over the longer term. Interest on the outstanding Notes (as described below) will be approximately \$206.1 million in Fiscal 2014, and we expect to fund these interest payments through a combination of cash from operations and borrowings under our Credit Facility. No principal is due on the Notes until Fiscal 2017, when our Senior Subordinated Notes will mature. We expect to pay the outstanding principal amount of these Notes at maturity through a combination of new indebtedness, cash from operations and other available sources. In addition, we anticipate the cash generated from operations and borrowings under the Credit Facility will be sufficient to allow us to fund new store expenditures and future working capital requirements in both the next twelve months and over the longer term. However, our ability to make interest payments and meet operational liquidity needs, as well as our ability to refinance the Senior Subordinated Notes when they mature in Fiscal 2017, will depend, in part, on our future operating performance. Our future operating performance and liquidity, as well as our ability to refinance our indebtedness, 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 1, 2014.

A summary of cash flows provided by (used in) operating, investing and financing activities for the six months ended August 2, 2014 and August 3, 2013 is outlined in the table below (in thousands):

	Six Months	Six Months
	Ended	Ended
	August 2, 2014	August 3, 2013
Operating activities	\$ (19,739)	\$ (46,423)
Investing activities	(31,437)	(42,335)
Financing activities	19,285	(3,529)

*Cash flows from operating activities*

For the six months ended August 2, 2014, cash used in operations decreased \$26.7 million compared to the prior year period. The primary reason for the decrease was a decrease in working capital, excluding cash and cash equivalents, of \$28.4 million, a decrease in tax payments and other items of \$6.5 million, and a decrease in interest payments of \$4.6 million, partially offset by a net decrease in operating income, of \$12.8 million.

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*Cash flows from investing activities*

For the six months ended August 2, 2014, cash used in investing activities was \$31.4 million and primarily consisted of \$31.4 million for capital expenditures. For the six months ended August 3, 2013, cash used in investing activities was \$42.3 million and primarily consisted of \$42.3 million for capital expenditures. During the remainder of Fiscal 2014, we expect to fund approximately \$10.0 million of capital expenditures.

*Cash flows from financing activities*

For the six months ended August 2, 2014, cash provided by financing activities was \$19.3 million, which consisted primarily of net borrowings of \$19.5 million under the revolving Credit Facility, partially offset by payment of \$0.2 million in financing costs. 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.

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 2, 2014, we had cash and cash equivalents of \$27.1 million and all cash equivalents were maintained in one money market fund invested exclusively in U.S. Treasury Securities.

As of August 2, 2014, our foreign subsidiaries held cash and cash equivalents of \$19.3 million. During the six months ended August 2, 2014, we repatriated cash held by foreign subsidiaries but did not accrue U.S. income taxes since the amount of our remaining U.S. net operating loss carry forwards was sufficient to offset the associated income tax liability. During the remainder of Fiscal 2014, 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 2, 2014, we do not expect to pay U.S. income tax on future Fiscal 2014 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, borrowings under our Credit Facility (as described below), and future refinancings of our indebtedness will be sufficient to allow us to satisfy payments of interest and principal on our indebtedness as they become due, to fund new store expenditures, and future working capital requirements in both the next twelve months and over the longer term. However, this will depend, in part, on our future operating performance. Our future operating performance and liquidity, as well as our ability to refinance our indebtedness, may 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 1, 2014.

*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 (as amended, 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, maturing September 20, 2017. On April 30, 2014, the Company entered into Amendment No. 1 to its Credit Facility (the Amendment ). The Amendment increased the maximum permitted Total Net Secured Leverage Ratio from 5.50:1.00 to 6.00:1.00 for purposes of the covenant described below.

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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 6.125% Senior Secured First Lien Notes and the 9.0% Senior Secured First Lien Notes due 2019 (the "9.0% Senior Secured First Lien Notes").

The Credit Facility 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 are required to maintain, at each borrowing date measured at the end of the prior fiscal quarter (but reflecting borrowings and repayments under the Credit Facility through the measurement date) and at the end of each fiscal quarter, a maximum Total Net Secured Leverage Ratio of 6.0:1.0 based upon the ratio of our 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 2, 2014, our revolving loans and letters of credit outstanding exceeded \$15.0 million, and our Total Net Secured Leverage Ratio was 5.1:1.0.

The Credit Facility also contains various covenants that limit our ability to engage in specified types of transactions. These covenants, subject to certain exceptions and other basket amounts, limit our and our 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 2, 2014, we were in compliance with the covenants.

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As of August 2, 2014, we had \$19.5 million of borrowings and \$3.3 million of letters of credit outstanding, which reduces the borrowing availability under the Credit Facility to \$92.2 million as of that date.

### *Note Covenants*

Our 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") also contain various covenants that limit our ability to engage in specified types of transactions. These covenants, subject to certain exceptions and other basket amounts, limit our and our subsidiaries' ability to, among other things:

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 2, 2014, we were in compliance with the covenants under the Notes.

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*Europe Credit Facilities*

Our non-U.S. subsidiaries have bank credit facilities totaling \$2.5 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 2, 2014, we had a reduction of \$2.4 million of outstanding bank guarantees under this facility, which reduces the borrowing availability to \$0.1 million as of that date.

*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 2013 Annual Report on Form 10-K, filed on April 2, 2014, 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.

**Recent Accounting Pronouncements**

See Note 2 – Recent Accounting Pronouncements, in the Notes to 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, for similar expressions. Some of these risks, uncertainties and other factors are as follows: our level of indebtedness; general economic conditions; changes in consumer preferences and consumer spending; unwillingness of vendors and service providers to supply goods or services pursuant to historical customary credit arrangements; 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 other 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; increase in our cost of merchandise; significant increases in our merchandise markdowns; inability to grow our Company operated store base in North America and Europe, or expand

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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; results from any future asset impairment analysis; changes in applicable laws, rules and regulations, including changes in North America and Europe, 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 anti-bribery laws; changes in employment laws, including 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; 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 2013 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, excluding restricted cash, at financial institutions that are in excess of federally insured limits. With the current financial environment, 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 2, 2014, all cash equivalents were maintained in one money market fund that was invested exclusively in U.S. Treasury securities and our restricted cash was deposited with a significant and credit worthy financial institution.

*Interest Rates*

As of August 2, 2014, we had fixed rate debt of \$2,377.7 million and variable rate debt of \$19.5 million. Based on our variable rate balance as of August 2, 2014, a 1% change in interest rates would increase or decrease our annual interest expense by approximately \$0.2 million.

*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 2, 2014, 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 income (loss) are \$1.0 million and \$(7.1) 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 2, 2014 and August 3, 2013, 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

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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 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. See also Cautionary Note Regarding Forward Looking Statements and Risk Factors.

**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 and 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 2, 2014, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****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 1, 2014.

**Item 6. Exhibits**

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.

**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, 2014

By: /s/ Beatrice Lafon  
Beatrice Lafon, Chief Executive Officer (principal executive officer)

August 29, 2014

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**

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