

TILLY'S, INC.  
Form 10-Q  
June 13, 2013  
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**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 May 4, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-35535

**TILLY S, INC.**

(Exact name of Registrant as specified in its charter)

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**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 June 1, 2013, the registrant had the following shares of common stock outstanding:

|  |            |
|--|------------|
| Class A common stock \$0.001 par value | 10,796,664 |
| Class B common stock \$0.001 par value | 16,919,910 |

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**TILLY S, INC.**

**FORM 10-Q**

**For the Quarter Ended May 4, 2013**

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**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)

|  | May 4,<br>2013 | February 2,<br>2013 |
|--|----------------|---------------------|
| <b>ASSETS</b>  |                |                     |
| Current assets:  |                |                     |
| Cash and cash equivalents  | \$ 18,624      | \$ 17,314           |
| Marketable securities  | 29,935         | 39,868              |
| Receivables  | 8,089          | 5,934               |
| Merchandise inventories  | 49,665         | 46,595              |
| Prepaid expenses and other current assets  | 12,376         | 11,387              |
| Total current assets   | 118,689        | 121,098             |
| Property and equipment, net  | 87,322         | 80,926              |
| Other assets   | 3,660          | 3,357               |
| Total assets   | \$ 209,671     | \$ 205,381          |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                |                     |
| Current liabilities:   |                |                     |
| Accounts payable   | \$ 20,173      | \$ 18,261           |
| Deferred revenue   | 4,525          | 5,453               |
| Accrued compensation and benefits  | 3,366          | 6,094               |
| Accrued expenses   | 13,244         | 12,132              |
| Current portion of deferred rent   | 4,830          | 4,555               |
| Current portion of capital lease obligation/Related party (Note 10)  | 723            | 712                 |
| Total current liabilities  | 46,861         | 47,207              |
| Long-term portion of deferred rent   | 39,227         | 37,620              |
| Long-term portion of capital lease obligation/Related party (Note 10)  | 3,073          | 3,258               |
| Total long-term liabilities  | 42,300         | 40,878              |
| Total liabilities  | 89,161         | 88,085              |
| Commitments and contingencies (Note 5)   |                |                     |
| Stockholders equity:   |                |                     |
| Common stock (Class A), \$0.001 par value; May 4, 2013 - 100,000 shares authorized, 10,783 shares issued and outstanding; February 2, 2013 - 100,000 shares authorized, 10,772 shares issued and outstanding | 11             | 11                  |
| Common stock (Class B), \$0.001 par value; May 4, 2013 and February 2, 2013 - 35,000 shares authorized, 16,920 shares issued and outstanding   | 17             | 17                  |

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|  |                |                |
|--|----------------|----------------|
| Preferred stock, \$0.001 par value; May 4, 2013 and February 2, 2013 - 10,000 shares authorized, no shares issued or outstanding |                |                |
| Additional paid-in capital   | 118,283        | 117,391        |
| Retained earnings (deficit)  | 2,168          | (140)          |
| Accumulated other comprehensive income   | 31             | 17             |
| <b>Total stockholders' equity</b>  | <b>120,510</b> | <b>117,296</b> |
| Total liabilities and stockholders' equity   | \$ 209,671     | \$ 205,381     |

*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)

|   | <b>Thirteen Weeks Ended</b> |                           |
|---|-----------------------------|---------------------------|
|   | <b>May 4,<br/>2013</b>      | <b>April 28,<br/>2012</b> |
| Net sales   | \$ 109,119                  | \$ 96,524                 |
| Cost of goods sold (includes buying, distribution, and occupancy costs) | 76,921                      | 66,106                    |
| Gross profit  | 32,198                      | 30,418                    |
| Selling, general and administrative expenses                            | 28,281                      | 24,392                    |
| Operating income  | 3,917                       | 6,026                     |
| Interest expense, net   | 49                          | 44                        |
| Income before income taxes  | 3,868                       | 5,982                     |
| Income tax expense  | 1,560                       | 68                        |
| Net income  | \$ 2,308                    | \$ 5,914                  |
| Basic earnings per share  | \$ 0.08                     | \$ 0.30                   |
| Diluted earnings per share  | \$ 0.08                     | \$ 0.29                   |
| Weighted average basic shares outstanding                               | 27,692                      | 20,000                    |
| Weighted average diluted shares outstanding                             | 28,027                      | 20,512                    |
| Pro forma income information (Note 1):                                  |                             |                           |
| Historical income before income taxes                                   |                             | \$ 5,982                  |
| Pro forma income tax expense  |                             | 2,393                     |
| Pro forma net income  |                             | \$ 3,589                  |
| Pro forma basic earnings per share                                      |                             | \$ 0.18                   |
| Pro forma diluted earnings per share                                    |                             | \$ 0.18                   |

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

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**TILLY S, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)

(Unaudited)

|  | <b>Thirteen Weeks Ended</b> |                           |
|--|-----------------------------|---------------------------|
|  | <b>May 4,<br/>2013</b>      | <b>April 28,<br/>2012</b> |
| Net income   | \$ 2,308                    | \$ 5,914                  |
| Other comprehensive income:  |                             |                           |
| Unrealized gain on available-for-sale securities, net of tax of \$21 | 31                          |                           |
| Other comprehensive income   | 31                          |                           |
| <b>Comprehensive income</b>  | <b>\$ 2,339</b>             | <b>\$ 5,914</b>           |

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

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

(In thousands)

(Unaudited)

|  | Number of Shares |           |        |            |           | Accumulated   |              |  |
|--|------------------|-----------|--------|------------|-----------|---------------|--------------|--|
|  | Common           | Common    | Common | Additional | Retained  | Other         | Total        |  |
|  | Stock            | Stock     | Stock  | Paid-in    | Earnings  | Comprehensive | Stockholders |  |
|  | (Class           | (Class B) |        | Capital    | (Deficit) | Income        | Equity       |  |
|  | A)               |           |        |            |           |               |              |  |
| Balance at February 2, 2013                                | 10,772           | 16,920    | \$ 28  | \$ 117,391 | \$ (140)  | \$ 17         | \$ 117,296   |  |
| Net income   |                  |           |        |            | 2,308     |               | 2,308        |  |
| Restricted stock   | 11               |           |        |            |           |               |              |  |
| Change in unrealized gain on available-for-sale securities |                  |           |        |            |           | 14            | 14           |  |
| Stock-based compensation expense                           |                  |           |        | 892        |           |               | 892          |  |
| Balance at May 4, 2013                                     | 10,783           | 16,920    | \$ 28  | \$ 118,283 | \$ 2,168  | \$ 31         | \$ 120,510   |  |

*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>Thirteen Weeks Ended</b> |                           |
|---|-----------------------------|---------------------------|
|   | <b>May 4,<br/>2013</b>      | <b>April 28,<br/>2012</b> |
| <b>Cash flows from operating activities</b>                                       |                             |                           |
| Net income  | \$ 2,308                    | \$ 5,914                  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                             |                           |
| Depreciation and amortization   | 4,650                       | 3,904                     |
| Gain on disposal of assets  | (3)                         | (115)                     |
| Gain on sales and maturities of marketable securities                             | (44)                        |                           |
| Deferred income taxes   | 347                         |                           |
| Stock-based compensation expense  | 892                         |                           |
| Changes in operating assets and liabilities:                                      |                             |                           |
| Receivables   | (2,155)                     | (2,489)                   |
| Merchandise inventories   | (3,070)                     | (3,599)                   |
| Prepaid expenses and other assets   | (1,648)                     | (502)                     |
| Accounts payable  | 1,912                       | 687                       |
| Accrued expenses  | 1,493                       | 22                        |
| Accrued compensation and benefits   | (2,728)                     | (2,672)                   |
| Deferred rent   | 1,882                       | 3,761                     |
| Deferred revenue  | (928)                       | (981)                     |
| Net cash provided by operating activities   | 2,908                       | 3,930                     |
| <b>Cash flows from investing activities</b>                                       |                             |                           |
| Purchase of property and equipment  | (11,435)                    | (7,523)                   |
| Proceeds from sale of property and equipment                                      | 11                          |                           |
| Insurance proceeds from casualty loss   |                             | 641                       |
| Maturities of marketable securities   | 10,000                      |                           |
| Net cash used in investing activities   | (1,424)                     | (6,882)                   |
| <b>Cash flows from financing activities</b>                                       |                             |                           |
| Payment of capital lease obligation   | (174)                       | (163)                     |
| Distributions   |                             | (260)                     |
| Net cash used in financing activities   | (174)                       | (423)                     |
| Change in cash and cash equivalents   | 1,310                       | (3,375)                   |
| Cash and cash equivalents, beginning of period                                    | 17,314                      | 25,091                    |
| Cash and cash equivalents, end of period  | \$ 18,624                   | \$ 21,716                 |
| <b>Supplemental disclosures of cash flow information</b>                          |                             |                           |
| Interest paid   | \$ 67                       | \$ 75                     |
| Income taxes paid   | \$ 786                      | \$ 7                      |

**Supplemental disclosure of non-cash activities**

|  |          |        |
|--|----------|--------|
| Unpaid purchases of property and equipment | \$ 2,494 | \$ 243 |
|--|----------|--------|

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

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**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 175 and 168 stores as of May 4, 2013 and February 2, 2013, 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 weeks ended May 4, 2013 and April 28, 2012 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 consolidated financial statements and notes included in the Company s Annual Report on Form 10-K for the fiscal year ended February 2, 2013, filed with the SEC.

***Fiscal Periods***

The Company s fiscal year ends on the Saturday closest to January 31. References to the fiscal quarters ended May 4, 2013 and April 28, 2012 refer to the thirteen-week periods ended as of those dates.

***Initial Public Offering***

On May 3, 2012, the Company 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 the Company 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. The Company 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.

**Table of Contents****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. Therefore, the pro forma net income and per share amounts for the quarter ended April 28, 2012 includes an adjustment for income tax expense as if the Company had been a C Corporation during that period at an assumed combined federal, state and local effective tax rate of 40%, which approximates the calculated statutory tax rate for the 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 thirteen weeks ended April 28, 2012 was a reduction of approximately 68,000 shares.

**2. Summary of Significant Accounting Policies**

Information regarding significant accounting policies is contained in Note 2, Summary of Significant Accounting Policies, of the consolidated financial statements in the Company's Annual Report on Form 10-K.

**3. Marketable Securities**

Marketable securities are classified as available-for-sale and, as of May 4, 2013 and February 2, 2013, consisted entirely of commercial paper, all of which was less than one year from maturity.

The following table summarizes the Company's investments in marketable securities at May 4, 2013 and February 2, 2013 (in thousands):

|                  | Cost      | May 4, 2013                    |                                 | Fair Value |
|------------------|-----------|--------------------------------|---------------------------------|------------|
|                  |           | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses |            |
| Commercial paper | \$ 29,883 | \$ 52                          | \$                              | \$ 29,935  |

  

|                  | Cost      | February 2, 2013               |                                 | Fair Value |
|------------------|-----------|--------------------------------|---------------------------------|------------|
|                  |           | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses |            |
| Commercial paper | \$ 39,839 | \$ 31                          | \$ 2                            | \$ 39,868  |

For the thirteen weeks ended May 4, 2013, the Company recognized gains on investments of \$44 thousand for commercial paper which matured during the period. Upon recognition of the gains, the Company reclassified these amounts out of accumulated other comprehensive income and into current period earnings.

**4. 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

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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 May 4, 2013, the Company was in compliance with all of its covenants and had no outstanding borrowings under the line of credit.

## **5. Commitments and Contingencies**

### ***Legal Proceedings***

From time to time, the Company may become involved in lawsuits and other claims arising from our ordinary course of business. 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 because of the uncertainties related to the incurrence, amount and range of loss on any pending litigation or claim. Because of the 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 that the ultimate outcome of any of the matters threatened or pending against it, including those disclosed below, will not have a material adverse effect on our financial condition, results of operations or cash flows.

*Kristin Christiansen and Shellie Smith, on behalf of themselves and all others similarly situated vs. World of Jeans & Tops, Superior Court of California, County of Sacramento, Case No. 34-2013-00139010.* On January 29, 2013, the plaintiffs in this matter filed a putative class action lawsuit against the Company alleging violations of California Civil Code Section 1747.08, which prohibits requesting or requiring personal identification information from a customer paying for goods with a credit card and recording such information. In May 2013, the Company filed a motion to strike portions of the plaintiffs' complaint. The Company intends to defend this case vigorously.

*Maria Rebolledo, individually and on behalf of all others similarly situated and on behalf of the general public vs. Tilly's, Inc.; World of Jeans & Tops, Superior Court of the State of California, County of Orange, Case No. 30-2012-00616290-CU-OE-CXC.* On December 5, 2012, the plaintiff in this matter filed a putative class action lawsuit against the Company alleging violations of California's wage and hour, meal break and rest break rules and regulations, and unfair competition law, among other things. An amended complaint was filed on February 28, 2013, to include enforcement of California's private attorney general act. The complaint seeks an unspecified amount of damages and penalties. In April 2013, the Company filed a motion to compel arbitration, which was denied in May. The Company intends to defend this case vigorously.

*Deborah Lyddy v. World of Jeans & Tops and Tilly's, Inc., Superior Court of California, County of San Diego (37-2011-00098812-CU-BT-CTL).* In October 2011, plaintiff filed a putative class action lawsuit against the Company alleging various causes of action based on its California gift card redemption policies. The lawsuit is ongoing and the Company intends to defend this case vigorously.

## **6. Fair Value Measurements**

Financial Accounting Standards Board (FASB) Accounting Standards Codification (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.

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*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.

During the thirteen weeks ended May 4, 2013 and April 28, 2012, the Company did not make any transfers between Level 1 and Level 2 financial assets. Furthermore, as of May 4, 2013 and April 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.

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.

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):

|                               | May 4, 2013 |         |         | February 2, 2013 |         |         |
|-------------------------------|-------------|---------|---------|------------------|---------|---------|
|                               | Level 1     | Level 2 | Level 3 | Level 1          | Level 2 | Level 3 |
| <b>Cash equivalents:</b>      |             |         |         |                  |         |         |
| Money market securities       | \$ 16,224   | \$      | \$      | \$ 15,224        | \$      | \$      |
| <b>Marketable securities:</b> |             |         |         |                  |         |         |
| Commercial paper              |             | 29,935  |         |                  | 39,868  |         |

**7. Stock-Based Compensation**

On March 25, 2013, the Company granted stock options to purchase a total of 554,500 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 \$12.82, which was the closing price of Tilly's Class A common stock on the date of grant. These stock options 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 weeks ended May 4, 2013 was \$3.4 million, 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 Company did not grant any stock options during the thirteen weeks ended April 28, 2012.

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.



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The fair value of stock options granted during the thirteen weeks ended May 4, 2013 was estimated on the grant date using the following assumptions:

|                                |           |
|--------------------------------|-----------|
| Expected option term(1)        | 5.0 years |
| Expected volatility factor(2)  | 56.2%     |
| Risk-free interest rate(3)     | 0.8%      |
| Expected annual dividend yield | 0%        |

- (1) The Company has limited historical information regarding expected option term. Accordingly, the Company determined the expected option term of the awards using historical data available from comparable public companies and management's expectation of exercise behavior.
- (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 thirteen weeks ended May 4, 2013 (aggregate intrinsic value in thousands):

|                                    | Stock<br>Options | Grant Date<br>Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (in Years) | Aggregate<br>Intrinsic<br>Value(1) |
|------------------------------------|------------------|---|--|------------------------------------|
| Outstanding at February 2, 2013    | 2,133,625        | \$ 12.83  |  |                                    |
| Granted                            | 554,500          | \$ 12.82  |  |                                    |
| Exercised                          |                  | \$  |  |                                    |
| Forfeited                          | (2,500)          | \$ 15.50  |  |                                    |
| Outstanding at May 4, 2013         | 2,685,625        | \$ 12.82  | 7.7  | \$ 7,521                           |
| Vested at May 4, 2013              | 1,276,500        | \$ 10.94  | 6.1  | \$ 5,930                           |
| Expected to vest after May 4, 2013 | 1,214,616        | \$ 14.52  | 9.1  | \$ 1,378                           |

- (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 \$15.39 at May 3, 2013.

There are a total of 2,913,900 shares issuable under the 2012 Plan, of which 1,615,434 shares were still available for issuance as of May 4, 2013. The Company recorded a total of \$0.9 million of stock-based compensation expense in the thirteen weeks ended May 4, 2013. At May 4, 2013, there was \$8.1 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 3.1 years.

**8. 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 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.

The Company accounts for income taxes and the related accounts under the liability method in accordance with ASC 740, *Income Taxes*. Deferred tax assets and liabilities are determined based on the difference between the





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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 for interim periods is based on an estimate of the annual effective tax rate adjusted to reflect the impact of discrete items. Significant management judgment is required in projecting ordinary income (loss) to estimate the Company's annual effective tax rate.

The annual effective income tax rate was 40.3% and 1.1% for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively. The annual effective rate for the thirteen weeks ended May 4, 2013 is higher than the thirteen weeks ended April 28, 2012 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 weeks ended April 28, 2012 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 during the thirteen weeks ended April 28, 2012.

**9. Earnings Per Share**

Net income per share is computed under the provisions of ASC Topic 260, *Earnings Per Share*. Basic net income per share is computed based on the weighted average number of common shares outstanding during the period. Diluted net income per share is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method, whereby proceeds from such exercise, unamortized compensation and hypothetical excess tax benefits, if any, 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. Dilutive potential common shares represent outstanding stock options and restricted stock awards. The components of basic and diluted net income per share are as follows (in thousands, except per share amounts):

|  | <b>Thirteen Weeks Ended</b> |                           |
|--|-----------------------------|---------------------------|
|  | <b>May 4,<br/>2013</b>      | <b>April 28,<br/>2012</b> |
| Net income   | \$ 2,308                    | \$ 5,914                  |
| Weighted average basic shares outstanding              | 27,692                      | 20,000                    |
| Dilutive effect of stock options and restricted stock  | 335                         | 512                       |
| Weighted average shares for diluted earnings per share | 28,027                      | 20,512                    |
| Basic earnings per share                               | \$ 0.08                     | \$ 0.30                   |
| Diluted earnings per share                             | \$ 0.08                     | \$ 0.29                   |

**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. On June 29, 2012, the Company exercised the first of its three five-year renewal options on this lease, with the renewal commencing on January 1, 2013. The lease now expires on December 31, 2017. 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 the thirteen weeks ended May 4, 2013 and April 28, 2012 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 \$3.8 million and \$4.0 million as of May 4, 2013 and February 2, 2013, respectively. The gross amount of the building under capital lease was \$7.8 million as of both May 4, 2013 and February 2, 2013. The gross amount of accumulated depreciation of the building under capital lease was \$5.4 million and \$5.3 million as of May 4, 2013 and February 2, 2013, 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

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the thirteen weeks ended May 4, 2013 and April 28, 2012. The Company subleases part of the building to an unrelated third party. The sublease terminates on May 31, 2014.

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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 occupied the building on June 29, 2012 and incurred rent expense of \$0.1 million for the thirteen weeks ended May 4, 2013.

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 as its e-commerce distribution center. Pursuant to the lease agreement, the Company requested during fiscal year 2012 that the landlord expand the building. Upon commencement of the building expansion, the Company returned the building to the landlord. As of February 2, 2013, the landlord returned the expanded building to the Company and monthly lease payments re-commenced by the Company in February 2013. The Company incurred rent expense of \$0.3 million and \$0.2 million for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively.

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 consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended February 2, 2013. 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 Annual Report on Form 10-K for the fiscal year ended February 2, 2013, 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 May 4, 2013, we operated 175 stores, averaging 7,800 square feet, in 30 states. We also sell our products through our e-commerce website, [www.tillys.com](http://www.tillys.com) (the information available at our website address is not incorporated by reference into this report).

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 13%, to \$109.1 million for the thirteen weeks ended May 4, 2013 from \$96.5 million for the thirteen weeks ended April 28, 2012. Operating income decreased 35%, to \$3.9 million for the thirteen weeks ended May 4, 2013 from \$6.0 million for the thirteen weeks ended April 28, 2012, primarily due to a slower sales pace than experienced in the first quarter of fiscal year 2012, which led to de-leverage of some expenses as well as to higher markdowns to increase the sell-through rate of styles, and therefore to lower gross margins. The lower operating income was also due to the recognition of stock-based compensation expense, which began upon our completion of our initial public offering in May 2012. Our comparable store sales increased 1.1% for the thirteen weeks ended May 4, 2013, which followed a 2.2% increase for the full fiscal year 2012 and compares to a 4.3% increase in the first quarter of fiscal year 2012.

Since the beginning of fiscal 2008, we more than doubled our store count from 73 stores to 175 stores as of May 4, 2013. As of May 4, 2013, we added seven net new stores in fiscal year 2013 and plan to add at least 18 additional net stores by the end of the year. We plan to continue opening new stores 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.

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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 Annual Report on Form 10-K for the fiscal year ended February 2, 2013 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 of common stock, 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 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.

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***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.

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***

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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 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.

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.



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***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 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.

***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.

***Income Taxes***

Prior to May 2, 2012, we were taxed as an S Corporation for federal income tax purposes under Section 1362 of the Internal Revenue Code, and therefore were 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, our S Corporation status terminated and we became subject to corporate-level federal and state income taxes at prevailing corporate rates.

**Table of Contents****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>May 4, 2013</b>          | <b>April 28,<br/>2012</b> |
|  | <b>(in thousands)</b>       |                           |
| <b>Statements of Income Data:</b>            |                             |                           |
| Net sales                                    | \$ 109,119                  | \$ 96,524                 |
| Cost of goods sold                           | 76,921                      | 66,106                    |
| Gross profit                                 | 32,198                      | 30,418                    |
| Selling, general and administrative expenses | 28,281                      | 24,392                    |
| Operating income                             | 3,917                       | 6,026                     |
| Interest expense, net                        | 49                          | 44                        |
| Income before income taxes                   | 3,868                       | 5,982                     |
| Income tax expense                           | 1,560                       | 68                        |
| Net income                                   | \$ 2,308                    | \$ 5,914                  |
| <b>Percentage of Net Sales:</b>              |                             |                           |
| Net sales                                    | 100.0%                      | 100.0%                    |
| Cost of goods sold                           | 70.5%                       | 68.5%                     |
| Gross profit                                 | 29.5%                       | 31.5%                     |
| Selling, general and administrative expenses | 25.9%                       | 25.3%                     |
| Operating income                             | 3.6%                        | 6.2%                      |
| Interest expense, net                        | 0.0%                        | 0.0%                      |
| Income before income taxes                   | 3.5%                        | 6.2%                      |
| Income tax expense                           | 1.4%                        | 0.1%                      |
| Net income                                   | 2.1%                        | 6.1%                      |
| <b>Pro Forma Data (1):</b>                   |                             |                           |
| Income before income taxes                   |                             | \$ 5,982                  |
| Pro forma income tax expense                 |                             | 2,393                     |
| Pro forma net income                         |                             | \$ 3,589                  |

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

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|  | Thirteen Weeks Ended |                   |
|--|----------------------|-------------------|
|  | May 4,<br>2013       | April 28,<br>2012 |
| <b>Store Operating Data:</b>                   |                      |                   |
| Stores operating at end of period              | 175                  | 145               |
| Comparable store sales change (1)              | 1.1%                 | 4.3%              |
| Total square feet at end of period             | 1,370,539            | 1,133,566         |
| Average net sales per store (in thousands) (2) | \$ 565               | \$ 605            |
| Average net sales per square foot (2)          | \$ 72                | \$ 77             |
| E-commerce revenues (in thousands) (3)         | \$ 12,597            | \$ 10,900         |

- (1) E-commerce sales contributed 2.3% and 2.8% to the comparable store sales change for the thirteen week periods ended May 4, 2013 and April 28, 2012, 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.

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***Thirteen Weeks Ended May 4, 2013 Compared to Thirteen Weeks Ended April 28, 2012***

*Net Sales*

Net sales increased \$12.6 million, or 13%, to \$109.1 million for the thirteen weeks ended May 4, 2013 from \$96.5 million for the thirteen weeks ended April 28, 2012. A portion of this increase was due to net sales of \$11.6 million from stores open in the first quarter of fiscal 2013 that were not open during the same period last year, as well as the increase in e-commerce shipping fees, due to the increase in e-commerce sales. Net sales also increased due to a comparable store net sales increase of 1.1%, or \$1.0 million, in the thirteen weeks ended May 4, 2013 compared to the thirteen weeks ended April 28, 2012. This increase was due to higher net sales of guys , juniors and girls apparel, offset by lower net sales of accessories, footwear and boys apparel. There were 141 comparable brick-and-mortar stores and 34 non-comparable brick-and-mortar stores open as of May 4, 2013.

Net sales from our e-commerce store, including shipping fees, increased \$1.7 million, or 16%, to \$12.6 million for the thirteen weeks ended May 4, 2013 from \$10.9 million for the thirteen weeks ended April 28, 2012.

*Gross Profit*

Gross profit increased \$1.8 million, or 6%, to \$32.2 million for the thirteen weeks ended May 4, 2013 from \$30.4 million for the thirteen weeks ended April 28, 2012. As a percentage of net sales, gross profit was 29.5% and 31.5% for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively. The decrease in gross profit margin was due to a 1.1% increase in product costs as a percentage of sales due to increased markdowns and a 0.9% increase in buying, distribution and occupancy costs as a percentage of sales due to costs increasing faster than the growth in net sales.

*Selling, General and Administrative Expenses*

SG&A expenses increased \$3.9 million, or 16%, to \$28.3 million for the thirteen weeks ended May 4, 2013 from \$24.4 million for the thirteen weeks ended April 28, 2012. As a percentage of net sales, SG&A expenses were 25.9% and 25.3% for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively.

Store selling expenses increased \$2.6 million, or 16%, to \$18.8 million for the thirteen weeks ended May 4, 2013 from \$16.2 million for the thirteen weeks ended April 28, 2012. As a percentage of net sales, store selling expenses were 17.3% and 16.8% for the thirteen weeks ended May 4, 2013 and April 28, 2012, 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 \$2.3 million, or 0.7% as a percentage of net sales, as these costs increased at a higher rate than net sales due to a relatively small increase in comparable store sales and a greater proportion of the store base this year comprised of newer stores with immature sales volumes;

marketing costs, credit card processing, supplies and other costs increased \$0.4 million, which represents a decrease of 0.2% as a percentage of net sales, due to these costs increasing at a lower rate than the net sales;

General and administrative expenses increased \$1.3 million, or 15%, to \$9.4 million for the thirteen weeks ended May 4, 2013 from \$8.2 million for the thirteen weeks ended April 28, 2012. As a percentage of net sales, general and administrative expenses were 8.6% and 8.5% for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively.

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

payroll, payroll benefits and related costs for corporate office personnel decreased \$0.3 million, which represents a decrease of 1.0% as a percentage of net sales, mostly due to a decrease in incentive bonus accruals for corporate employees in fiscal year 2013 as

compared to fiscal year 2012;

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depreciation, legal and other office expenses increased \$0.6 million, or 0.4% as a percentage of net sales, due to increased costs associated with being a publicly traded company and due to the growth of the company; and

stock-based compensation expense of \$0.9 million, or 0.8% of net sales, in the thirteen weeks ended May 4, 2013, as compared to no stock-based compensation expense recognized in the thirteen weeks ended April 28, 2012.

*Operating Income*

Operating income decreased \$2.1 million, or 35%, to \$3.9 million for the thirteen weeks ended May 4, 2013 from \$6.0 million for the thirteen weeks ended April 28, 2012. As a percentage of net sales, operating income was 3.6% and 6.2% for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively. The decrease in operating income as a percentage of net sales was mostly due to certain costs increasing more slowly than sales, lower gross profit due to higher markdowns, as well as stock-based compensation expense, the recognition of which did not begin until the completion of our IPO early in the second quarter of fiscal year 2012, as discussed above.

*Interest Expense, Net*

Net interest expense was \$49 thousand and \$44 thousand for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively. Net interest expense reflects interest paid on a capitalized lease of our corporate office and distribution center as well as costs related to maintaining our unused line of credit bank facility, net of interest income earned on cash balances and on tenant construction allowances due from landlords.

*Provision for Income Taxes*

Income taxes were \$1.6 million and \$68 thousand for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively. This reflects an annual effective tax rate of 40.3% for the thirteen weeks ended May 4, 2013 compared to an annual effective tax rate of 1.1% for the thirteen weeks ended April 28, 2012, when the company was operating as an S Corporation.

Historically, World of Jeans & Tops recognized income taxes as an S Corporation for federal and state income tax purposes and therefore, with the exception of a limited number of state and local jurisdictions, it was not subject to income taxes. The shareholders of World of Jeans & Tops, and not World of Jeans & Tops itself, were subject to income tax on their distributive share of its earnings. In connection with the Reorganization, World of Jeans & Tops converted to a C Corporation. On a pro forma basis, if World of Jeans & Tops had been taxed as a C Corporation at an estimated 40% effective tax rate, income taxes would have been \$2.4 million for the thirteen weeks ended April 28, 2012.

*Net Income*

Net income decreased \$3.6 million, or 61%, to \$2.3 million for the thirteen weeks ended May 4, 2013 from \$5.9 million for the thirteen weeks ended April 28, 2012, due to the factors discussed above. Applying a pro forma 40% C Corporation effective tax rate to the thirteen weeks ended April 28, 2012, rather than the S Corporation tax rate that actually applied to us, pro forma net income decreased \$1.3 million, or 36%, to \$2.3 million for the thirteen weeks ended May 4, 2013 from \$3.6 million for the thirteen weeks ended April 28, 2012.

Basic earnings per share decreased 73%, to \$0.08 for the thirteen weeks ended May 4, 2013 from \$0.30 for the thirteen weeks ended April 28, 2012. Diluted earnings per share decreased 72%, to \$0.08 for the thirteen weeks ended May 4, 2013 from \$0.29 for the thirteen weeks ended April 28, 2012. Applying a pro forma 40% C Corporation effective tax rate to the thirteen weeks ended April 28, 2012, rather than the S Corporation tax rate that actually applied to us, pro forma basic and diluted earnings per share decreased 56%, to \$0.08 for the thirteen weeks ended May 4, 2013 from \$0.18 for the thirteen weeks ended April 28, 2012.

**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 access to additional liquidity through a \$25.0 million revolving credit facility with Wells Fargo Bank, NA. We have never drawn funds from or issued letters of credit financing from the revolving credit facility. We do not expect to draw from the revolving credit facility over the next 12 months. We expect to finance company operations and store growth with existing cash on hand and net proceeds from the IPO.

Historically our primary cash needs have been for merchandise inventories, payroll, store rent, capital expenditures associated with opening new stores, improvements to our distribution facilities, marketing and information technology expenditures and shareholder distributions. In addition to cash and cash equivalents, the most significant components of our working capital are merchandise inventories, accounts payable and other current liabilities. We believe that cash flows from operating activities and, if needed, 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 cash flows from operations and borrowings under our revolving credit facility are not sufficient to meet our capital requirements, then we will 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>Thirteen Weeks Ended</b> |                  |
|---|-----------------------------|------------------|
|   | <b>May 4,</b>               | <b>April 28,</b> |
|   | <b>2013</b>                 | <b>2012</b>      |
|   | <b>(in thousands)</b>       |                  |
| Net cash provided by operating activities | \$ 2,908                    | \$ 3,930         |
| Net cash used in investing activities     | (1,424)                     | (6,882)          |
| Net cash used in financing activities     | (174)                       | (423)            |

**Net Cash Provided by Operating Activities**

Operating activities consist primarily of net income adjusted for non-cash items that include depreciation, stock-based compensation expense, deferred income taxes and gains or losses on disposals of assets, plus the effect on changes during the period in our assets and liabilities.

We generated \$2.9 million of net cash from operating activities for the thirteen weeks ended May 4, 2013. The significant components of cash flows from operating activities were net income of \$2.3 million and the add-back of non-cash depreciation and amortization expense of \$4.7 million, stock-based compensation expense of \$0.9 million and the increase in deferred taxes of \$0.3 million. Accounts payable and accrued expenses increased by \$3.4 million. In addition, deferred rent increased by \$1.9 million due to the opening of new stores. The above was offset by an increase in merchandise inventories of \$3.1 million due to the seasonality of inventory purchases and the opening of new stores, an increase in receivables of \$2.2 million and deferred revenue of \$0.9 million due to the growth of the business, an increase in prepaid expenses and other assets of \$1.6 million due mainly to an increase in non-current deferred taxes and a decrease in accrued compensation and benefits of \$2.7 million due mainly to lower annual incentive bonuses paid in the thirteen weeks ended May 4, 2013 as compared to the thirteen weeks ended April 28, 2012.

We generated \$3.9 million of net cash from operating activities for the thirteen weeks ended April 28, 2012. The significant components of cash flows from operating activities were net income of \$5.9 million and the add-back of non-cash depreciation and amortization expense of \$3.9 million. In addition, deferred rent increased by \$3.8 million due to the opening of new stores. The above was offset by an increase in merchandise inventories of \$3.6

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million due to the seasonality of inventory purchases and the opening of new stores, an increase in receivables of \$2.5 million due to the growth of the business and a decrease in accrued compensation and benefits of \$2.7 million due mainly to the payment of incentive bonuses during the first quarter of fiscal 2012 relating to the company's fiscal 2011 results.

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

Investing activities consist primarily of capital expenditures for growth related to new store openings as well as for remodels and changes in fixtures and equipment at existing stores, investments in information technology, distribution center enhancements, investments in assets at our corporate headquarters and the addition or replacement of company vehicles, net of proceeds from sales and maturities of marketable securities.

Net cash used in investing activities was \$1.4 million and \$6.9 million for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively. Capital expenditures totaled \$11.4 million, the majority of which related to stores. Spending on new stores and the remodeling or other improvements of existing stores were \$6.6 million and \$6.4 million for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively. The remaining capital expenditures in each period were primarily for our investment in information technology systems and distribution and corporate facility enhancements. This was offset by \$10.0 million of proceeds from the maturities of marketable securities during the thirteen weeks ended May 4, 2013.

***Net Cash Used in Financing Activities***

Financing activities consist of distributions to the S Corporation shareholders of World of Jeans & Tops prior to the Reorganization and payments on our capital lease obligation.

Net cash used in financing activities was \$0.2 million and \$0.4 million for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively. This included \$0.2 million in both periods for payments on our capital lease obligation and \$0.3 million in distributions to the then-current shareholders of World of Jeans & Tops during the first quarter of fiscal year 2012. We did not pay any dividends during the thirteen weeks ended May 4, 2013.

**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**

As of May 4, 2013, there were no material changes to our contractual obligations described in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

**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.



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**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 consolidated financial statements of Tilly's, Inc. in the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

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 Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

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

As of May 4, 2013, there were no material changes in the market risks described in the Quantitative and Qualitative Disclosure of Market Risks section of our Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

**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 May 4, 2013. 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 May 4, 2013, 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 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

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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.

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**Part II. Other Information**

**Item 1. Legal Proceedings**

From time to time, the Company may become involved in lawsuits and other claims arising from our ordinary course of business. 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 because of the uncertainties related to the incurrence, amount and range of loss on any pending litigation or claim. Because of the 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 that the ultimate outcome of any of the matters threatened or pending against it, including those disclosed below, will not have a material adverse effect on our financial condition or results of operations.

*Kristin Christiansen and Shellie Smith, on behalf of themselves and all others similarly situated vs. World of Jeans & Tops, Superior Court of California, County of Sacramento, Case No. 34-2013-00139010.* On January 29, 2013, the plaintiffs in this matter filed a putative class action lawsuit against the Company alleging violations of California Civil Code Section 1747.08, which prohibits requesting or requiring personal identification information from a customer paying for goods with a credit card and recording such information. In May 2013, the Company filed a motion to strike portions of the plaintiffs' complaint. The Company intends to defend this case vigorously.

*Maria Rebolledo, individually and on behalf of all others similarly situated and on behalf of the general public vs. Tilly's, Inc.; World of Jeans & Tops, Superior Court of the State of California, County of Orange, Case No. 30-2012-00616290-CU-OE-CXC.* On December 5, 2012, the plaintiff in this matter filed a putative class action lawsuit against the Company alleging violations of California's wage and hour, meal break and rest break rules and regulations, and unfair competition law, among other things. An amended complaint was filed on February 28, 2013, to include enforcement of California's private attorney general act. The complaint seeks an unspecified amount of damages and penalties. In April 2013, the Company filed a motion to compel arbitration, which was denied in May. The Company intends to defend this case vigorously.

*Deborah Lyddy v. World of Jeans & Tops and Tilly's, Inc., Superior Court of California, County of San Diego (37-2011-00098812-CU-BT-CTL).* In October 2011, plaintiff filed a putative class action lawsuit against the Company alleging various causes of action based on its California gift card redemption policies. The lawsuit is ongoing and the Company intends to defend this case vigorously.

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

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**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 May 4, 2013, 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 (iv) Notes to Consolidated Financial Statements. ** |
| *                  | Furnished herewith and not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.  |
| **                 | 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.   |

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**SIGNATURES**

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

Tilly s, Inc.

Date: June 13, 2013

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

*(Principal Executive Officer)*

Date: June 13, 2013

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

*(Principal Financial Officer)*