

bebe stores, inc.
Form 10-Q
November 12, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 3, 2009

OR

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

Commission File Number 0-24395

bebe stores, inc.

(Exact name of registrant as specified in its charter)

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(State or Jurisdiction of
Incorporation or Organization)

(IRS Employer
Identification Number)

400 Valley Drive

Brisbane, California 94005

(Address of principal executive offices)

Telephone: **(415) 715-3900**

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of October 30, 2009 was 86,784,121.

Table of Contents

bebe stores, inc.

TABLE OF CONTENTS

	Page No.
<u>PART I.</u>	<u>FINANCIAL INFORMATION</u>
<u>ITEM 1.</u>	<u>Condensed Consolidated Financial Statements</u>
	<u>Condensed Consolidated Balance Sheets as of October 3, 2009, July 4, 2009 and October 4, 2008</u> 3
	<u>Condensed Consolidated Statements of Operations for the three months ended October 3, 2009 and October 4, 2008</u> 4
	<u>Condensed Consolidated Statements of Cash Flows for the three months ended October 3, 2009 and October 4, 2008</u> 5
	<u>Notes to Condensed Consolidated Financial Statements</u> 6
<u>ITEM 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 12
<u>ITEM 3.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u> 17
<u>ITEM 4.</u>	<u>Controls and Procedures</u> 18
<u>PART II.</u>	<u>OTHER INFORMATION</u>
<u>ITEM 1.</u>	<u>Legal Proceedings</u> 19
<u>ITEM 1A.</u>	<u>Risk Factors</u> 19
<u>ITEM 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 23
<u>ITEM 3.</u>	<u>Defaults Upon Senior Securities</u> 23
<u>ITEM 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u> 23
<u>ITEM 5.</u>	<u>Other Information</u> 23
<u>ITEM 6.</u>	<u>Exhibits</u> 23
<u>SIGNATURE</u>	24
<u>EXHIBIT INDEX</u>	25

Table of Contents**PART I. FINANCIAL INFORMATION**

ITEM 1. Condensed Consolidated Financial Statements

bebe stores, inc.**CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share data)****(unaudited)**

	As of October 3, 2009	As of July 4, 2009	As of October 4, 2008
Assets:			
Current assets:			
Cash and equivalents	\$ 80,710	\$ 91,390	\$ 119,565
Available for sale securities	38,477	40,018	
Trading securities	69,460	69,504	
Auction rate securities written put option	12,106	12,740	
Receivables (net of allowance of \$1,277, \$1,277 and \$1,215)	5,953	5,134	9,976
Inventories, net	36,483	39,194	49,312
Deferred income taxes, net	7,822	8,549	9,283
Prepaid and other	32,422	30,947	19,538
Total current assets	283,433	297,476	207,674
Available for sale securities	120,431	118,187	228,155
Property and equipment, net	120,187	126,301	137,022
Deferred income taxes, net	25,264	24,272	24,846
Other assets	5,644	5,219	4,007
Total assets	\$ 554,959	\$ 571,455	\$ 601,704
Liabilities and Shareholders Equity:			
Current liabilities:			
Accounts payable	\$ 19,214	\$ 26,621	\$ 33,592
Accrued liabilities	29,394	36,671	29,529
Total current liabilities	48,608	63,292	63,121
Deferred rent and other lease incentives	44,781	45,448	47,736
Uncertain tax positions	3,258	3,220	3,401
Total liabilities	96,647	111,960	114,258
Commitments and contingencies			
Shareholders equity:			
Preferred stock-authorized 1,000,000 shares at \$0.001 par value per share; no shares issued and outstanding			
Common stock-authorized 135,000,000 shares at \$0.001 par value per share; issued and outstanding 86,780,290, 86,758,973 and 89,004,780	87	87	89

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shares				
Additional paid-in capital	140,098	139,437	141,962	
Accumulated other comprehensive loss	(7,753)	(12,261)	(7,739)	
Retained earnings	325,880	332,232	353,134	
Total shareholders' equity	458,312	459,495	487,446	
Total liabilities and shareholders' equity	\$ 554,959	\$ 571,455	\$ 601,704	

See accompanying notes to condensed consolidated financial statements.

Table of Contents

bebe stores, inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended	
	October 3, 2009	October 4, 2008
Net sales	\$ 125,659	\$ 163,260
Cost of sales, including production and occupancy	79,498	89,958
Gross margin	46,161	73,302
Selling, general and administrative expenses	53,022	59,155
Operating income (loss)	(6,861)	14,147
Interest and other income, net	1,042	3,030
Income (loss) before income taxes	(5,819)	17,177
Income tax provision (benefit)	(1,637)	5,972
Net income (loss)	\$ (4,182)	\$ 11,205
Basic income (loss) per share	\$ (0.05)	\$ 0.13
Diluted income (loss) per share	\$ (0.05)	\$ 0.12
Basic weighted average shares outstanding	86,766	88,962
Diluted weighted average shares outstanding	86,766	90,038

See accompanying notes to condensed consolidated financial statements.

Table of Contents

bebe stores, inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Three Months Ended	
	October 3, 2009	October 4, 2008
Cash flows from operating income:		
Net income	\$ (4,182)	\$ 11,205
Adjustments to reconcile net income to cash provided by operating activities		
Non-cash compensation expense	631	1,739
Depreciation and amortization	7,040	6,201
Net loss on disposal of property	2,220	156
Gain on trading securities	(22)	
Tax benefit from exercise of stock options and awards	17	53
Excess tax benefit from exercise of stock options and awards	(6)	(28)
Deferred rent and other lease incentives	(748)	1,591
Deferred income taxes	(75)	
Long term income taxes payable	38	
Changes in operating assets and liabilities:		
Receivables	(1,206)	(1,791)
Inventories	2,795	(6,660)
Prepaid expenses and other	(1,668)	(3,071)
Accounts payable	(7,409)	10,392
Accrued liabilities	(7,306)	(5,185)
Net cash provided (used) by operating activities	(9,881)	14,602
Cash flows from investing activities:		
Purchase of property and equipment	(3,144)	(8,830)
Purchase of marketable securities	(8,477)	
Proceeds from sales of investment securities	10,718	2,200
Net cash used by investing activities	(903)	(6,630)
Cash flows from financing activities:		
Net proceeds from issuance of common stock	122	374
Excess tax benefit from exercise of stock options and awards	6	28
Cash dividends paid	(6,507)	(8,895)
Other		(38)
Net cash used by financing activities	(6,379)	(8,531)
Net decrease in cash and cash equivalents	(17,163)	(559)
Effect of exchange rate changes on cash	6,483	(3,220)
Cash and equivalents:		
Beginning of period	91,390	123,344
End of period	\$ 80,710	\$ 119,565

See accompanying notes to condensed consolidated financial statements.

Table of Contents

bebe stores, inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTERIM FINANCIAL STATEMENTS

The accompanying condensed consolidated balance sheets of bebe stores, inc. (the Company) as of October 3, 2009, July 4, 2009 and October 4, 2008, the condensed consolidated statements of operations for the three months ended October 3, 2009 and October 4, 2008 and the condensed consolidated statements of cash flows for the three months ended October 3, 2009 and October 4, 2008 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, without audit. Accordingly, they do not include all of the information required by accounting principles generally accepted in the United States of America for annual financial statements. Therefore, these condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended July 4, 2009.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to present fairly the financial position at the balance sheet dates and the results of operations for the periods presented have been included. The condensed consolidated balance sheet at July 4, 2009, presented herein, was derived from the audited balance sheet included in the Company's Annual Report on Form 10-K for the fiscal year ended July 4, 2009.

The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. The results for the periods presented are not necessarily indicative of future financial results.

The Company revised cash flows from operating activities for the three months ended October 4, 2008 on its statements of cash flows to separately present the tax benefit and excess tax benefit from exercise of stock options and awards. Net cash provided by (used in) operating and financing activities for the quarter changed by immaterial amounts.

The Company has evaluated all subsequent events that occurred after the balance sheet date through November 12, 2009, the date the condensed consolidated financial statements were issued.

FISCAL YEAR

The Company's fiscal year is a 52 or 53 week period, each period ending on the first Saturday after June 30. Fiscal years 2009 and 2008 each include 52 weeks.

The three month periods ended October 3, 2009 and October 4, 2008 each include 13 weeks.

RECENT ACCOUNTING PRONOUNCEMENTS

Codification

Effective July 1, 2009, the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) became the single official source of authoritative, nongovernmental generally accepted accounting principles (GAAP) in the United States. The historical GAAP hierarchy was eliminated, and the ASC became the only level of authoritative GAAP, other than guidance issued by the Securities and Exchange Commission. The Company's accounting policies were not affected by the conversion to ASC. However, references to specific accounting standards in the footnotes to the Company's consolidated financial statements have been changed to refer to the appropriate section of ASC.

Fair Value

In September 2006, the FASB issued guidance which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. This guidance is contained in ASC 820, Fair Value Measurements and Disclosures. In February 2008, the FASB deferred the effective date for non-financial assets and liabilities, except for certain items that are recognized or disclosed at fair value at least annually. The Company elected to partially adopt the provisions ASC 820 as of July 6, 2008 for financial instruments. Although the partial adoption did not materially impact the Company's financial condition, results of operations or cash flow, the Company is now required to provide additional disclosures as part of its financial statements. The Company's adoption of the remaining provisions of ASC 820, pertaining to fair value disclosures related to non-financial assets and liabilities, on July 5, 2009 has not had a material impact on the Company's consolidated financial position, statements of operations or cash flows.

In April 2009, the FASB issued additional guidance in accordance with ASC 825, Financial Instruments. The additional guidance adds required disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements. The guidance also requires those disclosures in summarized financial information at interim reporting periods.

Table of Contents

This guidance is effective for interim periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company's adoption of this requirement has not had a material impact on the Company's consolidated financial position, statements of operations or cash flows, as it relates to disclosure only.

INVENTORIES

The Company's inventories consisted of:

	October 3, 2009	As of July 4, 2009 (In thousands)	October 4, 2008
Merchandise available for sale	\$ 34,717	\$ 37,043	\$ 44,329
Raw materials	1,766	2,151	4,983
Inventories, net	\$ 36,483	\$ 39,194	\$ 49,312

EARNINGS PER SHARE

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

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

	Three Months Ended October 3, 2009	October 4, 2008 (In thousands)
Basic weighted average number of shares outstanding	86,766	88,962
Incremental shares from the assumed issuance of stock options		1,076
Diluted weighted average number of shares outstanding	86,766	90,038

The number of incremental shares from the assumed issuance of stock options is calculated by applying the treasury stock method.

Excluded from the computation of the number of diluted weighted average shares outstanding were options to purchase 5,056,980 and 3,372,000 shares of common stock for the three months ended October 3, 2009 and October 4, 2008, respectively, which would have been anti-dilutive.

COMMON STOCK PURCHASES

In October 2008, the board of directors authorized a program to repurchase up to \$30 million of the Company's common stock. The Company intends, from time to time, as business conditions warrant, to purchase stock in the open market or through private transactions. Purchases may be increased, decreased or discontinued at any time without prior notice. The plan does not obligate the Company to repurchase any specific number of shares and may be suspended at any time at management's discretion. No shares were repurchased during the three months ended October 3, 2009 or the three months ended October 4, 2008. As of October 3, 2009, there was \$16.7 million available for repurchase under the program.

Table of Contents**COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (income, expenses, gains and losses that bypass the income statement and are reported directly as a separate component of equity). The Company's comprehensive income (loss) consists of net income (loss), gain (loss) on available for sale securities and foreign currency translation adjustments for all periods presented.

	Three Months Ended	
	October 3, 2009	October 4, 2008
	(in thousands)	
Net income (loss)	\$ (4,182)	\$ 11,205
Gain (loss) on available for sale securities	2,243	(5,396)
Accumulated translation adjustments	2,265	2,082
Total comprehensive income (loss)	\$ 326	\$ 7,891

INVESTMENTS

The Company's investment portfolio consists of treasury bills, guaranteed investment certificates and auction rate securities. The Company holds a variety of interest bearing auction rate securities (ARS) consisting of federally insured student loan backed securities and insured municipal authority bonds. As of October 3, 2009, the Company's ARS portfolio totaled approximately \$189.9 million, \$69.5 million classified as trading securities (net of impairment charges of \$12.7 million) and \$120.4 million (net of a temporary impairment charge of \$14.6 million, of which a \$2.2 million gain has been recognized in the current year) classified as available for sale securities. The Company's ARS portfolio includes approximately 98% federally insured student loan backed securities and 2% municipal authority bonds. The Company's ARS portfolio consists of approximately 46% AAA rated investments, 10% AA rated investments, 33% A rated investments and 11% BBB rated investments. This is a change from the Company's fiscal 2009 portfolio, which consisted of 46% AAA rated investments, 14% AA rated investments, 30% A rated investments and 10% BBB rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected the Company's holdings in ARS investments and auctions for the Company's investments in these securities have failed to settle on their respective settlement dates. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While the Company continues to earn interest on its ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and the Company will not be able to access these funds until a future auction of these investments is successful, the issuer redeems the securities, or at maturity. Maturity dates for these ARS investments range from 2010 to 2044 with principal distributions occurring on certain securities prior to maturity.

In November 2008, the Company entered into a settlement agreement related to its ARS held with UBS Financial Services, Inc. (UBS) that grants the Company certain rights related to these ARS (the Right). Beginning June 30, 2010, at the Company's request, UBS has agreed to purchase all of the Company's ARS currently held with them at par value. Conversely, UBS has the right, in its discretion, to purchase or sell the Company's ARS at any time until July 2, 2012, so long as the Company receives payment at par value upon any sale or disposition. The enforceability of the Right results in a put option which should be recognized as a free standing asset separate from the ARS. Upon acceptance of the offer from UBS in November 2008, the Company recorded the put option at fair value of \$11.6 million, with a corresponding credit to interest and other income, net. Although it is a financial instrument, the put option does not meet the FASB's definition of a derivative instrument, therefore the Company has elected to measure the put option at fair value. As a result, unrealized gains and losses are included in earnings. At October 3, 2009, the fair value of the put option is \$12.1 million, net of a reserve of \$0.6 million, of which a gain of \$0.02 million

has been recognized in the current year.

Prior to accepting the UBS offer, the Company recorded its ARS held with UBS as investments available for sale, with an associated unrealized loss included in other comprehensive income. In connection with our acceptance of the UBS offer in November 2008, the Company transferred approximately \$84.4 million in ARS subject to the UBS settlement from investments available for sale to trading securities and recorded a loss on investments of approximately \$12.1 million. As a result, subsequent changes in fair value of the ARS have been recorded as a component of net income. The Company intends to exercise the Right when it becomes available, and as such the associated investments have been classified as short term on the balance sheet.

The remainder of the Company's ARS investment portfolio of \$120.4 million, net of a temporary impairment charge of \$14.6 million, remains available for sale on our balance sheet. The related temporary impairment charge remains as a loss in accumulated other comprehensive income.

Table of Contents

The Company also holds short term available for sale securities totaling \$38.5 million as of October 3, 2009, that consist of treasury bills and guaranteed investment certificates which are classified as available for sale securities on its balance sheet at cost which approximates fair value.

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

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

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

	Cost	As of October 3, 2009		Estimated Fair Value
		Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	
(in thousands)				
Treasury bills	\$ 30,000	\$	\$	\$ 30,000
Guaranteed investment certificates	8,477			8,477
Auction rate securities	135,025		(14,594)	120,431
Total	\$ 173,502	\$	\$ (14,594)	\$ 158,908

	Cost	As of October 4, 2008		Estimated Fair Value
		Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	
(in thousands)				
Auction rate securities	\$ 241,350	\$ (13,195)	\$	\$ 228,155

CREDIT FACILITIES

The Company has an unsecured commercial line of credit agreement which provides for borrowings and issuance of letters of credit of up to a combined total of \$25.0 million and expires on March 31, 2012. The outstanding balance bears interest at either the bank's reference rate (which

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was 3.25% as of October 3, 2009) or the LIBOR rate (which was 0.25% as of October 3, 2009) plus 1.75 percentage points. As of October 3, 2009, there were no outstanding cash borrowings and there was \$2.7 million of letters of credit outstanding.

This credit facility requires the Company to maintain a \$2.5 million compensating balance and to comply with certain financial covenants, including amounts for minimum tangible net worth, unencumbered liquid assets and profitability, and certain restrictions on making loans and investments. As of October 3, 2009 the Company was not in compliance with respect to one covenant of the agreement requiring specified quarterly income levels. A waiver has been obtained for the quarter ended October 3, 2009.

Table of Contents**STOCK BASED COMPENSATION**

The following table summarizes the stock based compensation expense recognized under the Company's stock plan during the three months ended October 3, 2009 and October 4, 2008:

	Three Months Ended	
	October 3, 2009	October 4, 2008
	(in thousands)	
Stock options	\$ 699	\$ 1,595
Nonvested stock awards/units	(68)	144
Total stock based compensation expense	\$ 631	\$ 1,739

Unrecognized compensation cost related to nonvested stock options and nonvested stock awards/units totaled approximately \$7.7 million and \$0.3 million, respectively, as of October 3, 2009. This cost is expected to be recognized over a weighted average period of 2.9 years. The weighted average fair value of stock options at their grant date during the three months ended October 3, 2009 and October 4, 2008 was \$2.87 and \$4.10, respectively.

During the first quarter of 2010, the Company filed a Tender Offer Statement on Schedule TO with the SEC pursuant to which the Company extended an offer to employees and non-employee directors to exchange up to an aggregate of 2,058,475 options to purchase shares of our common stock, whether vested or unvested. Options with an exercise price greater than \$10.74 per share and an expiration date after September 29, 2009 were eligible to be tendered pursuant to the offer. The closing market price on September 29, 2009 was \$7.64. In accordance with the Tender Offer (the "TO"), the number of new options issued was based on exchange ratios as set forth in the table below:

Exercise Price Range	Shares Subject to Option Surrendered	Shares Subject to Replacement Option To Be Granted
\$10.75-\$14.99	1.14	1
\$15.00-\$19.99	1.84	1
\$20.00 and above	2.06	1

A total of 1,710,735 options were tendered and cancelled, and a total of 1,126,267 options were granted on September 29, 2009 with an exercise price of \$7.64 per share. Replacement options granted in exchange for fully or partially unvested surrendered options at the time they were surrendered for cancellation will vest as follows: (A) vested shares subject to eligible options and unvested shares subject to eligible options scheduled to vest prior to the one-year anniversary of the replacement grant date shall vest on the one-year anniversary of the replacement grant date and (B) unvested shares subject to eligible options scheduled to vest after the one-year anniversary of the replacement grant date shall vest according to the original vest dates of the eligible option. The TO was subject to modification accounting pursuant to FASB ASC 718-20-35-3 whereby the total compensation cost measured at the date of modification was the incremental cost resulting from the modification. The incremental cost resulting from the modification is measured as the excess of the fair value of the modified award over the fair value of the original award immediately before its terms are modified. The incremental fair value of \$0.3 million for the new awards was computed using an expected life of 4.07 years, a risk-free interest rate of 1.94% and a volatility of 54%. The incremental fair value of the unvested awards is being amortized over the remaining service period.

FAIR VALUE MEASUREMENTS

The FASB has established a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

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

As of October 3, 2009, the Company held financial instruments that are measured at fair value on a recurring basis. These included cash equivalents, trading securities, a written put option related to a UBS settlement and available for sale securities. Cash equivalents consist of money market funds. Short term available for sale securities consist of government treasury bills and guaranteed investment certificates. Trading securities consist of auction rate securities (ARS) held with UBS. Long term available for sale securities consist of ARS held with another broker. These securities consist of federally insured student loan backed securities and insured municipal authority bonds.

Table of Contents

The Company determined the estimated fair value of its investment in ARS as of October 3, 2009 using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing, credit ratings, credit wrap and amount of cash flows and expected holding periods of the ARS. The ARS written put right is a free-standing asset separate from the ARS and represents the Company's contractual right to require UBS to purchase its ARS at par value during the two-year period beginning June 20, 2010. In order to value the ARS written put right, the Company considered intrinsic value, time value of money and its assessment of the credit worthiness of UBS.

The following items are measured at fair value on a recurring basis as of October 3, 2009:

Description	October 3, 2009	Using Quoted Prices	Significant	Significant
		in Active Markets for	Other	Unobservable Inputs
		Identical Assets	Observable	(Level 3)
		(Level 1)	Inputs	(Level 3)
		Fair value measurements at reporting date		
		(In thousands)		
Cash equivalents	\$ 51,083	\$ 51,083	\$	\$
Current available for sale securities	38,477	38,477		
Trading securities	69,460			69,460
ARS written put option	12,106			12,106
Non-current available for sale securities	120,431			120,431
Total	\$ 291,557	\$ 89,560	\$	\$ 201,997

The following table presents the Company's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended October 3, 2009:

	Investments in ARS
	(In thousands)
Balance as of July 4, 2009	\$ 200,431
Total gains or (losses) (realized or unrealized)	
Included in net loss	22
Included in accumulated other comprehensive loss	2,244
Settlements	(700)
Balance as of October 3, 2009	\$ 201,997

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis:

The Company measures certain non-financial assets and liabilities, including long-lived assets, at fair value on a non-recurring basis. During the 13 weeks ended October 3, 2009, the Company recorded a charge of approximately \$1.7 million related to the impairment of assets related to under-performing stores. The fair market value of these assets was determined using the income approach and level 3 inputs, which required management to make significant estimates about future cash flows. Management estimates the amount and timing of future cash flows based on its experience and knowledge of the retail market in which each store operates. This impairment charge is included in selling, general and administrative expenses (SG&A) in the accompanying condensed consolidated statements of operations. The Company was not required to

measure any other significant non-financial assets and liabilities at fair value.

LEGAL MATTERS

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

A former employee sued the Company in a complaint filed on April 28, 2005 in the United States District Court for the Northern District of California (case No. C050177) alleging violations under the Fair Labor Standards Act, specifically that the Company obligated her to buy and wear its brand clothing as a uniform, without reimbursement or credit, and the net effect of deducting the value of such required purchases from her wages would often result in her not being paid minimum wages. The plaintiff purports to bring the action also on behalf of a class of hourly, non-managerial employees who are similarly situated. The lawsuit seeks compensatory, statutory and injunctive relief. The Company negotiated a confidential settlement in this case which received final court approval on November 3, 2009. The Company accrued an amount the Company believes reasonably estimates the potential liability, which did not have a material impact on the Company's financial position or results of operations.

Table of Contents

A former employee sued the Company in a complaint filed July 27, 2006 in the Superior Court of California, San Mateo County (case No. CIV 456550) alleging a failure to pay all wages, failure to pay overtime wages, failure to pay minimum wages, failure to provide meal periods, violation of Labor Code §450, violation of Labor Code §2802 and California Code of Regulations §11040(9)(A), statutory wage violations (late payment of wages), unlawful business practices under Business and Professions Code §16720 and §17200, conversion of wages and violation of Civil Code §52.1. The plaintiff purports to bring the action also on behalf of current and former California bebe employees who are similarly situated. The lawsuit seeks compensatory, statutory, punitive, restitution and injunctive relief. In August 2009, the court extended its prior order conditionally denying class certification and maintained a stay of the action until a final order is issued regarding the proposed class settlement described in the lawsuit immediately above (filed April 28, 2005).

The Company is also involved in various other legal proceedings arising in the normal course of business. None of these matters nor the matters listed above are expected, individually or in the aggregate, to have a material adverse effect on the Company's business, financial condition or results of operations.

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

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

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

OVERVIEW

We design, develop and produce a distinctive line of contemporary women's apparel and accessories. While we attract a broad audience, our target customer is a 18 to 34-year-old woman who seeks current fashion trends to suit her lifestyle. The "bebe look" appeals to a hip, sexy, sophisticated, body-conscious woman who takes pride in her appearance. The bebe customer expects value in the form of current fashion and high quality at a competitive price.

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Our distinctive product offering includes a full range of separates, tops, sweaters, dresses, active wear and accessories in the following lifestyle categories: career, evening, casual and active. We design and develop the majority of our merchandise in-house, which is manufactured to our specifications. The remainder of our merchandise is sourced directly from third-party manufacturers.

We market our products under the bebe, BEBE SPORT, bbsp, 2b bebe and PH8 brand names through our 307 retail stores, of which 212 are bebe stores, 61 are BEBE SPORT stores, 33 are 2b bebe stores and 1 is a bebe accessories store as of October 3, 2009. These stores are located in 35 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Canada. In addition, we have an on-line store at www.bebe.com, and our licensees operate 37 international stores as of October 3, 2009. During the three months ended October 3, 2009, we opened 2 bebe stores and closed a bebe store, a BEBE SPORT store and a 2b bebe store. We expect to open approximately 5 bebe stores during fiscal 2010. We also plan to expand an existing store. We intend to convert our BEBE SPORT stores to PH8 stores in the second quarter of fiscal 2010.

bebe stores. We were founded by Manny Mashouf, our Chief Executive Officer and Chairman of the Board. We opened our first store in San Francisco, California in 1976, which was also the year we incorporated. We also operate one bebe accessory store that features a limited assortment of bebe merchandise, including outerwear, shoes and accessories.

BEBE SPORT. We launched BEBE SPORT during fiscal 2003 to address the performance and active lifestyle needs of the bebe customer. We offer a selection of sportswear and footwear under the BEBE SPORT and bbsp brand names. In September 2009, we began introducing product under our new PH8 label in our existing BEBE SPORT stores and we intend to convert the BEBE SPORT stores to PH8 stores in November 2009, and begin to offer BEBE SPORT product in bebe and 2b bebe stores starting Holiday 2009. In our PH8 stores, we will offer a selection of casual weekend apparel, work-out attire and accessories such as bags, shoes and various seasonal items. In addition, we will launch a separate PH8 on-line store in June 2010 that will provide a complete assortment of PH8 product and will also be used as a vehicle to communicate with our new customers. Due to the change in store fronts and product offering we will exclude the new PH8 stores from comparable store sales as of November 2009.

Table of Contents

2b bebe stores. We currently operate 15 2b bebe stores and 18 stores operating in the outlet store design under the 2b bebe name. The stores operating in the 2b bebe design sell bebe logo, 2b bebe merchandise and a small percentage of bebe retail markdowns. The stores operating in the outlet design with the same name change sell bebe logo, 2b bebe merchandise and a large percentage of bebe retail markdowns.

On-line. bebe.com is an extension of the bebe store experience and provides a complete assortment of bebe and BEBE SPORT merchandise. It is also used as a vehicle to communicate with our customers.

CRITICAL ACCOUNTING POLICIES

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

The preparation of these financial statements requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the financial statements. We believe our application of accounting policies, and the estimates inherently required therein, are reasonable. Our most critical accounting policies are those related to revenue recognition, stock based compensation, inventories, marketable securities, impairment of long lived assets, uncertain tax positions and liabilities for self-insurance. We continually evaluate these accounting policies and estimates, and we make adjustments when facts and circumstances dictate a change. Our accounting policies are described in Note 1 to the consolidated financial statements in our annual report on Form 10-K for the fiscal year ended July 4, 2009. This discussion and analysis should be read in conjunction with such discussion and with our condensed consolidated financials statements and related notes included in Part 1, Item 1 of this quarterly report.

RESULTS OF OPERATIONS

Our fiscal year is a 52 or 53 week period, each period ending on the first Saturday after June 30. Fiscal years 2010 and 2009 each include 52 weeks. The three months ended October 3, 2009 and October 4, 2008 each include 13 weeks.

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

	Three Months Ended	
	October 3, 2009	October 4, 2008
Net sales	100.0%	100.0%
Cost of sales, including production and occupancy (1)	63.3	55.1

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Gross margin	36.7	44.9
Selling, general and administrative expenses (2)	42.2	36.2
Operating income (loss)	(5.5)	8.7
Interest and other income, net	0.9	1.9
Income (loss) before income taxes	(4.6)	10.6
Provision (benefit) for income taxes	(1.3)	3.7
Net income (loss)	(3.3)%	6.9%

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- (1) Cost of sales includes the cost of merchandise, occupancy costs, distribution center and production costs.
- (2) Selling, general and administrative expenses primarily consist of non-occupancy store costs, corporate overhead and advertising costs.

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Table of Contents

Net Sales. Net sales decreased to \$125.7 million during the three months ended October 3, 2009 from \$163.3 million for the comparable period of the prior year, a decrease of \$37.6 million, or 23.0%. The decrease in sales was primarily due to a 25.7% decrease in comparable store sales resulting primarily from the overall macroeconomic environment, in which we saw lower traffic and conversion in stores, a reduced customer acceptance of the merchandise offering and a 16.6% decrease in our on-line sales. These decreases were partially offset by stores not included in the comparable store sales, an increase in wholesale sales to international licensees and an increase in royalty revenue.

	Three Months Ended	
	October 3, 2009	October 4, 2008
Net sales (In thousands)	\$ 125,659	\$ 163,260
Total net sales increase (decrease) percentage	(23.0)%	1.4%
Comparable store sales decrease percentage	(25.7)%	(10.8)%
Net sales per average square foot (1)	\$ 104	\$ 138
Square footage at end of period (In thousands)	1,155	1,143
Number of store locations:		
Beginning of period	308	303
New store locations	2	5
Closed store locations	3	1
Number of stores open at end of period	307	307

(1) We calculate net sales per average square foot using net store sales and monthly average store square footage.

Gross Margin. Gross margin decreased to \$46.2 million during the three months ended October 3, 2009 from \$73.3 million for the comparable period of the prior year, a decrease of \$27.1 million, or 37.0%. As a percentage of net sales, gross margin decreased to 36.7% for the three months ended October 3, 2009 from 44.9% in the comparable period of the prior year. The decrease in gross margin as a percentage of net sales was primarily due to higher markdowns and unfavorable occupancy leverage partially offset by lower other costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses, which primarily consist of non-occupancy store costs, corporate overhead and advertising costs, decreased to \$53.0 million during the three months ended October 3, 2009 from \$59.2 million for the comparable period of the prior year, a decrease of \$6.2 million, or 10.5%. As a percentage of net sales, selling, general and administrative expenses increased to 42.2% during the three months ended October 3, 2009 from 36.2% in the comparable period of the prior year. The decrease in dollars over the prior year was primarily due to an increase in depreciation expense and a \$1.7 million impairment charge related to under-performing stores offset by lower compensation and advertising expense. The increase as a percentage of net sales is a result of lower revenues.

Interest and Other Income, Net. We generated approximately \$1.0 million of interest and other income, net of other expenses during the three months ended October 3, 2009 compared to approximately \$3.0 million in the comparable period of the prior year. The decrease in interest and other income resulted from investments in lower-yielding tax-exempt investments and money market funds.

Provision for Income Taxes. Our effective tax rate was a 28.1% benefit for the three months ended October 3, 2009 compared to a 34.8% provision for the comparable period in the prior year. The lower effective tax rate was primarily due to discrete adjustments booked during the quarter offset by an increase in tax-exempt interest income as a percent of total pre-tax loss and a change in tax treatment related to our stock option exchange in which incentive stock options that were exchanged were converted to non-qualified stock options.

Table of Contents

SEASONALITY OF BUSINESS AND QUARTERLY RESULTS

Our business varies with general seasonal trends that are characteristic of the retail and apparel industries. As a result, our typical store generates a higher percentage of our annual net sales and profitability in the second quarter of our fiscal year, which includes the holiday selling season, compared to the other quarters of our fiscal year. If for any reason our sales were below seasonal norms during the second quarter of our fiscal year, our annual operating results would be negatively impacted. Because of the seasonality of our business, results for any quarter are not necessarily indicative of results that may be achieved for a full fiscal year.

LIQUIDITY AND CAPITAL RESOURCES

Our working capital requirements vary widely throughout the year and generally peak during the first and second fiscal quarters. As of October 3, 2009, we had approximately \$309.1 million of cash and equivalents and investments on hand of which approximately \$40.0 million were invested in government treasury bills (of these, \$10.0 million are classified as cash equivalents), approximately \$8.5 million were invested in guaranteed investment certificates, and approximately \$189.9 million, net of impairment charges of \$27.3 million, were invested in auction rate securities (ARS). We do not anticipate the lack of liquidity in the ARS to impact our ability to fund our operations in the foreseeable future and believe we have sufficient cash and equivalents to fund ongoing operations. In addition, we have a revolving line of credit, under which we may borrow or issue letters of credit up to a combined total of \$25 million. As of October 3, 2009, there were no cash borrowings outstanding under the line of credit, and letters of credit outstanding totaled \$2.7 million. This credit facility requires us to maintain a \$2.5 million compensating balance and to comply with certain financial covenants, including amounts for minimum tangible net worth, unencumbered liquid assets and profitability, and certain restrictions on making loans and investments. As of October 3, 2009, we were not in compliance with one covenant of the agreement requiring specified quarterly income levels. We obtained a waiver as of October 3, 2009, with respect to this covenant for the quarter ended October 3, 2009.

As of October 3, 2009, we had cash and equivalents of \$80.7 million held in accounts managed by third-party financial institutions consisting of invested cash and cash in our operating accounts. The invested cash is invested in interest bearing funds managed by third party financial institutions. These funds invest in direct obligations of the government of the United States. To date, we have experienced no loss or lack of access to our invested cash or equivalents; however, we can provide no assurances that access to our invested cash and equivalents will not be impacted by adverse conditions in the financial markets.

At any point in time we also have approximately \$75 to \$100 million of invested cash and cash in operating accounts that are with third party financial institutions. These balances exceed the Federal Deposit Insurance Corporation insurance limits. While we monitor daily the cash balances in our operating accounts and adjust the cash balances as appropriate, these cash balances could be impacted if the underlying financial institutions fail or could be subject to other adverse conditions in the financial markets. To date, we have experienced no loss or lack of access to invested cash or cash in our operating accounts.

Net cash used by operating activities for the three months ended October 3, 2009 was \$9.9 million versus cash provided by operating activities of \$14.6 million for the three months ended October 4, 2008. The decrease of \$24.5 million from the comparable period was primarily due to a decrease in net earnings of \$15.4 million and decreased changes in working capital of \$8.5 million primarily related to lower accounts payable resulting from decreases in finished goods inventory at stores and reduced costs related to new store openings.

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Net cash used by investing activities for the three months ended October 3, 2009 was \$0.9 million versus \$6.6 million for the three months ended October 4, 2008. The decrease of \$5.7 million versus the prior year comparable period was primarily due to lower capital expenditures. We expect that total capital expenditures will be below \$20 million in fiscal 2010.

Net cash used by financing activities was \$6.4 million for the three months ended October 3, 2009 versus \$8.5 million for the three months ended October 4, 2008. The decrease of \$2.1 million from the prior year comparable period was primarily due to lower dividends paid related to a lower rate declared for the first quarter of fiscal 2010 (\$0.025 per share versus \$0.05 per share in the prior year).

We hold a variety of interest bearing ARS consisting of federally insured student loan backed securities and insured municipal authority bonds. As of October 3, 2009, our ARS portfolio totaled approximately \$189.9 million, \$69.5 million (net of an impairment charge of \$12.7 million) classified as trading securities and \$120.4 million (net of temporary impairment charge of \$14.6 million) classified as long-term available for sale securities. Our ARS portfolio includes approximately 98% federally insured student loan backed securities and 2% municipal authority bonds. Our ARS portfolio consists of approximately 46% AAA rated investments, 10% AA rated investments, 33% A rated investments and 11% BBB rated investments. This is a change from our fiscal 2009 portfolio, which consisted of 46% AAA rates investments, 14% AA rated investments, 30% A rated investments and 10% BBB related investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected our holdings in ARS investments and auctions for our investments in these securities have failed to settle on their respective settlement dates. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and

Table of Contents

therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and we will not be able to access these funds until a future auction of these investments is successful, the issuer redeems the securities, or at maturity. Maturity dates for these ARS investments range from 2010 to 2044 with principal distributions occurring on certain securities prior to maturity.

In November 2008, we entered into a settlement agreement related to our ARS held with UBS Financial Services, Inc. (UBS) that grants us certain rights related to these ARS (the Right). Beginning June 30, 2010, at our request, UBS has agreed to purchase all of our ARS currently held with them at par value. Conversely, UBS has the right, in its discretion, to purchase or sell our ARS at any time until July 2, 2012, so long as we receive payment at par value upon any sale or disposition. The enforceability of the Right results in a put option which should be recognized as a free standing asset separate from the ARS. Upon acceptance of the offer from UBS, we recorded the put option at fair value of \$11.6 million, with a corresponding credit to interest income. Although it is a financial instrument, the put option does not meet the FASB's definition of a derivative instrument, therefore we have elected to measure the put option at fair value. As a result, unrealized gains and losses are included in earnings. At October 3, 2009, the fair value of the put option is \$12.1 million, net of a reserve of \$0.6 million, of which a gain of \$0.02 million has been recognized in the current year.

Prior to accepting the UBS offer, we recorded our ARS held with UBS as investments available for sale, with an associated unrealized loss included in other comprehensive income. In connection with our acceptance of the UBS offer in November 2008, we transferred approximately \$84.4 million in ARS subject to the UBS settlement from investments available for sale to trading securities and recorded a loss on investments of approximately \$12.1 million. As a result, changes in fair value of the ARS are recorded as a component of net income. We intend to exercise the Right when it becomes available, and as such the associated investments have been classified as short-term on the balance sheet.

In October 2008, our board of directors authorized a program to repurchase up to \$30 million of our common stock. We may, from time to time, as business conditions warrant, purchase stock in the open market or through private transactions. Purchases may be increased, decreased or discontinued at any time without prior notice. The plan does not obligate us to repurchase any specific number of shares and may be suspended at any time at management's discretion. We did not repurchase any shares during the first quarter of fiscal 2010 and \$16.7 million remains available under the program.

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

Table of Contents**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

Interest Rate Risk

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

All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents. Investments are considered short-term available for sale securities if the original maturity is between three months and twelve months, short-term trading securities if they are ARS related to the Right with UBS, or long term investments if the original maturity is greater than twelve months. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. We determined the estimated fair value of our investment in ARS as of October 3, 2009 using a discounted cash flow model to estimate the fair value of our investments in ARS. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows and expected holding periods of the ARS. The ARS written put right is a free standing asset separate from the ARS, and represents our contractual right to require UBS to purchase our ARS at par value during the two year period beginning June 20, 2010. In order to value the ARS written put right, we considered intrinsic value, time value of money and our assessment of the credit worthiness of UBS. We have modified our investment strategy and increased our investments in more liquid money market investments. An immediate and uniform increase in market interest rate of 100 basis points from levels as of October 3, 2009 would cause an additional decline of approximately 3.5%, or \$6.4 million, in the fair market value of our investments in ARS.

The following table lists our cash, cash equivalents and investments as of October 3, 2009:

	Fair Value (Dollars in thousands)	
Cash	\$	29,627
Weighted average interest rate		0.00%
Cash equivalents	\$	51,083
Weighted average interest rate		0.07%
Current available for sale securities	\$	38,477
Weighted average interest rate		0.09%
Trading securities	\$	69,460
Weighted average interest rate		0.77%
Non-current available for sale securities	\$	120,431
Weighted average interest rate		0.70%
Total	\$	309,078

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

Table of Contents

Foreign Currency Risks

We enter into a significant amount of purchase obligations outside of the United States, substantially all of which are negotiated and settled in U.S. Dollars and, therefore, have only minimal exposure to foreign currency exchange risks. We also operate a subsidiary for which the functional currency is the Canadian Dollar. In accordance with FASB ASC 830, *Foreign Currency Matters*, we translate assets and liabilities of Canada's operations into U.S. dollars at month-end rates, while we translate income and expenses at the weighted average exchange rates for the month. We record the related translation adjustments in accumulated other comprehensive income as a separate component of shareholders equity. Fluctuations in exchange rates therefore impact our financial condition and results of operations, as reported in U.S. Dollars. We do not hedge against foreign currency risks and believe that foreign currency exchange risk is immaterial.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report at the reasonable assurance level.

There has been no change in our internal control over financial reporting during the quarter ended October 3, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Our past performance may not be a reliable indicator of future performance because actual future results and trends may differ materially depending on a variety of factors, including, but not limited to, the risks and uncertainties discussed below. In addition, historical trends should not be used to anticipate results or trends in future periods.

Factors that might cause our actual results to differ materially from the forward looking statements discussed elsewhere in this report, as well as affect our ability to achieve our financial and other goals, include, but are not limited to, those set forth below. Except for changes to the general economic conditions risk factor, there have been no material changes in our risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended July 4, 2009.

RISKS RELATING TO OUR BUSINESS:

1. The success of our business depends in large part on our ability to identify fashion trends as well as to react to changing customer demand in a timely manner. Consequently, we depend in part upon the customer response to the creative efforts of our merchandising, design and marketing teams and their ability to anticipate trends and fashions that will appeal to our consumer base. If we miscalculate our customers' product preferences or the demand for our products, we may be faced with excess inventory. Historically, this type of occurrence has resulted in excess fabric for some products and markdowns and/or write-offs, which has impaired our profitability, and may do so in the future. Similarly, any failure on our part to anticipate, identify and respond effectively to changing customer demands and fashion trends will adversely affect our sales.

2. If we are unable to obtain raw materials, or unable to find manufacturing facilities or if our manufacturers perform unacceptably, our sales may be negatively affected and our financial condition may be harmed. We do not own any manufacturing facilities and therefore depend on contractors and third parties to manufacture our products. We place all of our orders for production of merchandise and raw materials by purchase order and do not have any long-term contracts with any manufacturer or supplier. If we fail to maintain favorable relationships with our manufacturers and suppliers or are unable to obtain sufficient quantities of quality raw materials on commercially reasonable terms, it could harm our business and results of operations. We cannot assure you that contractors and third-party manufacturers (1) will not supply similar products to our competitors, (2) will not stop supplying products to us completely or (3) will supply products in a timely manner. Untimely receipt of products may result in lower than anticipated sales and markdowns which would have a negative impact on earnings. Furthermore, we have received in the past, and may receive in the future, shipments of products from manufacturers that fail to conform to our quality control standards. In such event, unless we are able to obtain replacement products in a timely manner, we may lose sales. Certain of our third-party

manufacturers store our raw materials. In the event our inventory was damaged or destroyed and we were unable to obtain replacement raw materials, our earnings could be negatively impacted.

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

In addition, we depend on the expertise and execution of our key employees, particularly Manny Mashouf, our founder, Chief Executive Officer and Chairman of the Board of Directors and Kathy Lee, Chief Merchandising Officer. If we lose the services of Mr. Mashouf, Ms. Lee, or any key officers or employees, it could harm our business and results of operations.

4. If we are not able to successfully develop new concepts, including 2b bebe and PH8, our revenue base and earnings may be impaired. From time to time, we may pursue new concepts. If the 2b bebe, PH8 or other new concepts are not successful we may incur additional charges related to closed stores or store impairment and as such, our results from operations and financial condition may be harmed.

Table of Contents

5. General economic conditions, including increases in energy and commodity prices, that are largely out of our control may adversely affect our financial condition and results of operations. We are sensitive to changes in general economic conditions, both nationally and locally. Recessionary economic cycles, higher interest rates, higher fuel and other energy costs, inflation, deflation, increases in commodity prices, higher levels of unemployment, higher consumer debt levels, higher tax rates and other changes in tax laws or other economic factors that may affect consumer spending or buying habits could adversely affect the demand for products we sell in our stores. In addition, the recent turmoil in the financial markets may have an adverse effect on the U.S. and world economy, which could negatively impact consumer spending patterns. We cannot assure you that government responses to the disruptions in the financial markets will restore consumer confidence.

Furthermore, we could experience reduced traffic in our stores or limitations on the prices we can charge for our products, either of which could reduce our sales and profit margins and have a material adverse effect on our financial condition and results of operations. Also, economic factors such as those listed above and increased transportation costs, inflation, higher costs of labor, insurance and healthcare, and changes in other laws and regulations may increase our cost of sales and our operating, selling, general and administrative expenses, and otherwise adversely affect our financial condition and results of operations.

6. We cannot assure you that future store openings will be successful, and new store openings may impact existing stores. We expect to open approximately 5 bebe stores in fiscal 2010. In the past, we have closed stores as a result of poor performance, and we cannot assure you that the stores that we plan to open in fiscal 2010, or any other stores that we might open in the future, will be successful or that our overall operating profit will increase as a result of opening these stores. During the first quarter of fiscal 2010 we closed 3 stores and anticipate closing 3 additional stores during the remainder of the fiscal year. Most of our new store openings in fiscal 2010 will be in existing markets. These openings may affect the existing stores' net sales and profitability. Our failure to predict accurately the demographic or retail environment at any future store location could have a material adverse effect on our business, financial condition and results of operations.

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

7. We are subject to risks associated with our on-line sales. We operate an on-line store at *www.bebe.com* to sell our merchandise, which we migrated to a third-party platform in February 2006. Although our on-line sales encompass a relatively small percentage of our total sales, our on-line operations are subject to numerous risks, including unanticipated operating problems, reliance on third-party computer hardware and software providers, system failures and the need to invest in additional computer systems. The on-line operations also involve other risks that could have an impact on our results of operations including but not limited to diversion of sales from our other stores, rapid technological change, liability for on-line content, credit card fraud and risks related to the failure of the computer systems that operate the website and its related support systems. In addition, with the migration to a third-party platform, we no longer have direct control of certain aspects of our on-line business. We cannot assure that our on-line store will continue to achieve sales and profitability growth or even remain at its current level.

8. Any serious disruption at our major facilities could have a harmful effect on our business. We currently operate a corporate office in Brisbane, California, a distribution facility in Benicia, California, and a design studio and production facility in Los Angeles, California. Any serious disruption at these facilities whether due to construction, relocation, fire, earthquake, terrorist acts or otherwise could harm our operations and could have a harmful effect on our business and results of operations. Furthermore, we have little experience operating essential functions away from our main corporate offices and are uncertain what effect operating such satellite facilities might have on business, personnel and results of operations.

9. We rely on information technology, the disruption of which could adversely impact our business. We rely on various information systems to manage our operations and regularly make investments to upgrade, enhance or replace such systems. Any delays or difficulties in transitioning to these or other new systems, or in integrating these systems with our current systems, or any other disruptions affecting our information systems, could have a material adverse impact on our business. Any failure to maintain adequate system security controls to protect our computer assets and sensitive data, including client data, from unauthorized access, disclosure or use could also damage our reputation with our clients.

10. We face significant competition in the retail and apparel industry, which could harm our sales and profitability. The retail and apparel industries are highly competitive and are characterized by low barriers to entry. We expect competition in our markets to increase. The primary competitive factors in our markets are: brand name recognition, sourcing, product styling, quality, presentation and pricing, timeliness of product development and delivery, store ambiance, customer service and convenience. We compete with traditional department stores, specialty store retailers, business to consumer websites, off-price retailers and direct marketers for, among other things, raw materials, market share, retail space, finished goods, sourcing and personnel. Because many of these competitors are larger and have substantially greater financial, distribution and marketing resources than we do, we may lack the resources to adequately compete with them. If we fail to remain competitive in any way, it could harm our business, financial condition and results of operations.

Table of Contents

11. Our business could be adversely impacted by unfavorable international political conditions. Due to our international operations, our sales and operating results are, and will continue to be, affected by international social, political, legal and economic conditions. In particular, our business could be adversely impacted by instability or changes resulting in the disruption of trade with the countries in which our contractors, suppliers or customers are located, significant fluctuations in the value of the dollar against foreign currencies or restrictions on the transfer of funds, or additional trade restrictions imposed by the United States and other foreign governments. Trade restrictions, including increased tariffs or quotas, embargoes and customs restrictions could increase the cost or reduce the supply of merchandise available to us and adversely affect our financial condition and results of operations. In addition, we purchase a substantial amount of our raw materials from China and our business and operating results may be affected by changes in the political, social or economic environment in China.

12. If we are not able to successfully protect our intellectual property our ability to capitalize on the value of our brand name may be impaired. Even though we take actions to establish, register and protect our trademarks and other proprietary rights, we cannot assure you that we will be successful or that others will not imitate our products or infringe upon our intellectual property rights. In addition, we cannot assure that others will not resist or seek to block the sale of our products as infringements of their trademark and proprietary rights.

We are seeking to register our trademarks domestically and internationally. Obstacles may exist that may prevent us from obtaining a trademark for the bebe, BEBE SPORT, bbsp, 2b bebe and PH8 names or related names. We may not be able to register certain trademarks, purchase the right or obtain a license to use these names or related names on commercially reasonable terms. If we fail to obtain trademark, ownership or license the requisite rights, it would limit our ability to expand. In some jurisdictions, despite successful registration of our trademarks, third parties may allege infringement and bring actions against us. In addition, if our licensees fail to use our intellectual property correctly, the reputation and value associated with our trademarks may be diluted. Furthermore, if we do not demonstrate use of our trademarks, our trademark rights may lapse over time.

13. We may be required to record losses in future quarters as a result of the decline in value of our investments in auction rate securities or as a result of a change in our ability to hold our investment in auction rate securities. We hold a variety of interest bearing ARS comprised of federally insured student loan backed securities and insured municipal authority bonds. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The recent uncertainties in the credit markets that began in February 2008 have affected our holdings in ARS investments and the majority of auctions for our investments in these securities have failed to settle on their respective settlement dates. Consequently, \$189.2 million of our ARS are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful or securities are purchased or redeemed outside of the auction process. Maturity dates for these ARS investments range from 2010 to 2044, with principal distributions occurring on certain securities prior to maturity.

We entered into a settlement agreement related to our ARS held with UBS Financial Services, Inc. (UBS) that grants us certain rights related to these ARS (the Right). Beginning June 30, 2010, at our request, UBS has agreed to purchase all of our ARS currently held with them at par value. Conversely, UBS has the right, in its discretion, to purchase or sell our ARS at any time until July 2, 2012, so long as we receive payment at par value upon any sale or disposition. We expect to sell our ARS under our agreement with UBS. However, if the Right is not exercised before July 2, 2012, they will expire, and UBS will have no further right or obligation to buy our ARS. So long as we hold our ARS, they will continue to accrue interest as determined by the auction process or the terms of the ARS if the auction process fails. In addition, UBS's obligation under the Right is not secured by its assets and does not require UBS to obtain any financing to support its performance obligation under the Right. UBS has disclaimed any assurance that it will have sufficient financial resources to satisfy its obligation under the Right. If UBS has insufficient funding to buy back the ARS and the auction process continues to fail, then we may incur further losses on the carrying value of the ARS.

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

14. If an independent manufacturer violates labor or other laws, or is accused of violating any such laws, or if their labor practices diverge from those generally accepted as ethical, it could harm our business and brand image. While we maintain a policy to monitor the operations of our independent manufacturers by having an independent firm inspect these manufacturing sites, and all manufacturers are contractually required to comply with such labor practices, we cannot control the actions or the public's perceptions of such manufacturers, nor can we assure that these manufacturers will conduct their businesses using ethical or legal labor practices. Apparel companies can be held jointly liable for the wrongdoings of the manufacturers of their products. While we do not control their employees' employment conditions or the manufacturers' business practices, and the manufacturers act in their own interest, they may act in a manner that result in negative public perceptions of us and/or employee allegations or court determinations that we are jointly liable.

Table of Contents

RISKS RELATING TO OUR COMMON STOCK:

1. Because Manny Mashouf beneficially owns a substantial portion of the outstanding shares, other shareholders may not be able to influence the direction the company takes. As of October 30, 2009, Manny Mashouf, our Chief Executive Officer and Chairman of the Board, beneficially owned approximately 53% of the outstanding shares of our common stock. As a result, he can control the election of directors and the outcome of all issues submitted to the shareholders. This may make it more difficult for a third party to acquire shares, may discourage acquisition bids, and could limit the price that certain investors might be willing to pay for shares of common stock. This concentration of stock ownership may have the effect of delaying, deferring or preventing a change in control of our company.

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

In addition, our comparable store sales have fluctuated significantly in the past, and we expect that they will continue to fluctuate in the future. For example, we incurred a net loss for the first quarter of fiscal 2010 and cannot assure you of future profitability. A variety of factors affect comparable store sales, including fashion trends, competition, current economic conditions, the timing of release of new merchandise and promotional events, changes in our merchandise mix, the success of marketing programs and weather conditions. Our ability to deliver strong comparable store sales results and margins depends in large part on accurately forecasting demand and fashion trends, selecting effective marketing techniques, providing an appropriate mix of merchandise for our customer base, managing inventory effectively, and optimizing store performance by closing underperforming stores.

Such fluctuations may adversely affect the market price of our common stock.

3. Failure to comply with Section 404 of the Sarbanes-Oxley Act of 2002 could negatively impact investor confidence. In order to meet the requirements of the Sarbanes-Oxley Act of 2002 in future periods, we must continuously document, test, monitor and enhance our internal control over financial reporting. We cannot assure you that the periodic evaluation of our internal controls required by Section 404 of the Sarbanes-Oxley Act will not result in the identification of significant control deficiencies and/or material weaknesses or that our auditors will be able to attest to the effectiveness of our internal control over financial reporting. Failure to maintain the effectiveness of our internal control over financial reporting or to comply with the requirements of this Act could have a material adverse effect on our reputation, financial condition and market price of our common stock.

Table of Contents

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

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

Exhibit	Description
31.1	Section 302 Certification of Chief Executive Officer.
31.2	Section 302 Certification of Chief Financial Officer.
32.1	Section 906 Certification of Chief Executive Officer.
32.2	Section 906 Certification of Chief Financial Officer.

Table of Contents

SIGNATURE

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

Dated November 12, 2009

bebe stores, inc.

/s/ Walter Parks

Walter Parks, Chief Operating Officer and Chief Financial Officer

Table of Contents

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