

TILLY'S, INC.  
Form 10-Q  
December 04, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

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

For the quarterly period ended October 27, 2012

OR

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

For the transition period from            to

Commission file number: 001-35535

**TILLY S, INC.**

(Exact name of Registrant as specified in its charter)

Edgar Filing: TILLY'S, INC. - Form 10-Q

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

**45-2164791**  
(I.R.S. Employer  
Identification No.)

**10 Whatney**

**Irvine, CA 92618**

(Address of principal executive offices)

**(949) 609-5599**

(Registrant's telephone number, including area 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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (do not check if a smaller reporting company)

Smaller reporting company

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

As of October 27, 2012, the registrant had the following shares of common stock outstanding:

Class A common stock \$0.001 par value	9,281,625
Class B common stock \$0.001 par value	18,400,000

**Table of Contents**

**TILLY S, INC.**

**FORM 10-Q**

**For the Quarter Ended October 27, 2012**

**Index**

	<b>Page</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. <u>Financial Statements (Unaudited)</u>	
<u>Consolidated Balance Sheets as of October 27, 2012 and January 28, 2012</u>	3
<u>Consolidated Statements of Income for the Thirteen and Thirty-Nine Weeks Ended October 27, 2012 and October 29, 2011</u>	4
<u>Consolidated Statements of Comprehensive Income for the Thirteen and Thirty-Nine Weeks Ended October 27, 2012 and October 29, 2011</u>	4
<u>Consolidated Statement of Stockholders' Equity as of October 27, 2012</u>	5
<u>Consolidated Statements of Cash Flows for the Thirteen and Thirty-Nine Weeks Ended October 27, 2012 and October 29, 2011</u>	6
<u>Notes to the Consolidated Financial Statements for the Thirteen and Thirty-Nine Weeks Ended October 27, 2012 and October 29, 2011</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
Item 4. <u>Controls and Procedures</u>	33
<b>PART II. OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	34
Item 1A. <u>Risk Factors</u>	34
Item 6. <u>Exhibits</u>	35

**Table of Contents****Part I. Financial Information****Item 1. Financial Statements (Unaudited)****TILLY S, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share data)

(Unaudited)

	October 27, 2012	January 28, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 24,883	\$ 25,091
Marketable securities	24,891	
Receivables	8,139	6,605
Merchandise inventories	49,870	36,531
Prepaid expenses and other current assets	10,405	5,616
Total current assets	118,188	73,843
Property and equipment, net	74,869	64,077
Other assets	3,902	2,899
Total assets	\$ 196,959	\$ 140,819
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 25,307	\$ 16,830
Deferred revenue	3,490	4,865
Accrued compensation and benefits	6,464	7,536
Accrued expenses	9,849	12,935
Current portion of deferred rent	4,327	3,335
Current portion of capital lease obligation/Related party (Note 10)	701	669
Total current liabilities	50,138	46,170
Long-term portion of deferred rent	36,699	30,256
Long-term portion of capital lease obligation/Related party (Note 10)	3,440	3,969
Total long-term liabilities	40,139	34,225
Total liabilities	90,277	80,395
Commitments and contingencies (Note 9)		
Stockholders equity:		
Common stock, \$0.001 par value; October 27, 2012 - no shares authorized, issued or outstanding; January 28, 2012 - 21,600 shares authorized, 20,000 shares issued and outstanding		20
Common stock (Class A), \$0.001 par value; October 27, 2012 - 100,000 shares authorized, 9,282 shares issued and outstanding; January 28, 2012 - 100,000 shares authorized, 1 shares issued and outstanding	9	
Common stock (Class B), \$0.001 par value; October 27, 2012 - 35,000 shares authorized, 18,400 shares issued and outstanding; January 28, 2012 - 35,000 shares authorized, no shares issued or outstanding	18	

## Edgar Filing: TILLY'S, INC. - Form 10-Q

Preferred stock, \$0.001 par value; October 27, 2012 and January 28, 2012 - 10,000 shares authorized, no shares issued or outstanding

Additional paid-in capital	116,630	150
Retained earnings (deficit)	(9,981)	60,254
Accumulated other comprehensive income	6	
Total stockholders' equity	106,682	60,424
Total liabilities and stockholders' equity	\$ 196,959	\$ 140,819

*The accompanying notes are an integral part of these consolidated financial statements.*

**Table of Contents****TILLY S, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share data)

(Unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Net sales	\$ 124,895	\$ 107,304	\$ 326,521	\$ 277,695
Cost of goods sold (includes buying, distribution, and occupancy costs)	83,087	71,446	223,150	189,910
Gross profit	41,808	35,858	103,371	87,785
Selling, general and administrative expenses	27,940	23,514	86,795	66,915
Operating income	13,868	12,344	16,576	20,870
Interest expense, net	42	49	46	150
Income before income taxes	13,826	12,295	16,530	20,720
Income tax provision	4,532	140	2,478	236
Net income	\$ 9,294	\$ 12,155	\$ 14,052	\$ 20,484
Basic earnings per share	\$ 0.34	\$ 0.61	\$ 0.56	\$ 1.02
Diluted earnings income per share	\$ 0.33	\$ 0.59	\$ 0.55	\$ 1.00
Weighted average basic shares outstanding	27,658	20,000	24,979	20,000
Weighted average diluted shares outstanding	28,079	20,530	25,403	20,489
Pro forma income information (Note 1):				
Historical income before income taxes	\$ 13,826	\$ 12,295	\$ 16,530	\$ 20,720
Pro forma income tax provision	5,530	4,918	6,612	8,288
Pro forma net income	\$ 8,296	\$ 7,377	\$ 9,918	\$ 12,432
Pro forma basic earnings per share	\$ 0.30	\$ 0.37	\$ 0.40	\$ 0.62
Pro forma diluted earnings per share	\$ 0.30	\$ 0.36	\$ 0.39	\$ 0.61

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)

(Unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Net income	\$ 9,294	\$ 12,155	\$ 14,052	\$ 20,484
Other comprehensive income:				
Unrealized gain on available-for-sale securities, net of tax of \$4	6		6	

Edgar Filing: TILLY'S, INC. - Form 10-Q

Other comprehensive income	6		6	
Comprehensive income	\$ 9,300	\$ 12,155	\$ 14,058	\$ 20,484

*The accompanying notes are an integral part of these consolidated financial statements.*

**Table of Contents****TILLY S, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(In thousands)

(Unaudited)

	Number of Shares				Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total Stockholders Equity
	Common Stock (Class A)	Common Stock (Class B)	Common Stock (WOJT)	Common Stock				
Balance at January 28, 2012			20,000	\$ 20	\$ 150	\$ 60,254	\$	\$ 60,424
Net income						14,052		\$ 14,052
Reorganization (see Note 1)		20,000	(20,000)					\$
Issuance of stock in IPO, net of costs	9,200	(1,600)		7	106,782			\$ 106,789
Distributions to S Corporation shareholders						(84,287)		\$ (84,287)
Change in unrealized gain on available-for-sale securities, net of tax of \$4							6	\$ 6
Stock-based compensation expense					8,893			\$ 8,893
Exercise of stock options, including tax benefit of \$83	82				805			\$ 805
Balance at October 27, 2012	9,282	18,400		\$ 27	\$ 116,630	\$ (9,981)	\$ 6	\$ 106,682

*The accompanying notes are an integral part of these consolidated financial statements.*



**Table of Contents****TILLY S, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Thirty-Nine Weeks Ended</b>	
	<b>October 27, 2012</b>	<b>October 29, 2011</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 14,052	\$ 20,484
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,299	11,255
Loss on disposal of assets	153	227
Loss on sales of marketable securities	28	
Deferred income taxes	6,325	
Stock-based compensation expense	8,893	
Excess tax benefit from stock-based compensation	(94)	
Changes in operating assets and liabilities:		
Receivables	(2,184)	(680)
Merchandise inventories	(13,202)	(11,582)
Prepaid expenses and other assets	(12,121)	(2,202)
Accounts payable	8,477	10,417
Accrued expenses	(1,048)	(1,273)
Accrued compensation and benefits	(1,072)	3,613
Deferred rent	7,435	2,726
Deferred revenue	(1,375)	(1,166)
<b>Net cash provided by operating activities</b>	<b>26,566</b>	<b>31,819</b>
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(25,585)	(14,246)
Insurance proceeds from casualty loss	799	
Proceeds from sale of property and equipment	17	18
Purchases of marketable securities	(60,419)	
Sales of marketable securities	35,510	
<b>Net cash used in investing activities</b>	<b>(49,678)</b>	<b>(14,228)</b>
<b>Cash flows from financing activities</b>		
Payment of capital lease obligation	(497)	(468)
Net proceeds from initial public offering	106,789	
Proceeds from exercise of stock options	805	
Excess tax benefit from stock-based compensation	94	
Distributions	(84,287)	(30,794)
<b>Net cash provided by (used in) financing activities</b>	<b>22,904</b>	<b>(31,262)</b>
Change in cash and cash equivalents	(208)	(13,671)
Cash and cash equivalents, beginning of period	25,091	29,338

Edgar Filing: TILLY'S, INC. - Form 10-Q

Cash and cash equivalents, end of period	\$ 24,883	\$ 15,667
<b>Supplemental disclosures of cash flow information</b>		
Interest paid	\$ 229	\$ 249
Income taxes paid	\$ 8,834	\$ 121
<b>Supplemental disclosure of non-cash activities</b>		
Unpaid purchases of property and equipment	\$ 170	\$ 290

*The accompanying notes are an integral part of these consolidated financial statements.*

---

**Table of Contents**

**TILLY S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. Description of the Company and Basis of Presentation**

Tilly s, Inc. was formed as a Delaware corporation on May 4, 2011 for the purpose of reorganizing the corporate structure of World of Jeans & Tops, a California corporation ( WOJT ). On May 2, 2012, the shareholders of WOJT contributed all of their shares of common stock to Tilly s, Inc. in return for shares of Tilly s, Inc. Class B common stock on a one-for-one basis. In addition, effective May 2, 2012, WOJT converted from an S Corporation to a C Corporation for income tax purposes. These events are collectively referred to as the Reorganization . As a result of the Reorganization, WOJT became a wholly owned subsidiary of Tilly s, Inc. Except where context requires or where otherwise indicated, the terms Company and Tilly s refers to WOJT before the Reorganization and to Tilly s, Inc. and its subsidiary, WOJT, after the Reorganization.

Tilly s operates a chain of specialty retail stores featuring casual clothing, footwear and accessories for teens and young adults. The Company operated a total of 161 and 140 stores as of October 27, 2012 and January 28, 2012, respectively. The stores are located in malls, lifestyle centers, power centers, community centers, outlet centers and street-front locations. Customers may also shop online, where the Company features a similar assortment of product as is carried in its brick-and-mortar stores.

The accompanying unaudited consolidated financial statements include the assets, liabilities, revenues and expenses of the Company. These consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. ( GAAP ) have been omitted from this report as is permitted by SEC rules and regulations.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all normal and recurring adjustments necessary to present fairly the financial condition, results of operations and cash flows of the Company for the interim periods presented. The results of operations for the thirteen and thirty-nine weeks ended October 27, 2012 and October 29, 2011 are not necessarily indicative of results to be expected for the full fiscal year. These interim consolidated financial statements should be read in conjunction with the financial statements and notes included in the Company s Registration Statement on Form S-1, as amended (Registration No. 333-175299), which was declared effective on May 3, 2012.

***Fiscal Periods***

The Company s fiscal year ends on the Saturday closest to January 31. References to the fiscal quarters ended October 27, 2012 and October 29, 2011 refer to the thirteen week periods ended as of those dates.

## **Table of Contents**

### ***Initial Public Offering***

On May 3, 2012, Tilly's, Inc. completed its initial public offering ( IPO ) in which it issued and sold 7,600,000 shares of its Class A common stock and certain selling stockholders sold 400,000 shares of Class A common stock. In addition, on May 9, 2012, the underwriters exercised their option to purchase an additional 1,200,000 shares of Class A common stock from the selling stockholders to cover over-allotments. As a result, the total IPO size was 9,200,000 shares of Class A common stock, which consisted of 7,600,000 shares sold by Tilly's, Inc. and 1,600,000 shares sold by the selling stockholders. The 9,200,000 shares of Class A common stock sold in the offering were sold at a price of \$15.50 per share. Tilly's, Inc. did not receive any proceeds from the sale of shares by the selling stockholders.

As a result of the IPO, the Company received net proceeds of approximately \$107 million, after deducting the underwriting discount of \$8.7 million and related fees and expenses of approximately \$2.5 million. The Company used \$84.0 million of the net proceeds from the IPO to pay in full notes previously issued to the shareholders of WOJT. These notes represented WOJT's undistributed taxable income from the date of its formation through the date of termination of its S Corporation status.

### ***Unaudited Pro Forma Income Information***

The unaudited pro forma income information gives effect to the conversion of the Company to a C Corporation on May 2, 2012. Prior to such conversion, the Company was an S Corporation and generally not subject to income taxes. The pro forma net income and per share amounts, therefore, include an adjustment for income tax expense as if the Company had been a C Corporation during the periods presented at an assumed combined federal, state and local effective tax rate of 40%, which approximates the calculated statutory tax rate for each period. In addition, the unaudited pro forma diluted weighted average shares outstanding was computed using the assumed 40% effective tax rate. As a result, the pro forma adjustment to diluted weighted average shares outstanding for the thirty-nine weeks ended October 27, 2012 was a decrease of approximately 4,000 shares. There was no pro forma adjustment to the diluted weighted average shares outstanding for the thirteen weeks ended October 27, 2012. The pro forma adjustment to diluted weighted average shares outstanding for the thirteen and thirty-nine weeks ended October 29, 2011 were a decrease of approximately 111,000 and 89,000 shares, respectively.

## **2. Summary of Significant Accounting Policies**

Information regarding significant accounting policies is contained in Note 2, Summary of Significant Accounting Policies, of the financial statements of the Company's Registration Statement on Form S-1, as amended (File No. 333-175299). Presented below in the following notes is supplemental information that should be read in conjunction with Notes to Financial Statements.

## **Table of Contents**

### ***Marketable Securities***

Marketable securities are classified as available-for-sale and are carried at fair value, with the unrealized holding gains and losses, net of income taxes, reflected as a separate component of stockholders' equity until realized. For the purposes of computing realized and unrealized gains and losses, cost is determined on a specific identification basis. The Company considers all marketable securities available-for-sale, including those with maturity dates beyond 12 months, and classifies these securities within current assets on the consolidated balance sheet as they are available to support current operational liquidity needs.

### ***Income Taxes***

The Company calculates its interim income tax provision in accordance with Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) Topic 270, *Interim Reporting* and ASC Topic 740, *Accounting for Income Taxes* ( ASC 740 ). At the end of each interim period, the Company estimates the annual effective tax rate and applies that rate to its ordinary quarterly earnings. The tax expense or benefit related to significant, unusual or extraordinary items is recognized in the interim period in which those items occur. In addition, the effect of changes in enacted tax laws, rates or tax status is recognized in the interim period in which the change occurs. The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment including the expected operating income for the year, permanent and temporary differences as a result of differences between amounts measured and recognized in accordance with tax laws and financial accounting standards and the likelihood of recovering deferred tax assets generated in the current fiscal year. The accounting estimates used to compute the provision for income taxes may change as new events occur, additional information is obtained or as the tax environment changes.

### ***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, management evaluates its estimates and judgments, including those related to inventory valuation, property and equipment, recoverability of long-lived assets, income taxes and stock-based compensation.

### **3. Marketable Securities**

Marketable securities are classified as available-for-sale and, as of October 27, 2012, consisted entirely of commercial paper, all of which was less than one year from maturity. The Company did not have any marketable securities as of January 28, 2012.

**Table of Contents**

The following table summarizes the Company's investments in marketable securities at October 27, 2012 (in thousands):

	Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Commercial paper	\$ 24,881	\$ 10	\$	\$ 24,891

**4. Fair Value Measurements**

ASC Topic 820, *Fair Value Measurements and Disclosure*, (ASC 820) defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Fair value is defined under ASC 820 as the exit price associated with the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date. ASC 820 established the following three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value:

*Level 1* Quoted prices in active markets for identical assets and liabilities.

*Level 2* Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3* Unobservable inputs (i.e. projections, estimates, interpretations, etc.) that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company measures certain financial assets at fair value on a recurring basis, including its marketable securities, which are classified as available-for-sale securities, and certain cash equivalents, specifically money market accounts. The money market accounts are valued based on quoted market prices in active markets. The marketable securities are valued based on other observable inputs for those securities (including market corroborated pricing or other models that utilize observable inputs such as interest rates and yield curves) based on information provided by independent third party entities.

From time to time, the Company measures certain assets at fair value on a non-recurring basis, specifically long-lived assets evaluated for impairment. The Company estimates the fair value of its long-lived assets using company-specific assumptions which would fall within Level 3 of the fair value hierarchy.

During the thirteen and thirty-nine weeks ended October 27, 2012, the Company did not make any transfers between Level 1 and Level 2 financial assets. Furthermore, as of October 27, 2012 and January 28, 2012, the Company did not have any Level 3 financial assets. The Company conducts reviews on a quarterly basis to verify pricing, assess liquidity, and determine if significant inputs have changed that would impact the fair value hierarchy disclosure.

**Table of Contents**

The Company has no other financial instruments that would be considered significant for fair value measurement purposes.

In accordance with the provisions of ASC 820, the Company categorized its financial assets based on the priority of the inputs to the valuation technique for the instruments as follows (in thousands):

	October 27, 2012		
	Level 1	Level 2	Level 3
Cash equivalents:			
Money market securities	\$ 21,182	\$	\$
Marketable securities:			
Commercial paper		24,891	

**5. Line of Credit**

On May 3, 2012, the Company amended its revolving credit facility agreement with Wells Fargo Bank, N.A. The amended credit facility provides for a line of credit of \$25.0 million and matures on May 3, 2014. Interest charged on borrowings is either at the London Interbank Offered Rate ( LIBOR ) plus 1.75%, or at the bank's prime rate. The Company has the ability to select between the prime or LIBOR-based rate at the time of a cash advance. Borrowing from the credit facility is secured by substantially all of the Company's assets. A sub-feature of the credit facility allows stand-by and commercial letters of credit up to \$15.0 million. The Company is required to maintain certain financial and nonfinancial covenants in accordance with the revolving credit facility. The financial covenants contain requirements for certain levels of liquidity and profitability, such as: (i) a minimum current asset to current liability ratio of 1.25 to 1.00, (ii) a net profit before tax of at least \$1, determined as of the end of each fiscal quarter on a cumulative rolling four-quarter basis, excluding a non-cash expense of up to a maximum of \$2.0 million for the write-off of impaired fixed assets for that period and (iii) a maximum ratio of 4.00 to 1.00 for funded debt to EBITDAR, where funded debt includes credit facility borrowings, capital lease debt and eight times annual operating lease rent expense, and EBITDAR includes net income before interest, income taxes, depreciation, amortization and rent expense.

As of October 27, 2012, the Company was in compliance with all of its covenants and had no outstanding borrowings under the line of credit.

**6. Income Taxes**

Prior to May 2, 2012, WOJT was taxed as an S Corporation for federal income tax purposes under Section 1362 of the Internal Revenue Code, and therefore was not subject to federal and state income taxes (subject to an exception in a limited number of state and local jurisdictions that do not recognize the S Corporation status). On May 2, 2012, as part of the

---

**Table of Contents**

Reorganization, the Company's S Corporation status terminated and the Company became subject to corporate-level federal and state income taxes at prevailing corporate rates. As a result of the conversion, the Company recorded an increase in current deferred tax assets of \$3.6 million, an increase in noncurrent deferred tax liabilities of \$0.6 million and a one-time deferred tax benefit of \$3.0 million during the second quarter of fiscal year 2012. WOJT will file a tax return for the period January 1, 2012 through May 1, 2012 as an S Corporation. The Company will also file a tax return as a C Corporation for the period May 2, 2012 through February 2, 2013.

The Company accounts for income taxes and the related accounts under the liability method in accordance with ASC 740. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates expected to be in effect during the year in which the basis differences reverse. Because management believes that it is more likely than not that the Company will realize the full amount of the net deferred tax assets, the Company has not recorded any valuation allowance for the deferred tax assets.

The provision for income taxes is based on the current estimate of the annual effective tax rate and is adjusted as necessary for discrete events occurring in a particular period. The annual effective income tax rate was 32.9% and 1.1% for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively. The annual effective rate in fiscal 2012 is higher than fiscal 2011 primarily due to the Company's conversion from an S Corporation to a C Corporation on May 2, 2012. Pro forma tax expense for the thirteen and thirty-nine weeks ended October 27, 2012 and October 29, 2011 was calculated at an assumed combined federal, state and local effective tax rate of 40%, which approximates the calculated effective tax rate had the Company been a C Corporation in each of those periods.

For the thirty-nine weeks ended October 27, 2012, the Company recorded a net income tax provision of \$2.5 million. The net provision was comprised of (1) a one-time deferred tax benefit of \$3.0 million recognized upon the conversion to a C Corporation, (2) a provision of \$2.0 million related to the period during fiscal year 2012 in which the Company was an S Corporation (January 29, 2012 through May 1, 2012) computed at the annual effective tax rate of 32.9% rather than the previously recognized 1.1% S Corporation effective tax rate and (3) a tax provision of \$3.5 million related to the period in which the Company was a C Corporation (May 2, 2012 through October 27, 2012) at an annual effective tax rate of 32.9%.

**7. Stock-Based Compensation**

On May 3, 2012, in connection with the completion of the IPO, the Company recognized \$7.6 million of stock-based compensation expense relating to stock options previously granted to employees and directors under the Tilly's 2007 Stock Option Plan (the 2007 Plan). This amount represented the cumulative stock-based compensation expense from the inception of the 2007 Plan through the IPO date, as the Company had not previously recognized any stock-based compensation expense for these awards due to the performance condition wherein, if the stock options were vested, they would only become exercisable upon the consummation of the Company's IPO. In connection with the recognition of stock-based compensation, the Company recorded an increase in noncurrent deferred tax assets and income taxes payable of \$3.0 million.



**Table of Contents**

On May 4, 2012, the Company granted stock options to employees to purchase a total of 650,500 shares of Class A common stock under the Tilly's 2012 Equity and Incentive Award Plan (the 2012 Plan). The exercise price of these awards is equal to the IPO price of \$15.50 per share.

The Company also granted options to purchase a total of 80,000 shares of Class A common stock under the 2012 Plan to employees who joined the Company between July 9, 2012 and October 25, 2012. The exercise prices of these awards range between \$15.72 and \$18.37 per share, and were set equal to the Company's closing stock price on the date of each grant.

All stock options granted during the thirty-nine weeks ended October 27, 2012 vest in four equal annual installments beginning on the first anniversary of the date of grant, provided that the respective award recipient continues to be employed by the Company through each of those vesting dates. The total grant date fair value of stock options granted during the thirteen and thirty-nine weeks ended October 27, 2012 was \$0.5 million and \$6.6 million, respectively, before applying an estimated forfeiture rate. The Company is recognizing the expense relating to these stock options, net of estimated forfeitures, on a straight-line basis over the four year service period of the awards.

The stock option awards discussed above were measured at fair value on the grant date using the Black-Scholes option valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, expected volatility of the Company's stock over the option's expected term, the risk-free interest rate over the option's expected term and the Company's expected annual dividend yield, if any. The Company's estimate of pre-vesting forfeitures, or forfeiture rate, was based on its internal analysis, which included the award recipients' positions within the Company and the vesting period of the awards. The Company will issue shares of Class A common stock when the options are exercised.

The fair value of stock options granted during the thirteen and thirty-nine weeks ended October 27, 2012 were estimated on the grant dates using the following assumptions:

	<b>Thirteen Weeks Ended October 27, 2012</b>	<b>Thirty-Nine Weeks Ended October 27, 2012</b>
Expected option term(1)	5.0 years	5.0 years
Expected volatility factor(2)	57.6% - 62.9%	57.6% - 62.9%
Risk-free interest rate(3)	0.6% - 0.8%	0.6% - 0.8%
Expected annual dividend yield	0%	0%

- (1) The Company has limited historical information regarding expected option term. Accordingly, the Company determined the expected option term of the awards using the latest historical data available from comparable public companies and management's expectation of exercise behavior.

**Table of Contents**

- (2) Stock volatility for each grant is measured using the weighted average of historical daily price changes of the Company's competitors common stock over the most recent period equal to the expected option term of the Company's awards.
- (3) The risk-free interest rate is determined using the rate on treasury securities with the same term as the expected life of the stock option as of the grant date.

The following table summarizes the Company's stock option activity for the thirty-nine weeks ended October 27, 2012 (aggregate intrinsic value in thousands):

	Stock Options	Grant Date Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value(1)
Outstanding at January 28, 2012	1,540,000	\$ 11.34		
Granted year-to-date	730,500	\$ 15.60		
Exercised year-to-date	(81,625)	\$ 8.85		
Forfeited year-to-date	(16,000)	\$ 14.24		
Outstanding at October 27, 2012	2,172,875	\$ 12.84	7.6	\$ 7,497
Exercisable at October 27, 2012	928,000	\$ 9.66	5.8	\$ 6,145

- (1) Intrinsic value for stock options is defined as the difference between the market price of the Company's Class A common stock on the last business day of the fiscal quarter and the weighted average exercise price of in-the-money stock options outstanding at the end of each fiscal period. The market value per share was \$16.28 at October 26, 2012.

On May 4, 2012, the Company granted 5,161 restricted shares of Class A common stock to each of its four independent directors under the 2012 Plan. These shares vest in two equal annual installments beginning on May 4, 2013, provided that the respective award recipient continues to serve on the Company's board of directors through each of those vesting dates. The grant date fair value of these awards totaled \$0.3 million. The Company is recognizing the expense relating to these awards on a straight line basis over a two-year service period commencing on the date of grant.

There are a total of 2,913,900 shares issuable under the 2012 Plan, of which 2,154,934 shares were still available for issuance as of October 27, 2012. The Company recorded a total of \$0.7 million of stock-based compensation expense in the thirteen weeks ended October 27, 2012. The Company recorded a total of \$8.9 million of stock-based compensation expense, which includes the one-time charge of \$7.6 million noted above, in the thirty-nine weeks ended October 27, 2012. At October 27, 2012, there was \$6.7 million of total unrecognized stock-based compensation expense related to unvested stock options and restricted stock grants. This cost has a weighted average remaining recognition period of 2.9 years.

**8. Earnings Per Share**

Earnings per share is computed under the provisions of ASC Topic 260, *Earnings Per Share*. Basic earnings per share is based on the weighted average number of common shares outstanding for the period. Diluted earnings per share is based on the weighted average number of common shares and potentially dilutive common share equivalents outstanding for the period. Dilutive common share equivalents include shares issuable upon an assumed exercise of outstanding

**Table of Contents**

stock options using the treasury stock method, whereby proceeds from such exercise and unamortized compensation on share-based awards are assumed to be used by the Company to purchase the common shares at the average market price during the period. The dilutive effect of stock options and restricted stock is applicable only in periods of net income.

The components of basic and diluted earnings per share are as follows (in thousands, except per share amounts):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Net income	\$ 9,294	\$ 12,155	\$ 14,052	\$ 20,484
Weighted average basic shares outstanding	27,658	20,000	24,979	20,000
Dilutive effect of stock options and restricted stock	421	530	424	489
Weighted average common shares for diluted earnings per share	28,079	20,530	25,403	20,489
Basic earnings per share	\$ 0.34	\$ 0.61	\$ 0.56	\$ 1.02
Diluted earnings per share	\$ 0.33	\$ 0.59	\$ 0.55	\$ 1.00

Excluded from the computation of the number of diluted weighted average shares outstanding were options to purchase 728,000 and 577,000 shares of Class A common stock for the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively, and 654,000 and 578,000 shares of Class A common stock for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively, as these shares would have been anti-dilutive.

**9. Commitments and Contingencies**

The Company is subject to various claims and contingencies arising in the normal course of business, including those relating to product liability, legal, employee benefit, environmental and other matters. Management believes that the likelihood is remote that any of these claims will have a material effect on the Company's financial condition as of October 27, 2012 or its results of operations or cash flows for the periods presented.

**Legal Proceedings**

In October 2011, a putative class action, *Deborah Lyddy v. World of Jeans & Tops and Tilly's, Inc.* (37-2011-00098812-CU-BT-CTL) was filed against the Company in the Superior Court of the State of California for the County of San Diego, alleging various causes of action based on the Company's California gift card redemption policies.

From time to time, the Company may become involved in lawsuits and other claims arising in the ordinary course of business. Because of the uncertainties related to the incurrence, amount and range of loss on any pending litigation or claim, management is currently unable to predict the ultimate outcome of any litigation or claim, determine whether a liability has been incurred or make an estimate of the reasonably possible liability that could result from an unfavorable outcome. Management believes, after considering a number of factors and the nature of any outstanding litigation or claims, that the outcome will not have a material adverse effect upon the Company's results of operations, financial condition or cash flows. However, because of the

---

**Table of Contents**

unpredictable nature of these matters, the Company cannot provide any assurances regarding the outcome of any litigation or claim to which it is a party or the impact on it of an adverse ruling in such matters.

**10. Related Parties**

The Company leases its corporate headquarters and distribution center (10 and 12 Whatney, Irvine, California) from a company that is owned by the co-founders of Tilly's. This lease expires on December 31, 2012, with three five-year options to renew thereafter. On June 29, 2012, the Company informed the landlord of its intent to exercise the first of these five-year renewal options, with the renewal commencing on January 1, 2013. The land component of this lease is accounted for as an operating lease and the building component is accounted for as a capital lease. The Company incurred rent expense of \$0.2 million for both of the thirteen weeks ended October 27, 2012 and October 29, 2011, and \$0.7 million and \$0.6 million for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively, for the operating component of this lease. The initial obligation at inception under the capital lease was \$9.2 million, with an outstanding balance of \$4.1 million and \$4.6 million as of October 27, 2012 and January 28, 2012, respectively. The gross amount of the building under capital lease was \$7.8 million as of both October 27, 2012 and October 29, 2011. The gross amount of accumulated depreciation of the building under capital lease was \$5.1 million and \$4.7 million as of October 27, 2012 and January 28, 2012, respectively.

The Company leases warehouse space (15 Chrysler, Irvine, California) from a company that is owned by one of the co-founders of Tilly's. The lease expires on October 31, 2014 and is being accounted for as an operating lease. The Company incurred rent expense of \$0.1 million for both of the thirteen weeks ended October 27, 2012 and October 29, 2011, and \$0.2 million for both of the thirty-nine weeks ended October 27, 2012 and October 29, 2011. The Company subleases part of the building to an unrelated third party. The sublease terminates on May 31, 2014.

The Company leases office and warehouse space (11 Whatney, Irvine, California) from a company that is owned by one of the co-founders of Tilly's. The lease expires on June 30, 2022 and is being accounted for as an operating lease. The Company incurred rent expense of \$0.1 million for both the thirteen and thirty-nine weeks ended October 27, 2012. The Company did not incur any rent expense for this lease for either of the thirteen or thirty-nine weeks ended October 29, 2011.

The Company leases a building (17 Pasteur, Irvine, California) from a company that is owned by one of the co-founders of Tilly's. The lease terminates on October 31, 2021 and is being accounted for as an operating lease. The Company intends to use this building at its e-commerce distribution center. Pursuant to the lease agreement, the Company has requested that the landlord expand the building, and the Company expects the expansion to be completed by the second half of fiscal year 2013. The Company is currently using this building for warehousing until the commencement of the expansion, at which point the Company will return the building to the landlord for the duration of the construction. The Company incurred rent expense of \$0.2 million and \$0.6 million for the thirteen and thirty-nine weeks ended October 27, 2012, respectively, and incurred no rent expense for the thirteen and thirty-nine weeks ended October 29, 2011 for this lease.

**Table of Contents**

Prior to signing each of the related party leases above, the Company received an independent market analysis regarding the property and therefore believes that the terms of each lease are reasonable and are not materially different than terms the Company would have obtained from an unaffiliated third party.

---

**Table of Contents**

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

*The following discussion and analysis of the financial condition and results of our operations should be read together with the financial statements and related notes of Tilly's, Inc. included in Item 1 of this Quarterly Report on Form 10-Q and with our audited financial statements and the related notes included in our Registration Statement on Form S-1, as amended (File No. 333-175299), which was declared effective on May 3, 2012. As used in this Quarterly Report on Form 10-Q, except where the context otherwise requires or where otherwise indicated, the terms company, World of Jeans & Tops, we, our, us and Tilly's refer to Tilly's, Inc. and its subsidiary.*

**Cautionary Statement Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Forward-looking statements are often identified by the use of words such as, but not limited to, anticipate, believe, can, continue, could, estimate, expect, intend, may, plan, project, seek, should, target, will, variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. These forward-looking statements are subject to numerous risks and uncertainties, including the risks and uncertainties described under the section titled Risk Factors in our Registration Statement on Form S-1, as amended (File No. 333-175299), those identified in this Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in an evolving environment. New risk factors and uncertainties emerge from time to time and it is not possible for our management to predict all risk factors and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors may cause actual results to differ materially from those contained in any forward-looking statement. We qualify all of our forward-looking statements by these cautionary statements.

**Overview**

Tilly's is a fast-growing destination specialty retailer of West Coast inspired apparel, footwear and accessories. We believe we bring together an unparalleled selection of the most sought-after brands rooted in action sports, music, art and fashion. Our West Coast heritage dates back to 1982 when Hezy Shaked and Tilly Levine opened our first store in Orange County, California. As of October 27, 2012, we operated 161 stores, averaging 7,900 square feet, in 27 states. We also sell our products through our e-commerce website, www.tillys.com (the information available at our website address is not incorporated by reference into this report).

---

**Table of Contents**

Our growth and operating results reflect initiatives taken by our management team as well as our customers' increasing awareness of our brand and merchandise assortment as we have expanded our presence in both existing and new markets. We increased net sales \$17.6 million, or 16%, to \$124.9 million for the thirteen weeks ended October 27, 2012 from \$107.3 million for the thirteen weeks ended October 29, 2011. Our comparable store sales increased 1.9% for the thirteen weeks ended October 29, 2012, which followed a 10.7% increase for the full fiscal year 2011 and a 5.1% increase for the thirteen weeks ended July 28, 2012. Since the beginning of fiscal 2007, we have increased our store count more than two and a half times, from 61 stores to 161 stores as of October 27, 2012.

As of October 27, 2012, we have added 21 net new stores in fiscal year 2012 and plan to add seven additional net stores by the end of the year. We plan net new store growth at an annual rate of approximately 15% for the next several years thereafter. We expect to fund this store expansion through our cash on hand and cash flows from operations.

We believe our business strategy will continue to offer significant opportunity, but it also presents risks and challenges. These risks and challenges include, but are not limited to, that we may not be able to effectively identify and respond to changing fashion trends and customer preferences, that we may not be able to find desirable locations for new stores and that we may not be able to effectively manage our future growth. In addition, our financial results can be expected to be directly impacted by trends in the general economy. A decline in consumer spending or a substantial increase in product costs due to commodity cost increases or general inflation could lead to a reduction in our sales as well as greater margin pressure as costs may not be able to be passed on to consumers and the competitive environment could become more highly promotional. See "Risk Factors" in the company's Registration Statement on Form S-1, as amended (File No. 333-175299), for other important factors that could adversely impact us and our results of operations.

On May 2, 2012, all four shareholders of World of Jeans & Tops contributed all of their equity interests in World of Jeans & Tops to Tilly's, Inc. in exchange for shares of Tilly's, Inc. Class B common stock on a one-for-one basis. In addition, World of Jeans & Tops terminated its S Corporation status and became a C Corporation. These events are collectively referred to as the Reorganization. As a result of the Reorganization, World of Jeans & Tops became a wholly owned subsidiary of Tilly's, Inc.

On May 3, 2012, we completed an initial public offering, or IPO, in which we issued and sold 7,600,000 shares of Class A common stock at a price of \$15.50 per share, less underwriting discounts and offering expenses payable by us, a portion of which was reimbursed by the underwriters. Certain of our stockholders also sold 1,600,000 shares of Class A common stock in the IPO at a price of \$15.50 per share. We did not receive any of the proceeds from the sale of stock by our stockholders. As a result of the IPO, we raised net proceeds of approximately \$107 million, after deducting the underwriting discount of \$8.7 million and related fees and expenses of approximately \$2.5 million. On May 9, 2012, we used \$84.0 million of the net proceeds from the IPO to pay in full the principal amount of notes representing World of Jeans & Tops undistributed taxable income. These notes were issued to the former shareholders of World of

## **Table of Contents**

Jeans & Tops in connection with the Reorganization and all payments were made to trusts related to Hezy Shaked, Tilly Levine and their children. We intend to use the remaining net proceeds from the sale of shares by us for working capital and other general corporate purposes. The amounts and timing of any expenditures will vary depending on the amount of cash generated by our operations, competitive and technological developments and the rate of growth of our business.

### **How We Assess the Performance of Our Business**

In assessing the performance of our business, we consider a variety of performance and financial measures. The key indicators of the financial condition and operating performance of our business are net sales, comparable store sales, gross profit, selling, general and administrative expenses and operating income.

#### ***Net Sales***

Net sales reflect revenue from the sale of our merchandise at store locations as well as sales of merchandise through our e-commerce store, which is reflected in sales when the merchandise is received by the customer. Net sales also include shipping and handling fees for e-commerce shipments that have been delivered to the customer. Net sales are net of returns on sales during the period as well as an estimate of returns expected in the future stemming from current period sales. Revenue from the sale of gift cards is deferred and not included in net sales until the gift cards are used to purchase merchandise. However, over time, the redemption of some gift cards becomes remote (referred to as gift card breakage). Revenue from estimated gift card breakage is also included in net sales.

Our business is seasonal and as a result our revenues fluctuate from quarter to quarter. In addition, our revenues in any given quarter can be affected by a number of factors including the timing of holidays and weather patterns. The third and fourth quarters of the fiscal year, which include the back-to-school and holiday sales seasons, have historically produced stronger sales and disproportionately stronger operating results than have the first two quarters of the fiscal year.

#### ***Comparable Store Sales***

A store is included in comparable store sales when it has been open at least 12 full fiscal months as of the end of the current reporting period. A remodeled or relocated store is included in comparable store sales, both during and after construction, if the square footage of the store was not changed by more than 20% and the store was not closed for more than five days in any fiscal month. Comparable store sales include sales through our e-commerce store, but exclude e-commerce shipping and handling fee revenue. Some of our competitors and other retailers may calculate comparable or same store sales differently than we do. As a result, data regarding our comparable store sales may not be comparable to similar data made available by other retailers.



**Table of Contents**

Measuring the change in year-over-year comparable store sales allows us to evaluate how our store base is performing. Numerous factors affect our comparable store sales, including:

overall economic trends;

our ability to identify and respond effectively to consumer preferences and fashion trends;

competition;

the timing of our releases of new and seasonal styles;

changes in our product mix;

pricing;

the level of customer service that we provide in stores;

our ability to source and distribute products efficiently;

calendar shifts of holiday or seasonal periods;

the number and timing of store openings and the relative proportion of new stores to mature stores; and

the timing and success of promotional and advertising efforts.

Opening new stores is an important part of our growth strategy and we expect a significant percentage of our net sales during this growth period to come from non-comparable store sales. Accordingly, comparable store sales are only one element we use to assess the success of our business.

***Gross Profit***

Gross profit is equal to our net sales less our cost of goods sold. Cost of goods sold reflects the direct cost of purchased merchandise as well as buying, distribution and occupancy costs. Buying costs include compensation expense for our internal buying organization. Distribution costs include all inbound freight costs as well as costs for receiving, processing, warehousing and shipping of merchandise to or from our distribution center, to our e-commerce customers and between store locations. Occupancy costs include the rent, common area maintenance, utilities, property taxes, security, and depreciation costs of all store locations. These costs are significant and can be expected to continue to increase as our company grows. The components of our reported cost of goods sold may not be comparable to those of other retail companies.

## **Table of Contents**

We regularly analyze the components of gross profit as well as gross profit as a percentage of net sales. Specifically we look at the initial markup on purchases, markdowns and reserves, shrinkage, buying costs, distribution costs and occupancy costs. Any inability to obtain acceptable levels of initial markups, a significant increase in our use of markdowns or a significant increase in inventory shrinkage or inability to generate sufficient sales leverage on the buying, distribution and occupancy components of cost of goods sold could have an adverse impact on our gross profit and results of operations.

Gross profit is also impacted by shifts in the proportion of sales of proprietary branded products compared to third-party branded products as well as by sales mix shifts within and between brands and between major product categories such as between guys and juniors apparel, footwear or accessories. A substantial shift in the mix of products could have a material impact on our results of operations. In addition, gross profit and gross profit as a percent of sales have historically been higher in the third and fourth quarters of the fiscal year, as these periods include the back-to-school and winter holiday selling seasons. This reflects that various costs, including occupancy costs, generally do not increase in proportion to the seasonal sales increase.

### ***Selling, General and Administrative Expenses***

Our selling, general and administrative, or SG&A, expenses are comprised of store selling expenses and corporate-level general and administrative expenses. Store selling expenses include store and regional support costs, including personnel, advertising and debit and credit card processing costs, e-commerce processing costs and store supplies costs. General and administrative expenses include the payroll and support costs of corporate functions such as executive management, legal, accounting, information systems, human resources and other centralized services. Store selling expenses generally vary proportionately with net sales and store growth. In contrast, general and administrative expenses are generally not directly proportional to net sales and store growth, but will be expected to increase over time to support the needs of our growing company. SG&A expenses as a percentage of net sales are usually higher in lower volume periods and lower in higher volume periods.

The components of our SG&A expenses may not be comparable to those of other retailers. We expect that our SG&A expenses will increase in future periods due to our continuing store growth and in part due to additional legal, accounting, insurance and other expenses we expect to continue to incur as a result of being a public company. Among other things, we expect that compliance with the Sarbanes-Oxley Act of 2002 and related rules and regulations will result in significant incremental legal, accounting and other overhead costs.

Our stock-based awards granted prior to our IPO contained a performance condition wherein, if they were vested, they only became exercisable upon the consummation of an IPO of our common stock. Therefore, no stock-based compensation expense was recognized by us prior to the consummation of our IPO. Accordingly, the Company recognized \$7.6 million of compensation expense relating to these awards on May 3, 2012, the date of our IPO.

**Table of Contents****Operating Income**

Operating income equals gross profit less SG&A expenses. Operating income excludes interest income, interest expense and income taxes. Operating income percentage measures operating income as a percentage of our net sales.

**Results of Operations**

The following tables summarize key components of our unaudited results of operations for the periods indicated, both in dollars and as a percentage of our net sales.

	<b>Thirteen Weeks Ended</b>		<b>Thirty-Nine Weeks Ended</b>	
	<b>October 27, 2012</b>	<b>October 29, 2011</b>	<b>October 27, 2012</b>	<b>October 29, 2011</b>
	(in thousands)			
<b>Statements of Income Data:</b>				
Net sales	\$ 124,895	\$ 107,304	\$ 326,521	\$ 277,695
Cost of goods sold	83,087	71,446	223,150	189,910
Gross profit	41,808	35,858	103,371	87,785
Selling, general and administrative expenses	27,940	23,514	86,795	66,915
Operating income	13,868	12,344	16,576	20,870
Interest expense, net	42	49	46	150
Income before income taxes	13,826	12,295	16,530	20,720
Income tax provision	4,532	140	2,478	236
Net income	\$ 9,294	\$ 12,155	\$ 14,052	\$ 20,484
<b>Percentage of Net Sales:</b>				
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	66.5%	66.6%	68.3%	68.4%
Gross profit	33.5%	33.4%	31.7%	31.6%
Selling, general and administrative expenses	22.4%	21.9%	26.6%	24.1%
Operating income	11.1%	11.5%	5.1%	7.5%
Interest income, net	0.0%	0.0%	0.0%	0.0%
Income before income taxes	11.1%	11.5%	5.1%	7.5%
Income tax provision	3.7%	0.2%	0.8%	0.1%
Net income	7.4%	11.3%	4.3%	7.4%
<b>Pro Forma Data (1):</b>				
Historical income before income taxes	\$ 13,826	\$ 12,295	\$ 16,530	\$ 20,720
Pro forma income tax provision	5,530	4,918	6,612	8,288
Pro forma net income	\$ 8,296	\$ 7,377	\$ 9,918	\$ 12,432

## Edgar Filing: TILLY'S, INC. - Form 10-Q

- (1) The pro forma data for both periods presented gives effect to an adjustment for income tax expense as if we had been a C Corporation at an assumed combined federal, state and local effective tax rate of 40%, which approximates our statutory income tax rate.

**Table of Contents**

The following table presents store operating data for the periods indicated:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
<b>Store Operating Data:</b>				
Stores operating at end of period	161	134	161	134
Comparable store sales change (1)	1.9%	8.5%	3.6%	13.4%
Total square feet at end of period	1,272,247	1,044,260	1,272,247	1,044,260
Average net sales per store (in thousands) (2)	\$ 705	\$ 730	\$ 1,950	\$ 1,947
Average net sales per square foot (2)	\$ 90	\$ 94	\$ 249	\$ 251
E-commerce revenues (in thousands) (3)	\$ 12,924	\$ 11,073	\$ 33,650	\$ 27,459

- (1) E-commerce sales contributed 2.0% and 2.3% to the comparable store sales increase for the thirteen week periods ended October 27, 2012 and October 29, 2011, respectively. E-commerce sales contributed 2.1% and 2.2% to the comparable store sales increase for the thirty-nine week periods ended October 27, 2012 and October 29, 2011, respectively.
- (2) E-commerce sales, e-commerce shipping fee revenue and gift card breakage are excluded from net sales in deriving average net sales per store and average net sales per square foot.
- (3) E-commerce revenues include e-commerce sales and e-commerce shipping fee revenue.

**Thirteen Weeks Ended October 27, 2012 Compared to Thirteen Weeks Ended October 29, 2011***Net Sales*

Net sales increased \$17.6 million, or 16%, to \$124.9 million for the thirteen weeks ended October 27, 2012 from \$107.3 million for the thirteen weeks ended October 29, 2011. A portion of this increase was due to net sales of \$15.7 million from stores open in the third quarter of fiscal 2012 that were not open during the same period last year. Net sales also increased due to a comparable store net sales increase of 1.9%, or \$1.9 million, in the thirteen weeks ended October 27, 2012 compared to the thirteen weeks ended October 29, 2011. This comparable sales increase was due to higher net sales through our e-commerce store. The comparable store sales increase was in guys and juniors apparel and accessories, offset by lower net sales of boys and girls apparel and slightly lower net sales of footwear. There were 130 comparable brick-and-mortar stores and 31 non-comparable brick-and-mortar stores open as of October 27, 2012.

Net sales from our e-commerce store, including shipping fees, increased \$1.9 million, or 17%, to \$12.9 million for the thirteen weeks ended October 27, 2012 from \$11.1 million for the thirteen weeks ended October 29, 2011 due to increased traffic.

*Gross Profit*

Gross profit increased \$5.9 million, or 17%, to \$41.8 million for the thirteen weeks ended October 27, 2012 from \$35.9 million for the thirteen weeks ended October 29, 2011. As a percentage of net sales, gross profit was 33.5% and 33.4% for the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively. This improvement in gross profit as a percentage of

**Table of Contents**

net sales was driven by an increase of 0.2% of sales in retail product margin, reflecting improved initial margins over the third fiscal quarter of 2011 and markdowns at a similar rate to sales as in the third fiscal quarter of 2011. The improvement in gross profit was partially offset by buying, distribution and occupancy costs which increased 0.1% as a percentage of net sales compared to the third fiscal quarter of 2011, reflecting these costs increasing more quickly than the rate of increase in comparable store sales.

*Selling, General and Administrative Expenses*

SG&A expenses increased \$4.4 million, or 19%, to \$27.9 million for the thirteen weeks ended October 27, 2012 from \$23.5 million for the thirteen weeks ended October 29, 2011. As a percentage of net sales, SG&A expenses were 22.4% and 21.9% for the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively.

Store selling expenses increased \$2.7 million, or 17%, to \$18.8 million for the thirteen weeks ended October 27, 2012 from \$16.1 million for the thirteen weeks ended October 29, 2011. As a percentage of net sales, store selling expenses were 15.1% and 15.0% for the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively.

The following contributed to the increase in store selling expenses as a percentage of net sales:

store and regional payroll, payroll benefits and related personnel costs increased \$2.0 million, or 0.2% as a percentage of net sales, as these costs increased more quickly than sales;

marketing costs increased \$0.6 million, or 0.1% as a percentage of net sales, primarily resulting from increased distribution of catalog mailings, increased support of our e-commerce business and more new store grand openings than in the prior year; and

supplies and other field support costs increased \$0.1 million, but decreased 0.2% as a percentage of net sales, as these costs increased more slowly than sales.

General and administrative expenses increased \$1.7 million, or 23%, to \$9.1 million for the thirteen weeks ended October 27, 2012 from \$7.4 million for the thirteen weeks ended October 29, 2011. As a percentage of net sales, general and administrative expenses were 7.3% and 6.9% for the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively.

The following contributed to the increase in general and administrative expenses as a percentage of net sales:

stock-based compensation expense of \$0.7 million, or 0.5% of net sales, which commenced upon the completion of our IPO in May 2012 and therefore was not included in the fiscal 2011 results;

---

**Table of Contents**

payroll, payroll benefits and related costs for corporate office personnel remained constant, but decreased 0.8% as a percentage of net sales, as these costs increased more slowly than sales reflecting payroll growth slower than net sales and incentive pay accruals below fiscal 2011 levels; and

depreciation, legal and other office expenses, as well as incremental costs in the third quarter of 2012 as a result of becoming a public company during the second quarter of 2012, increased \$1.0 million, or 0.7% as a percentage of net sales.

*Operating Income (Loss)*

Operating income increased \$1.5 million, or 12%, to \$13.9 million for the thirteen weeks ended October 27, 2012 from \$12.3 million for the thirteen weeks ended October 29, 2011. As a percentage of net sales, operating income was 11.1% and 11.5% for the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively. The decrease in operating income as a percentage of net sales was due to the factors noted above.

*Interest Expense, Net*

Net interest expense was \$42,000 and \$49,000 for the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively. Interest income mainly represents interest income earned on cash balances and on tenant construction allowances due from landlords. Interest expense reflects interest paid on a capital lease of our corporate office and distribution center as well as costs related to maintaining our unused line of credit bank facility.

*Income Tax Provision*

The income tax provision increased \$4.4 million, to \$4.5 million for the thirteen weeks ended October 27, 2012 from \$0.1 million for the thirteen weeks ended October 29, 2011. The effective income tax rate for the thirteen weeks ended October 27, 2012 was 32.8%, compared to the effective income tax rate of 1.1% for the thirteen weeks ended October 29, 2011.

*Net Income*

Net income decreased \$2.9 million, or 24%, to \$9.3 million for the thirteen weeks ended October 27, 2012 from \$12.2 million for the thirteen weeks ended October 29, 2011, due to the factors discussed above. Applying a pro forma 40% C Corporation effective tax rate to these thirteen week periods in both years, rather than the blended S Corporation and C Corporation tax rates that actually applied to us, pro forma net income increased \$0.9 million, or 12%, to \$8.3 million for the thirteen weeks ended October 27, 2012 from \$7.4 million for the thirteen weeks ended October 29, 2011.

Basic earnings per share was \$0.34 for the thirteen weeks ended October 27, 2012, compared to \$0.61 for the thirteen weeks ended October 29, 2011. Diluted earnings per share was \$0.33 for the thirteen weeks ended October 27, 2012, compared to \$0.59 for the thirteen weeks ended October 29, 2011. Applying a pro forma 40% C Corporation effective tax rate to these thirteen

**Table of Contents**

week periods in both years, rather than the S Corporation and C Corporation tax rates that actually applied to us, pro forma basic earnings per share was \$0.30 for the thirteen weeks ended October 27, 2012, compared to \$0.37 for the thirteen weeks ended October 29, 2011, and pro forma diluted earnings per share was \$0.30 for the thirteen weeks ended October 27, 2012, compared to \$0.36 for the thirteen weeks ended October 29, 2011.

***Thirty-Nine Weeks Ended October 27, 2012 Compared to Thirty-Nine Weeks Ended October 29, 2011***

*Net Sales*

Net sales increased \$48.8 million, or 18%, to \$326.5 million for the thirty-nine weeks ended October 27, 2012 from \$277.7 million for the thirty-nine weeks ended October 29, 2011. A portion of this increase was due to net sales of \$39.1 million from stores open in the first thirty-nine weeks of fiscal 2012 that were not open during the same period last year. Net sales also increased due to a comparable store net sales increase of 3.6%, or \$9.7 million, in the thirty-nine weeks ended October 27, 2012 compared to the thirty-nine weeks ended October 29, 2011. This increase was due to higher net sales of guys and juniors apparel and accessories and footwear, offset by slightly lower net sales of boys and girls apparel. There were 130 comparable brick-and-mortar stores and 31 non-comparable brick-and-mortar stores open as of October 27, 2012.

Net sales from our e-commerce store, including shipping fees, increased \$6.2 million, or 23%, to \$33.7 million for the thirty-nine weeks ended October 27, 2012 from \$27.5 million for the thirty-nine weeks ended October 29, 2011.

*Gross Profit*

Gross profit increased \$15.6 million, or 18%, to \$103.4 million for the thirty-nine weeks ended October 27, 2012 from \$87.8 million for the thirty-nine weeks ended October 29, 2011. As a percentage of net sales, gross profit was 31.7% and 31.6% for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively. This reflects a 0.1% higher product margin due to higher initial margins while the total of buying, distribution and occupancy costs was similar as a percentage of net sales to the same period in fiscal 2011.

*Selling, General and Administrative Expenses*

SG&A expenses increased \$19.9 million, or 30%, to \$86.8 million for the thirty-nine weeks ended October 27, 2012 from \$66.9 million for the thirty-nine weeks ended October 29, 2011. As a percentage of net sales, SG&A expenses were 26.6% and 24.1% for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively.

Store selling expenses increased \$7.5 million, or 17%, to \$52.6 million for the thirty-nine weeks ended October 27, 2012 from \$45.1 million for the thirty-nine weeks ended October 29, 2011. As a percentage of net sales, store selling expenses were 16.1% and 16.3% for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively.



---

**Table of Contents**

The following contributed to the decrease in store selling expenses as a percentage of net sales:

store and regional payroll, payroll benefits and related personnel costs increased \$5.3 million, but decreased 0.1% as a percentage of net sales, as these costs increased more slowly than sales;

marketing costs increased \$1.8 million, or 0.2% as a percentage of net sales, primarily resulting from increased distribution of catalog mailings, increased support of our e-commerce business and more new store grand openings than in the prior year; and

credit and debit card processing fees and other field processing costs and supplies and other support costs increased \$0.4 million, but decreased 0.2% as a percentage of net sales as these costs increased slower than net sales.

General and administrative expenses increased \$12.4 million, or 57%, to \$34.2 million for the thirty-nine weeks ended October 27, 2012 from \$21.8 million for the thirty-nine weeks ended October 29, 2011. As a percentage of net sales, general and administrative expenses were 10.5% and 7.8% for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively.

The following contributed to the increase in general and administrative expenses as a percentage of net sales:

a one-time charge of \$7.6 million, or 2.3% of net sales, to recognize life-to-date stock-based compensation expense for stock options that was triggered by the consummation of our IPO during the second quarter of 2012;

ongoing stock-based compensation expense of \$1.3 million, or 0.4% of net sales, which commenced upon the completion of our IPO during the second quarter of 2012;

payroll, payroll benefits and related costs for corporate office personnel increased \$1.3 million, which represents a decrease of 0.5% as a percentage of net sales, as these costs increased more slowly than sales; and

depreciation, legal, audit and tax services and other office expenses, including incremental costs in the current year as a result of becoming a public company, increased \$2.2 million, or 0.4% as a percentage of net sales.

*Operating Income*

Operating income decreased \$4.3 million, or 21%, to \$16.6 million for the thirty-nine weeks ended October 27, 2012 from \$20.9 million for the thirty-nine weeks ended October 29, 2011. As a percentage of net sales, operating income was 5.1% and 7.5% for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively. The decrease in operating income as

---

**Table of Contents**

a percentage of net sales was primarily due to the recognition of \$8.9 million of stock-based compensation expense for stock options during the thirty-nine weeks ended October 27, 2012, as discussed above.

*Interest Expense, Net*

Net interest expense was \$46,000 and \$150,000 for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively. Interest income mainly represents interest earned on cash balances, marketable securities and on tenant construction allowances due from landlords. Interest expense reflects interest paid on a capital lease of our corporate office and distribution center as well as costs related to maintaining our unused line of credit bank facility. The decrease in net interest expense in fiscal 2012 was primarily due to an increase in interest income on our cash balances and marketable securities in fiscal 2012.

*Income Tax Provision*

For the thirty-nine weeks ended October 27, 2012, the Company recorded a net income tax provision of \$2.5 million. The net tax provision was comprised of (1) a one-time deferred tax benefit of \$3.0 million recognized upon the conversion to a C Corporation, (2) a provision of \$2.0 million related to the period during fiscal year 2012 in which the Company was an S Corporation (January 29, 2012 through May 1, 2012) computed at the annual effective tax rate of 32.9% rather than the previously recognized 1.1% S Corporation effective tax rate and (3) a tax provision of \$3.5 million related to the period in which the Company was a C Corporation (May 2, 2012 through October 27, 2012) at an annual effective tax rate of 32.9%.

*Net Income*

Net income decreased \$6.4 million, or 31%, to \$14.1 million for the thirty-nine weeks ended October 27, 2012 from \$20.5 million for the thirty-nine weeks ended October 29, 2011, due to the factors discussed above. Applying a pro forma 40% C Corporation effective tax rate to these thirty-nine week periods in both years, rather than the blended S Corporation and C Corporation tax rates that actually applied to us, pro forma net income decreased \$2.5 million, or 20%, to \$9.9 million for the thirty-nine weeks ended October 27, 2012 from \$12.4 million for the thirty-nine weeks ended October 29, 2011.

Basic earnings per share decreased 45%, to \$0.56 for the thirty-nine weeks ended October 27, 2012 from \$1.02 for the thirty-nine weeks ended October 29, 2011. Diluted earnings per share decreased 45%, to \$0.55 for the thirty-nine weeks ended October 27, 2012 from \$1.00 for the thirty-nine weeks ended October 29, 2011. Applying a pro forma 40% C Corporation effective tax rate to these thirty-nine week periods in both years, rather than the blended S Corporation and C Corporation tax rates that actually applied to us, pro forma basic earnings per share decreased 35%, to \$0.40 for the thirty-nine weeks ended October 27, 2012 from \$0.62 for the thirty-nine weeks ended October 29, 2011, and pro forma diluted earnings per share decreased 36%, to \$0.39 for the thirty-nine weeks ended October 27, 2012 from \$0.61 for the thirty-nine weeks ended October 29, 2011.

**Table of Contents****Liquidity and Capital Resources*****General***

Our business relies on cash flows from operating activities as well as cash on hand as our primary sources of liquidity. In addition, we have had access to additional liquidity through a \$25.0 million revolving credit facility with Wells Fargo Bank, N.A. We have neither drawn funds from nor have we issued letters of credit from the revolving credit facility.

Historically our primary cash needs have been for merchandise inventories, payroll, store rent, capital expenditures associated with opening new stores and improvements to our distribution facilities, marketing and information technology expenditures and, prior to the IPO, shareholder distributions. In addition to cash and cash equivalents and marketable securities, the most significant components of our working capital are merchandise inventories, accounts payable and other current liabilities. We believe that cash and marketable securities on hand, cash flows from operating activities and the availability of cash under our revolving credit facility will be sufficient to cover working capital requirements and anticipated capital expenditures for the next 12 months. If these sources of cash are not sufficient or available to meet our capital requirements, then we would be required to obtain additional equity or debt financing in the future. There can be no assurance that equity or debt financing will be available to us when we need it or, if available, that the terms will be satisfactory to us and not dilutive to our then-current stockholders.

**Cash Flow Analysis**

A summary of operating, investing and financing activities is shown in the following table:

	<b>Thirty-Nine Weeks Ended</b>	
	<b>October 27, 2012</b>	<b>October 29, 2011</b>
	<b>(in thousands)</b>	
Net cash provided by operating activities	\$ 26,566	\$ 31,819
Net cash used in investing activities	(49,678)	(14,228)
Net cash provided by (used in) financing activities	22,904	(31,262)

***Net Cash Provided by Operating Activities***

We generated \$26.6 million of net cash from operating activities for the thirty-nine weeks ended October 27, 2012. The significant components of cash flows from operating activities were net income of \$14.1 million, the add-back of non-cash depreciation and amortization expense of \$12.3 million, the change in deferred income taxes of \$6.3 million and non-cash stock-based compensation expense recognized during the period of \$8.9 million. In addition, accounts payable and accrued compensation and other accrued expenses increased by \$6.4 million due to the timing of payments and deferred rent increased by \$7.4 million due to the opening of new stores. The above was partially offset by an increase in merchandise inventories of \$13.2 million due to inventory purchases in anticipation of the upcoming holiday season and

## **Table of Contents**

the opening of new stores, an increase in prepaid expenses and other assets of \$12.1 million mainly due to increases in prepaid rent resulting from the opening of new stores and the recognition of deferred tax assets resulting from our conversion from an S Corporation to a C Corporation and an increase in receivables of \$2.2 million due to the growth of the business.

By comparison, we generated \$31.8 million of net cash from operating activities for the thirty-nine weeks ended October 29, 2011. The significant components of cash flows from operating activities were net income of \$20.5 million and the add-back of non-cash depreciation and amortization expense of \$11.3 million. In addition, accounts payable, accrued expenses and accrued compensation and benefits increased \$12.8 million due to the timing of payments, and deferred rent increased by \$2.7 million due to the opening of new stores. The above was offset by an increase in merchandise inventories of \$11.6 million due to inventory purchases in anticipation of the upcoming holiday season and the opening of new stores and an increase in prepaid expenses and other assets of \$2.2 million due mainly to the capitalization of IPO transaction costs.

### ***Net Cash Used in Investing Activities***

Net cash used in investing activities was \$49.7 million for the thirty-nine weeks ended October 27, 2012. Of this total, \$25.6 million was for capital expenditures. Spending on new stores and the remodeling or other improvements of existing stores was \$19.7 million of this total. The remaining capital expenditures were for our investment in information technology systems and distribution and corporate facility enhancements. In addition, we received \$0.8 million of insurance proceeds related to fixed assets that were destroyed by smoke damage as a result of a fire in 2010 at a mall where one of our stores was located. We purchased \$60.4 million of marketable securities and received proceeds of \$35.5 million from the sale of marketable securities during the period.

By comparison, net cash used in investing activities was \$14.2 million for the thirty-nine weeks ended October 29, 2011. Capital expenditures represented nearly all of this spending. Spending on new stores and the remodeling or other improvements of existing stores were \$11.4 million of this total. The remaining capital expenditures were for our investment in information technology systems and distribution and corporate facility enhancements.

### ***Net Cash Provided by (Used in) Financing Activities***

Net cash provided by financing activities was \$22.9 million for the thirty-nine weeks ended October 27, 2012. This included \$106.8 million in net proceeds from our initial public offering which was consummated during the second quarter of 2012. Partially offsetting this was \$84.3 million in distributions to the former shareholders of World of Jeans & Tops. We also received \$0.8 million in proceeds from the exercise of stock options, net of tax withholdings, and paid \$0.5 million for our capital lease obligation during the period.

By comparison, net cash used in financing activities was \$31.3 million for the thirty-nine weeks ended October 29, 2011. This included \$30.8 million in distributions to the then-current shareholders of World of Jeans & Tops and \$0.5 million for payments on our capital lease obligation.

**Table of Contents**

**Credit Agreement**

On May 3, 2012, we entered into an amended and restated credit agreement with Wells Fargo Bank, N.A. The revolving credit facility provides for a \$25.0 million revolving credit facility with a maturity date of May 3, 2014. The interest charged is either at the London Interbank Offered Rate, or LIBOR, plus 1.75% or at the bank's prime rate. We have the ability to select between the prime or LIBOR-based rate at the time of a cash advance. The revolving credit facility is secured by substantially all of the Company's assets. As a sub-feature under the revolving credit facility the bank may issue stand-by and commercial letters of credit up to \$15.0 million. We are required to maintain certain financial and nonfinancial covenants in accordance with the revolving credit facility. These covenants include maintaining a minimum current ratio, not exceeding a maximum funded debt to earnings before interest, taxes, depreciation, amortization and annual rent expense ( EBITDAR ) ratio, capital expenditures not exceeding established limits and achieving a minimum pre-tax profit on a rolling four quarter basis.

**Contractual Obligations**

There have been no significant changes to our contractual obligations described in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Registration Statement on Form S-1, as amended (File No. 333-175299), other than those which occur in the normal course of business.

**Off-Balance Sheet Arrangements**

We are not a party to any off-balance sheet arrangements, except for operating leases, purchase obligations and our revolving credit facility.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the related disclosures of contingent assets and liabilities at the date of the financial statements. A summary of the Company's significant accounting policies is included in Note 2 to the financial statements of World of Jeans & Tops dba Tilly's in the Company's Registration Statement on Form S-1, as amended (File No. 333-175299).

Certain of the Company's accounting policies and estimates are considered critical, as these policies and estimates are the most important to the depiction of the Company's consolidated financial statements and require significant, difficult or complex judgments, often about the effect of matters that are inherently uncertain. Such policies are summarized in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Registration Statement on Form S-1, as amended (File No. 333-175299). As

## **Table of Contents**

discussed in Note 1 to the unaudited consolidated financial statements in this report, on May 2, 2012, in conjunction with the conversion of World of Jeans & Tops from an S Corporation to a C Corporation for income tax purposes, we began recognizing income taxes as a C Corporation. As of the date of this filing, there were no other significant changes to any of the critical accounting policies and estimates described in the Registration Statement.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

As of October 27, 2012, there were no material changes in the market risks described in the Quantitative and Qualitative Disclosure of Market Risks section of our Registration Statement on Form S-1, as amended (File No. 333-175299).

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Disclosure Committee, including our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of October 27, 2012. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of October 27, 2012, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

#### **Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### **Inherent Limitations on Effectiveness of Controls**

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and

---

**Table of Contents**

all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**Part II. Other Information**

**Item 1. Legal Proceedings**

In October 2011, a putative class action, *Deborah Lyddy v. World of Jeans & Tops and Tilly's, Inc.*, (37-2011-00098812-CU-BT-CTL) was filed against us in the Superior Court of the State of California for the County of San Diego, alleging various causes of action based on our California gift card redemption policies.

From time to time, we may become involved in lawsuits and other claims arising from our ordinary course of business. Because of the uncertainties related to the incurrence, amount and range of loss on any pending litigation or claim, management is currently unable to predict the ultimate outcome of any litigation or claim, determine whether a liability has been incurred or make an estimate of the reasonably possible liability that could result from an unfavorable outcome. Management believes, after considering a number of factors and the nature of any outstanding litigation or claims, that the outcome will not have a material effect upon our results of operations, financial condition or cash flows. However, because of the unpredictable nature of these matters, we cannot provide any assurances regarding the outcome of any litigation or claim to which we are a party or the impact on us of an adverse ruling in such matters. Therefore, see the Risk Factors Litigation costs and the outcome of litigation could have a material adverse effect on our business section of our Registration Statement on Form S-1, as amended (File No. 333-175299).

**Item 1A. Risk Factors**

We operate in a rapidly changing environment that involves a number of risks that could materially and adversely affect our business, financial condition, prospects, operating results or cash flows. For a detailed discussion of the risks that affect our business, please refer to the section entitled Risk Factors in our Registration Statement on Form S-1, as amended (File No. 333-175299). There have been no material changes to our risk factors as previously disclosed in our Registration Statement.

**Table of Contents**

**Item 6. Exhibits**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive data files from Tilly's, Inc.'s Quarterly Report on Form 10-Q for the quarter ended October 27, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Income; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statement of Stockholders Equity; (v) the Consolidated Statements of Cash Flows; and (vi) the Notes to Consolidated Financial Statements. **
**	Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, and are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.



**Table of Contents**

**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.

Tilly s, Inc.

Date: December 4, 2012

/s/ Daniel Griesemer  
Daniel Griesemer  
*President, Chief Executive Officer and Director*  
*(Principal Executive Officer)*

Date: December 4, 2012

/s/ William Langsdorf  
William Langsdorf  
*Senior Vice President and Chief Financial Officer*  
*(Principal Financial Officer)*