

Vera Bradley, Inc.  
Form 10-K  
March 27, 2012  
[Table of Contents](#)

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

Washington, D.C. 20549

**FORM 10-K**

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

**For the Fiscal Year Ended January 28, 2012**

**OR**

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

**For the Transition Period From            to**

**Commission File Number: 001-34918**

**VERA BRADLEY, INC.**

**(Exact name of registrant as specified in its charter)**

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|  |  |
|--|--|
| <b>Indiana</b><br>(State or other jurisdiction of<br>incorporation or organization)          | <b>27-2935063</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>2208 Production Road, Fort Wayne, Indiana</b><br>(Address of principal executive offices) | <b>46808</b><br>(Zip Code)                                   |
| <b>(877) 708-8372</b><br>(Registrant's telephone number, including area code)                |  |

**Securities registered pursuant to Section 12(b) of the Act:**

| <b>Title of each class</b> | <b>Name of each exchange on which registered</b> |
|----------------------------|--|
| Common Stock               | The NASDAQ Global Select Market                  |

**Securities registered pursuant to Section 12(g) of the Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

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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 aggregate market value of the registrant's voting stock held by non-affiliates of the registrant as of July 30, 2011 was \$713,454,367.

The registrant had 40,506,720 shares of its common stock outstanding as of March 23, 2012.

**DOCUMENT INCORPORATED BY REFERENCE:**

Portions of the registrant's definitive proxy statement for the 2012 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

**Table of Contents**

**Forward-Looking Statements**

This annual report contains forward-looking statements that are subject to risks and uncertainties. All statements other than statements of historical or current fact included in this report are forward-looking statements. Forward-looking statements refer to our current expectations and projections relating to our financial condition, results of operations, plans, objectives, strategies, future performance, and business. You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. These statements may include words such as anticipate, estimate, expect, project, plan, intend, believe, may, might, will, should, can have, and likely and similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events. For example, all statements we make relating to our estimated and projected earnings, revenues, costs, expenditures, cash flows, growth rates, and financial results, our plans and objectives for future operations, growth, initiatives, or strategies, or the expected outcome or impact of pending or threatened litigation are forward-looking statements. All forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those that we expected, including:

possible adverse changes in general economic conditions and their impact on consumer confidence and consumer spending;

possible inability to predict and respond in a timely manner to changes in consumer demand;

possible loss of key management or design associates or inability to attract and retain the talent required for our business;

possible inability to maintain and enhance our brand;

possible inability to successfully implement our growth strategies or manage our growing business;

possible inability to successfully open and operate new stores as planned; and

possible inability to sustain levels of comparable-store sales.

We derive many of our forward-looking statements from our operating plans and forecasts, which are based upon detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is difficult to predict the impact of known factors, and it is impossible for us to anticipate all factors that could affect our actual results.

For a discussion of these risks and other risks and uncertainties that could cause actual results to differ materially from those contained in our forward-looking statements, please refer to **Risk Factors** in Item 1A of this report.

We caution you that the risks and uncertainties identified by us may not be all of the factors that are important to you. Furthermore, the forward-looking statements included in this report are made only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events, or otherwise, except as required by law.

**Table of Contents**

**TABLE OF CONTENTS**

|   |    |
|---|----|
| <b><u>PART I.</u></b>   | 4  |
| Item 1. <u>Business</u>   | 4  |
| Item 1A. <u>Risk Factors</u>  | 16 |
| Item 1B. <u>Unresolved Staff Comments</u>   | 26 |
| Item 2. <u>Properties</u>   | 26 |
| Item 3. <u>Legal Proceedings</u>  | 27 |
| Item 4. <u>Mine Safety Disclosure</u>   | 27 |
| <b><u>PART II.</u></b>  | 28 |
| Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 28 |
| Item 6. <u>Selected Financial Data</u>  | 30 |
| Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 32 |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 45 |
| Item 8. <u>Financial Statements and Supplementary Data</u>  | 46 |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | 69 |
| Item 9A. <u>Controls and Procedures</u>   | 69 |
| Item 9B. <u>Other Information</u>   | 69 |
| <b><u>PART III.</u></b>   | 70 |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u>  | 70 |
| Item 11. <u>Executive Compensation</u>  | 72 |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>              | 72 |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>                                   | 72 |
| Item 14. <u>Principal Accounting Fees and Services</u>  | 72 |
| <b><u>PART IV.</u></b>  | 73 |
| Item 15. <u>Exhibits, Financial Statement Schedules</u>   | 73 |

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**Table of Contents**

**PART I**

**Item 1. Business**  
**Our Company**

Vera Bradley is a leading designer, producer, marketer, and retailer of stylish and highly functional accessories for women. Our products include a wide offering of handbags, accessories, and travel and leisure items. Over our 30-year history, Vera Bradley has become a true lifestyle brand that appeals to a broad range of consumers. Our brand vision is accessible luxury that inspires a casual, fun, and family-oriented lifestyle. We have positioned our brand to highlight the high quality, distinctive and vibrant styling, and functional design of our products. Frequent releases of new designs help keep the brand fresh and our customers continually engaged.

We generate net revenues by selling products through two reportable segments: Direct and Indirect. As of January 28, 2012, our Direct segment consisted of sales of Vera Bradley products through our 48 full-price stores, our eight outlet stores in the United States, seven pop-up stores in Japan, our websites, verabradley.com and verabradley.co.jp, and our annual outlet sale in Fort Wayne, Indiana. As of January 28, 2012, our Indirect segment consisted of sales of Vera Bradley products to approximately 3,300 specialty retailers, substantially all of which are located in the United States, as well as select national retailers and third party e-commerce sites. For financial information about our reportable segments, refer to Note 15 of the Notes to Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data, of this report.

Effective January 1, 2008, we changed our fiscal year to end on the Saturday closest to January 31. Our most recent fiscal years ended on January 28, 2012 ( fiscal 2012 ), January 29, 2011 ( fiscal 2011 ), and January 30, 2010 ( fiscal 2010 ), and the current fiscal year will end on February 2, 2013 ( fiscal 2013 ).

**Reorganization Transaction and Stock Split**

Vera Bradley, Inc. was formed as an Indiana corporation on June 23, 2010, for the purpose of reorganizing the corporate structure of Vera Bradley Designs, Inc., which was incorporated in Indiana on November 15, 1982. On October 3, 2010, the shareholders of Vera Bradley Designs, Inc. contributed all of their shares of Class A Voting Common Stock and Class B Non-Voting Common Stock of Vera Bradley Designs, Inc. to Vera Bradley, Inc. in return for shares of Vera Bradley, Inc. Class A Voting Common Stock and Class B Non-Voting Common Stock on a one-for-one basis. In addition, effective October 3, 2010, Vera Bradley Designs, Inc. converted from an S Corporation to a C Corporation for income-tax purposes. Further, on October 18, 2010, Vera Bradley, Inc. recapitalized all of its Class A Voting Common Stock and Class B Non-Voting Common Stock into a single class of common stock and effectuated a 35.437-for-1 stock split of all outstanding shares of its common stock. These events collectively are referred to as the Reorganization. As a result of the Reorganization, Vera Bradley Designs, Inc. became a wholly owned subsidiary of Vera Bradley, Inc.

The only significant asset of Vera Bradley, Inc. is its investment in Vera Bradley Designs, Inc., and all of our operations are conducted through Vera Bradley Designs, Inc. Except where context requires or where otherwise indicated, the terms Company, Vera Bradley, we, our, and us to Vera Bradley Designs, Inc. and its subsidiaries before the Reorganization and to Vera Bradley, Inc. and its subsidiaries, including Vera Bradley Designs, Inc., after the Reorganization. All historical common stock and per share common stock information has been changed to reflect the stock split.

## Table of Contents

### **Our History**

Barbara Bradley Baekgaard and Patricia Miller founded the Company in 1982 in Fort Wayne, Indiana, after recognizing a lack of stylish travel accessories in the market. Within weeks, the friends created Vera Bradley, named after Barbara's mother, and began manufacturing and marketing their distinctive products. The founders, together with the executive management team, have been instrumental in our growth and success. The following timeline sets forth a summary of significant milestones in Vera Bradley's history:

- 1982 Barbara Bradley Baekgaard and Patricia Miller launched Vera Bradley by introducing three products: the handbag, the sports bag, and the duffel bag.
- 1987 We relocated to our current headquarters in Fort Wayne, Indiana. Ernst & Young honored our Co-Founders with an Entrepreneur of the Year award.
- 1991 To accommodate the increasing number of attendees, we relocated our annual outlet sale from a tent in our parking lot to its present location at the Allen County War Memorial Coliseum in Fort Wayne, Indiana.
- 1998 We founded our primary philanthropy, the Vera Bradley Foundation for Breast Cancer.
- 1999 Our products were being sold in all 50 states through Indirect retailers.
- 2005 We launched the Vera Bradley Visual Merchandising Program, providing retailers a framework for presenting the brand and merchandising our products in a consistent manner. In addition, we launched a series of strategic initiatives to build a foundation for future growth.
- 2006 We launched our e-commerce business through our website, verabradley.com.
- 2007 We opened a state-of-the-art warehouse and distribution facility in Roanoke, Indiana. In mid-September, we also opened our first store at the Natick Collection, in greater Boston, and opened six additional stores later in the year.
- 2008 We transitioned from using an independent sales force to a sales force comprised entirely of in-house, full-time employees. We opened fourteen additional stores.
- 2009 We opened five additional stores, and in early November, we opened our first outlet store at Chicago Premium Outlets in Aurora, Illinois.
- 2010 We opened a design office in New York City as well as nine additional full-price stores and three additional outlet stores, and we completed our initial public offering.
- 2011 We entered the Japanese market, opened the Vera Bradley Design Center in Roanoke, Indiana, began the 200,000 square-foot expansion of the distribution facility in Roanoke, Indiana, launched our products in 65 Dillard's locations, and opened thirteen additional full-price stores and four additional outlet stores.

The passion for design and customer service established by our founders has driven our growth over the past 30 years and remains the cornerstone of Vera Bradley today. As Chief Creative Officer, Ms. Bradley Baekgaard continues to play a role in the team responsible for our day-to-day creative functions, including product development and store design. As our National Spokesperson, Ms. Miller continues to play a role representing the brand at events, business and community functions, and philanthropic activities.

### **Evolution of Our Business**

Beginning in 2005, we embarked on a series of strategic initiatives designed to take advantage of the growing interest in the Vera Bradley brand. These initiatives were designed to strengthen and enhance our business and operating model, expand our demographic and geographic market opportunity, and position us for future growth. The core components of these initiatives included the following:

*Merchandising Strategy.* To appeal to a broader range of consumers, we developed a mix of pattern and product offerings specifically targeted at different consumer demographics, refined our product release strategy to

## **Table of Contents**

significantly expand our product portfolio, and increased the number of new patterns released as well as the frequency of new product launches. In addition, we substantially enhanced our visual merchandising strategy, focusing on a consistent presentation of Vera Bradley as a lifestyle brand. In fiscal 2012, we established a dedicated merchant function and elevated the role of marketing to work more collaboratively with the design team to continue improving our process of bringing products to market.

*Multi-Channel Distribution Capability.* In 2006, we initiated a Direct channel strategy that was designed to expand our brand presence and broaden our consumer demographic while complementing the growing Indirect segment of our business. The first step in establishing the Direct segment of our business was selling directly to consumers through verabradley.com beginning in 2006. In September 2007, we opened our first full-price store. In fiscal 2012, we had more than 43 million visits to verabradley.com, and as of January 28, 2012, we operated 48 full-price stores and eight outlet stores, and entered the Japanese market.

*Infrastructure Investment.* Beginning in 2005, we made a series of investments to strengthen our supply chain capabilities, information systems, and product development processes, resulting in substantial cost savings and a more flexible and scalable operating structure. During this period, we shifted our production from a primarily domestic manufacturing model to a more cost-effective global sourcing platform. In 2007, we opened a state-of-the-art warehouse and distribution facility in Roanoke, Indiana, which will be expanded in fiscal 2013.

## **Our Brand**

For over 30 years, we have created, developed, and solidified a true lifestyle brand that resonates with a broad range of female consumers. Our brand vision is accessible luxury that inspires a casual, fun, and family-oriented lifestyle. Employees, family members, and friends are often depicted throughout our advertising in fun, friendly, and family-oriented settings, accentuating our brand image in an authentic manner. Our visual merchandising strategy, particularly in our full-price stores, seeks to create the feeling of home. We believe that our lifestyle brand is well positioned to extend into complementary product categories. The strength of our brand is demonstrated during our annual outlet sale in Fort Wayne, Indiana, a sales event that attracts tens of thousands of highly enthusiastic shoppers from across the country each year.

We have positioned our brand to highlight the high quality, distinctive and vibrant styling, and functional design of our products. At the same time, our frequent releases of new patterns and styles keep the brand fresh, inspire our customers to express their individuality and sense of style in a colorful way, and encourage multiple purchases. We also provide consumers a consistently fresh set of patterns, styles, and products from which to choose that fit with different ages, wardrobes, seasons, and personalities.

We also offer a broad assortment of products that meets our customers' different functional needs, including: handbags such as purses, totes, and specialty bags; accessories such as wallets, ID cases, and eyewear; and travel and leisure items such as weekend bags, duffel bags, and garment bags. We believe this combination of patterns, styles, and products allows us to appeal to all age brackets, including teens, young women, mothers, and grandmothers. Although our customers represent a broad range of demographic segments, our market research has shown that they generally have a common attitude toward the brand: Vera Bradley is a colorful way of allowing them to express their individuality and sense of style.

## **Competitive Strengths**

We believe the following competitive strengths differentiate us within the marketplace and provide a strong foundation for our future growth:

*Strong Brand Identity and Positioning.* We believe the Vera Bradley brand is highly recognized for its distinctive and vibrant style. Vera Bradley is positioned in the market as a lifestyle brand that inspires consumers to express their individuality and sense of style. We have also positioned our brand to highlight the high quality and functional attributes of our products. The Vera Bradley brand is more price accessible than many competing brands, which allows us to attract a wide range of consumers and inspire repeat purchases.



## **Table of Contents**

*Exceptional Customer Loyalty.* We believe that, as consumers become familiar with the Vera Bradley brand and begin using our products, they become loyal and enthusiastic brand advocates. We believe enthusiasm for our brand inspires repeat purchases and helps us expand our customer base. Our customers often purchase our products as gifts for family members and friends, who, in turn, become loyal customers.

*Product Development Expertise.* Our product development team combines an understanding of consumer preferences with a knowledge of color, fashion, and style trends to design our products. Our highly creative design associates utilize a disciplined product design process that seeks to maximize the productivity of our product releases and drive consumer demand.

*Dynamic Multi-Channel Distribution Model.* We offer our products through a diverse choice of shopping options across channels that are intimate, highly shop-able, fun, and characteristic of our brand. Whether they are at a Vera Bradley store, a specialty retail store, or verabradley.com, we believe consumers have an opportunity to find the brand in places that match their unique shopping interests. Our multi-channel distribution model enables us to maximize brand exposure and customer access to our products.

*Established Network of Indirect Retailers.* Our Indirect business consists of an established and diverse network of over 3,300 specialty retailers. This channel of gift, apparel and accessories, travel, and other specialty retailers, located throughout the United States, provides a strong foundation for our growth. Our Indirect retailers include some of the brand's strongest advocates, and their passion has been instrumental in the development of our brand.

*Distinctive Retail Stores.* Our stores provide a shopping experience that is uniquely Vera Bradley. We bring the Vera Bradley brand to life in our stores through visual presentation of our wide range of product offerings, the stylish, inviting décor of our stores, and personalized service from our friendly and knowledgeable sales associates. We believe the distinctive shopping experience and personalized service encourage repeat visits and multiple purchases.

*Unique Company Culture.* We were founded in 1982 by two friends, Barbara Bradley Baekgaard and Patricia Miller, who built our company around their passion for design and commitment to customer service. We believe our founders created a unique company culture that attracts passionate and motivated employees who are excited about our products and our brand. Our employees share our founders' commitment to Vera Bradley customers. We believe that a fun, friendly, and welcoming work environment fosters creativity and collaboration and that, by empowering our employees to become personally involved in product design, testing, and marketing, they become passionate and devoted brand advocates.

*Experienced Management Team.* Our senior management team led by Michael C. Ray, our Chief Executive Officer, has extensive experience across a diverse range of disciplines in product design, merchandising, marketing, store development, supply chain management, and finance. The current management team has been instrumental in the development and execution of our long-term strategies.

## **Growth Strategies**

We believe there are significant opportunities to expand our business and increase our net revenues and net income through the execution of the following growth strategies:

*Grow in Underpenetrated Markets.* Our historic growth focused primarily on the eastern United States, and accordingly, the Vera Bradley brand is most recognized in that region. In recent years, we have successfully expanded our Direct and Indirect channels in key developing markets, including in the Midwest and Southwest. In addition, in fiscal 2012 we expanded internationally by entering the Japanese market. We believe the success of our expansion efforts is a testament to the strength and portability of our brand and the power of our multi-channel distribution capabilities. We intend to utilize these strengths to further penetrate our existing markets and successfully expand our business into other foreign markets and relatively underpenetrated U.S. markets.

## **Table of Contents**

*Expand Our U.S. Store Base.* We plan to expand our retail presence in the United States by opening new stores. We believe that the market in the United States can support at least 300 Vera Bradley full-price stores. We plan to open 14 to 20 new stores annually during each of the next five fiscal years.

*Drive Comparable-Store Sales and Our E-Commerce Business.* We have several ongoing initiatives to drive comparable-store sales growth, including focusing on store-level merchandising programs and enhancing in-store customer service and selling capabilities. As a key element of our Direct channel strategy, we intend to grow our e-commerce business through focused marketing efforts, online merchandising initiatives, and social networking sites such as Facebook and Twitter. We believe our retail and e-commerce businesses are complementary and facilitate frequent contact with our customers.

*Expand Our Product Offerings.* We design products to accessorize a woman's life and believe this core competence serves as a platform for growth within and beyond our current product lines. We have expanded our product offerings to include new line extensions, such as focused gift and special occasion offerings, and brand extensions, such as our paper and stationery collection. We believe that opportunities exist to accessorize a woman's life through complementary product collections that fit within our positioning as a lifestyle brand.

### **Our Product Release Strategy**

We introduce new patterns seasonally. Within each season, we generally introduce three to five patterns. These patterns are incorporated into the designs of a wide range of products, including handbags, accessories, and travel and leisure items, that are part of the core seasonal release. These product assortments each season, can be classic styles, updates to older designs, or new product introductions.

After each seasonal launch, we release additional new collections. These collections often utilize or are inspired by that season's patterns (e.g., the paper and gift collection in a new pattern), but a few of our releases are separate from the Signature Collection (e.g., the Vera Vera collection in solid colors).

We have increased the number of patterns per Signature release as well as the frequency of subsequent releases over time and believe that the assortment, breadth, and cadence allow us to reach a broader range of consumer demographics and needs. We believe this approach keeps consumers continually engaged with our brand and repeatedly shopping at our points of distribution. In addition, we believe this approach allows us to minimize the risk associated with a single pattern not performing to our expectations. To keep our assortment current and fresh and to focus our inventory investments on our best performers, we discontinue patterns from time to time. We sell our remaining inventory of discontinued products at our annual outlet sale and through our website and outlet stores.

### **Our Products**

The following chart presents net revenues generated by each of our three product categories and other revenues as a percentage of our total net revenues for fiscal 2012, 2011, and 2010:

|                             | <b>Fiscal Year Ended</b>    |                             |                             |
|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                             | <b>January 28,<br/>2012</b> | <b>January 29,<br/>2011</b> | <b>January 30,<br/>2010</b> |
| Handbags                    | 43.1%                       | 49.2%                       | 52.4%                       |
| Accessories                 | 32.2%                       | 31.9%                       | 31.7%                       |
| Travel and Leisure Items    | 15.2%                       | 12.7%                       | 11.1%                       |
| Other <sup>(1)</sup>        | 9.5%                        | 6.2%                        | 4.8%                        |
| <b>Total <sup>(2)</sup></b> | <b>100.0%</b>               | <b>100.0%</b>               | <b>100.0%</b>               |

(1) Includes primarily merchandising, freight, promotional products, and licensing revenues.

(2) Excludes net revenues generated by our annual outlet sale.



## **Table of Contents**

*Handbags.* Handbags are a core part of our product offerings and are the primary component of every Signature Collection. The category consists of classic and new styles developed by our product development team to meet consumer demand and drive repeat purchases. Our handbag product category extends beyond handbags to include totes and specialty bags such as baby bags, backpacks, and laptop portfolios. Handbags play a prominent role in our visual merchandising, and we focus on showcasing the different patterns, colors, and features of each bag.

*Accessories.* Accessories, our second largest revenue category, include fashion accessories such as wallets, ID cases, eyeglass cases, cosmetics, paper and gift products, and eyewear. Accessories are attractively priced and allow the consumer to include some color in her wardrobe, even if tucked into another bag. Our product development team consistently updates the accessories assortment based on consumer demand and fashion trends.

*Travel and Leisure Items.* Our travel and leisure product category includes duffel bags, garment bags, rolling luggage, and travel accessories, such as travel cosmetic cases. The first Vera Bradley product offering included duffel bags, which consistently have been a strong performer. We believe their popularity, as well as the appeal of our other travel and leisure items, results from our vibrant designs, functional styles, and lightweight fabrications.

## **Product Development**

We have implemented a fully integrated and cross-functional product development process that aligns design, market research, merchandise management, sales, marketing, and sourcing. Product development is a core capability that makes our products unique and provides us with a competitive advantage. Our designs and aesthetics set our products apart and drive customer loyalty. Our product development team mixes an understanding of the needs of our target customers with knowledge of upcoming color and fashion trends to design new collections as well as new product categories that will resonate in the market.

We begin the development stage of our products in the Vera Bradley portfolio 12–18 months in advance of their release. The development of each new pattern includes the design of an overall print, a complementary fabric backing, and three sizes of coordinating trim materials. To seek fresh perspectives, we collaborate with independent designers to create unique patterns for each season. We oversee the development and exercise the final approval of all patterns and designs. Once developed, we generally copyright each pattern, including the print, fabric backing and coordinating trim. We believe that great design is not only central to our product development efforts, but also is a fundamental part of our brand development and growth strategies. In the past several years, we have made investments to evolve and integrate our product development expertise, including opening a design office in New York City, as well as opening a design center in Roanoke, Indiana that puts all individuals involved in the product design process in the same location.

Our product development team works to ensure that new collections contain an assortment of products and styles that are in line with both fashion trends and customer needs and regularly updates classic styles to enhance functionality. In addition, we actively pursue opportunities to expand our product offerings through new line and brand extensions. Our product development team monitors fashion trends and customer needs by attending major trend shows in Europe and the United States, subscribing to trend monitoring services, and engaging in comparison shopping.

Our product development team is also responsible for assortment planning, pricing, forecasting, promotional development, and product lifecycle management. Forecasting is based on seasonal market research and in-store testing. We gather seasonal market research through a variety of methodologies, including scheduled interviews and online and in-person surveys. We conduct seasonal in-store testing by releasing test products in our full-price stores and evaluating their success in the marketplace prior to product introduction on a larger scale. The team assures that we offer a broad range of patterns, fabrics, styles, and functionality features in a cost-effective

## **Table of Contents**

manner. We believe that with our cross-functional, collaborative approach, we are able to introduce and sell our merchandise in a way that clearly communicates the Vera Bradley brand and the Vera Bradley lifestyle.

### **Marketing**

We believe that the growth of our brand and our business is influenced by our ability to introduce and sell our merchandise in a way that clearly conveys the Vera Bradley lifestyle. We use marketing and advertising as critical tools in our efforts to promote our brand.

*Catalogs and Collateral.* The seasonal Vera Bradley catalog is a key vehicle for the brand and our product portfolio. Each season's catalog is sent to a targeted customer mailing list. In addition to distributing the catalog, we produce and distribute a number of other marketing pieces, or collateral, including postcards, gift guides, in-store signage, and release-focused mailers. Catalogs and collateral provide consumers with a powerful visual representation of both the products and lifestyle images embodied by the Vera Bradley brand. We believe that Vera Bradley's catalogs and other mailed collateral generate excitement and awareness about the brand and seasonal introductions and allow us to reach both new and loyal customers in their homes.

*Advertising.* We employ print and outdoor advertising to increase overall brand awareness. Our advertisements are placed primarily in national magazines that have a readership similar to our target demographics. These publications have recently included *Seventeen*, *InStyle*, *O the Oprah Magazine*, and *Real Simple*. We continually assess our advertising strategies and tactics.

*Public Relations and Product Placement.* Vera Bradley has received considerable exposure in the press, including in publications such as *InStyle*, *O the Oprah Magazine*, *Good Housekeeping*, *Coastal Living*, and *The New York Times*. In addition, we have expanded our marketing efforts to promote product placement in feature-length films and on prime-time television shows such as *Desperate Housewives*, *Brothers and Sisters*, *Entourage*, *Modern Family*, and *New Girl*.

*Social Media and Online Marketing.* In recent years, we have greatly increased traffic to verabradley.com and have increased awareness of our brand through online marketing and social networking sites. We have captured more than 1.2 million customer e-mail addresses in our online customer file, with many of these customers providing age, occupation, and location data. This captured information provides us with deeper insight into the products and categories that are in the highest demand, and allows us to better target our customers with appropriate messages. As of January 28, 2012, we had over 700,000 Facebook fans and a growing number of Twitter followers. We believe these media not only connect us with our fans, but also allow us to target them through cross-channel marketing.

### **Channels of Distribution**

We distribute our products through our Direct and Indirect segments. This multi-channel distribution model not only enables us to have operational flexibility, but also maximizes the methods by which we can access potential customers.

#### **Direct Segment**

*Full-Price Stores.* We have developed a retail presence through our full-price stores, all located in the United States, which provides us with a format to showcase the image and products of Vera Bradley. As of January 28, 2012, we operated 48 full-price stores. Our full-price stores average approximately 1,800 square feet per store. Our stores are designed to create a feeling of home with a high standard of visual merchandising. The welcoming nature of our full-price stores provides our customers with a comfortable shopping experience in a setting that showcases our merchandise and conveys the Vera Bradley lifestyle. Our sales associates are passionate about our products and customer service, which, we believe, translates into a superior shopping experience.

## **Table of Contents**

*E-Commerce.* In 2006, we began selling our products through the verabradley.com website. The objective of verabradley.com is to provide both a mechanism for marketing directly to consumers and a storefront where consumers can find the entire Vera Bradley collection. In fiscal 2010, we invested in upgrades to our website that enable us to provide customized shopping experiences tailored to each online shopper and allow better integration with third-party sites such as Facebook.com. We believe the enhanced functionality allows us to provide a superior experience to our e-commerce customers. In fiscal 2012, we had over 43 million visits to verabradley.com.

*Outlet Stores.* Our outlet stores are a vehicle for selling discontinued merchandise at discounted prices, while maintaining brand identity. We believe our outlet stores are an integral part of our distribution strategy, as this format provides an additional channel of distribution for our products and enables us to better target value-oriented customers.

*International.* We launched a marketing campaign to connect with the Japanese consumer on April 18, 2011. This campaign included seven temporary pop-up stores in several department stores including Isetan Shinjuku and Marui Yurakucho located across Tokyo and Kyoto. The international channel includes the Japanese website verabradley.co.jp launched in fiscal 2012.

*Annual Outlet Sale.* For the last ten years, our annual outlet sale has been held in the Allen County War Memorial Coliseum Exposition Center in Fort Wayne, Indiana. The annual outlet sale is an important tradition for Vera Bradley, has many loyal followers, and is an opportunity for us to sell our discontinued merchandise at discounted prices in a brand-right fashion. We attracted more than 60,000 attendees to our 2011 annual outlet sale.

## **Indirect Segment**

As of January 28, 2012, we had approximately 3,300 Indirect retailers, the majority of which were specialty retailers with whom we have had long-standing relationships. In fiscal 2012, 2011, and 2010, our Indirect channel generated net revenues of \$235.6 million, \$214.9 million, and \$192.8 million, respectively, or, as a percentage of our total net revenues, 51.1%, 58.7%, and 66.7%, respectively. Indirect retailers are primarily gift, apparel and accessories, travel, or other specialty retailers. No single account represented more than 3.0% of total Indirect net revenues in fiscal 2012, with the top ten accounts representing in the aggregate less than 13.0% of total Indirect net revenues. The majority of our Indirect retailers have been customers for over five years. In fiscal 2012, we launched our products in the department store channel.

## **Sales Force**

We believe that having an in-house sales force results in more consistent brand presentation and messaging, enhanced support for our Indirect retailers, and a more predictable, scalable, and cost-efficient business model. As of January 28, 2012, our sales team consisted of 87 in-house, full-time sales consultants. The compensation structure for our sales consultants consists of a combination of fixed pay and sales-based incentives.

In addition to acquiring new and growing existing accounts, our sales consultants serve as a support center for our Indirect retailers by assisting and educating them in areas such as merchandising and visual presentation, marketing of the brand, product selection, and inventory management. Our sales consultants also participate in our semi-annual product introduction and education event for our Indirect retailers. Our visual merchandising program provides our sales consultants with a framework to guide our Indirect retailers regarding optimal product placement and display that is intended to reinforce the message that our brand is distinct from those of our competitors.

## **Our Stores**

As of January 28, 2012, we operated 56 stores in 27 states throughout the United States, which includes 48 full-price stores. We believe there is a significant opportunity to grow our store base, as we believe the market in the

**Table of Contents**

United States can support at least 300 Vera Bradley full-price stores. Based on the success of our existing outlet stores, the number of attractive outlet centers in the United States, and the growing popularity of outlet shopping, we believe the United States has capacity to support additional Vera Bradley outlet stores.

We opened thirteen full-price stores and four outlet stores in fiscal 2012. We plan to open 14 to 20 new stores annually during each of the next five fiscal years.

*Store Location Selection Strategy*

Our store location decisions are made case by case, depending on the combined retail strategy we have developed for the particular market. This includes actual and planned penetration in both Indirect and Direct segments, as well as existing e-commerce demand. At this time, we do not believe any market has been fully penetrated. We believe that expansion of our store base complements our Indirect segment by increasing brand awareness and reinforcing our brand image. In addition to analyzing store economics, we pay particular attention to the location within the shopping center, the size and shape of the space, and desirable co-tenancies. Along with seeking co-tenants that we believe share our target customer, we seek a balanced mix of moderate and high-end retailers to encourage high levels of traffic. Our target full-price store size is approximately 1,800 square feet, but we are comfortable with spaces as small as 1,000 square feet or, depending on our market strategy and relevant economic factors, spaces as large as 2,800 square feet.

*Store Locations*

Our full-price stores are located primarily in high-traffic regional malls, lifestyle centers, and mixed-use shopping centers across the United States. The following table shows the number of full-price and outlet stores we operated in each state as of January 28, 2012:

| State         | Total Number of Full-Price Stores | Total Number of Outlet Stores | State          | Total Number of Full-Price Stores | Total Number of Outlet Stores |
|---------------|-----------------------------------|-------------------------------|----------------|-----------------------------------|-------------------------------|
| Alabama       | 1                                 |                               | Minnesota      | 1                                 |                               |
| California    | 4                                 |                               | Missouri       | 1                                 |                               |
| Colorado      | 1                                 |                               | New Jersey     | 2                                 |                               |
| Connecticut   | 1                                 |                               | New York       | 2                                 | 1                             |
| Delaware      | 1                                 |                               | North Carolina | 1                                 |                               |
| Florida       | 2                                 | 2                             | Ohio           | 2                                 |                               |
| Georgia       | 1                                 |                               | Pennsylvania   | 1                                 | 1                             |
| Hawaii        | 1                                 |                               | Rhode Island   | 1                                 |                               |
| Illinois      | 4                                 | 1                             | Tennessee      | 1                                 |                               |
| Indiana       | 1                                 |                               | Texas          | 7                                 | 1                             |
| Kansas        | 1                                 |                               | Virginia       | 1                                 | 1                             |
| Maryland      | 2                                 |                               | Washington     | 1                                 |                               |
| Massachusetts | 4                                 | 1                             | Wisconsin      | 1                                 |                               |
| Michigan      | 2                                 |                               |                |                                   |                               |

*Store Operations*

The focus of our store operations is providing consumers with a comfortable shopping experience. We strive to make the experience interactive through special store events, such as showcasing newly launched products or celebrating our namesake's birthday. Our customer service philosophy emphasizes friendly service, merchandise knowledge, and passion for the brand. Consequently, an essential requirement for the success of our stores is our ability to attract, train, and retain talented, highly motivated district managers, store managers, and sales associates. Our district and store managers are our primary link to the consumer, and we continually invest in their development.

## **Table of Contents**

### *Store Economics*

We believe that our innovative retail concept and distinctive retail experience contribute to the success of our stores, most of which generate strong productivity and returns. We expect our full-price stores to average approximately 1,800 square feet per store, and we expect to invest approximately \$0.4 million per new store, consisting of inventory costs, pre-opening costs, and build-out costs less tenant-improvement allowances. New full-price stores generate on average between \$1.1 million and \$1.3 million in net revenues during the first twelve months, and the payback on our investment is expected to occur in less than 18 months.

### **Manufacturing and Supply Chain Model**

Our manufacturing and supply chain model is designed to maximize flexibility in order to meet shifting demands in the market. Our model utilizes offshore raw material suppliers and a blend of offshore and domestic manufacturing. We place a strong emphasis on continuous improvement and have employed lean manufacturing concepts. Our broad-based, multi-country manufacturing and supply chain model is designed to achieve efficient, timely, and accurate order fulfillment while maintaining appropriate levels of inventory.

Our sourcing strategy is part of the larger cross-functional product development process. The overall objective for our sourcing team is to build and sustain collaborative partnerships throughout our supply chain, with a focus on identifying appropriate countries and partners to manufacture our products. The sourcing team leverages its expertise in negotiation, relationship management, and change management to maintain a strong global supply chain.

We strive to maintain the appropriate balance of inventory to enable us to provide a high level of service to our customers, including prompt and accurate delivery of our products. We have an active sales and operations planning process that helps us balance the supply and demand issues that we encounter in our business, optimize our inventory levels, and anticipate inventory needs. We have also integrated our planning, forecasting, and segmentation processes under one function called Inventory Planning and Deployment. This integrated function along with the creation of a Merchant function, has allowed for further improvements to our inventory management processes.

The majority of our products are cotton-based. Our other products are made from specialty fabrics (including nylon and microfiber) and paper. We source our materials from various suppliers in Asia, with the majority coming from China and South Korea. Our global supply chain and purchasing teams work together with select suppliers enabling us to optimize the mix of cost, lead time, quality, and reliability within our global supply network. All of our suppliers must comply with our quality standards, and we use only a limited number of pre-approved suppliers who have demonstrated a commitment to delivering the highest quality products. In December 2008, we opened an office in Dongguan, China, which enables us to increase our control over the manufacturing and supply chain process and monitor compliance with our quality standards.

A significant majority of our finished goods products are manufactured externally overseas. These products are made by a variety of global manufacturers located primarily in China. We are not dependent upon any single manufacturer for our products. When determining the size of orders placed with our manufacturers, we take into account forward-looking demand, lead times for specific products, current inventory levels, and minimum order quantity requirements. Overseas production has resulted in substantial cost savings and a reduction of capital investment. With the oversight of our office in China and our independent contractors, we believe these financial benefits have been realized without sacrificing the level of quality inherent in our products or service to our customers.

The remainder of our products are manufactured in the United States to provide flexibility in our supply chain. This production, almost all of which is internal to Vera Bradley, enables us to manufacture a finished product in



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## **Table of Contents**

two weeks. This capability allows us to manufacture finished product to respond quickly to shifts in marketplace demand and changes in consumer preferences. In fiscal 2012, approximately 10% of our units were produced in our domestic manufacturing facility.

### **Distribution Center**

In 2007, we consolidated our warehousing and shipping functions into one, 217,320 square-foot distribution center, located in Roanoke, Indiana. This highly automated, computerized facility allows Vera Bradley employees to receive information directly from the order-collection center and quickly identify the products and quantity necessary for a particular order. In addition, we employ a warehouse-control system that controls the flow of our products through 5,000 feet of automated conveyer. The facility's advanced technology enables us to more accurately process and pack orders, as well as track shipments and inventory. We believe that our systems for the processing and shipment of orders from our distribution center have enabled us to improve our overall customer service through enhanced order accuracy and reduced turnaround time. During fiscal 2012, we began a 200,000 square-foot expansion of the distribution facility, which we expect to complete in fiscal 2013.

We strive to maintain the appropriate balance of inventory to enable us to provide a high level of service to our customers, including prompt and accurate delivery of our products. We have an active Inventory Planning and Deployment function that helps us balance the supply and demand issues that we encounter in our business, optimize our inventory levels, and anticipate inventory needs.

Our products are shipped primarily via FedEx and common carriers to our stores, our Indirect retailers, and directly to our customers who purchase through our website. We believe we are positioned well to support the order fulfillment requirements of our growing business, including business generated through our website.

### **Management Information Systems**

We believe that high levels of automation and technology are essential to maintain our competitive position. We maintain computer hardware, systems applications, and networks to enhance and accelerate the design process, to support the sale and distribution of our products to our customers, and to improve the integration and efficiency of our operations. Our management information systems are designed to provide, among other things, comprehensive order processing, production, accounting, and management information for the product development, retail, sales, marketing, manufacturing, distribution, finance, and human resources functions of our business. We use several specialized systems, including MICROS-Retail, SAP, and SCALE, for our information technology requirements.

### **Competition**

We face strong competition in each of the product lines and markets in which we compete. We believe that all of our products are in similar competitive positions with respect to the number of competitors they face and the level of competition within each product line. Due to the number of different products we offer, it is not practicable for us to quantify the number of competitors we face. Our products compete with other branded products within their product categories and with private label products sold by retailers. In our Indirect business, we compete with numerous manufacturers, importers, and distributors of handbags, accessories, and other products for the limited space available for the display of such products to the consumer. Moreover, the general availability of contract manufacturing allows new entrants access to the markets in which we compete, which may increase the number of competitors and adversely affect our competitive position and our business. In our Direct business, we compete against other specialty retailers, department stores, catalog retailers, gift retailers, and Internet businesses that engage in the retail sale of similar products.

The market for handbags, in particular, is highly competitive. Our competitors include not only established companies that are expanding their production and marketing of handbags, but also frequent new entrants to the market. We directly compete with wholesalers and direct sellers of branded handbags and accessories, such as Coach, Nine West, Liz Claiborne, Dooney & Bourke, and Michael Kors.

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## **Table of Contents**

In varying degrees, depending on the product category involved, we compete on the basis of design (aesthetic appeal), quality (construction), function, price point, distribution, and brand positioning. We believe that our primary competitive advantages are consumer recognition of our brand, customer loyalty, product development expertise, and our widespread presence through our multi-channel distribution model. Some of our competitors have achieved significant recognition for their brand names or have substantially greater financial, distribution, marketing, and other resources than we do. Further, we may face new competitors and increased competition from existing competitors as we expand into new markets and increase our presence in existing markets.

### **Copyrights and Trademarks**

The development of each new pattern includes the design of an overall print, a complementary fabric backing, and coordinating trim materials. Once developed, we generally copyright each pattern, including the print, fabric backing, and coordinating trim. We currently have in excess of 400 copyrights.

We also own all of the material trademark rights used in connection with the production, marketing, and distribution of all of our products, both in the United States and in the other countries in which our products are principally sold. Our trademarks include Vera Bradley. We aggressively police our trademarks and copyrights and pursue infringers both domestically and internationally. We also pursue counterfeiters domestically and internationally through leads generated internally, as well as through external sources monitoring use in the market. Our trademarks will remain in existence for as long as we continue to use and renew them on their expiration dates. We have no material patents.

### **Employees**

As of January 28, 2012, we had 2,078 employees. Of the total, 1,046 were engaged in retail selling positions, 327 were engaged in manufacturing functions, 32 were engaged in product design, and 460 were engaged in corporate support and administrative functions. The remaining employees were engaged in other aspects of our business. None of our employees is represented by a union. We believe that our relations with our employees are good, and we have never encountered a significant work stoppage.

### **Government Regulation**

Many of our imported products are subject to existing or potential duties, tariffs, or quotas that may limit the quantity of products that we may import into the United States and other countries or impact the cost of such products. To date, we have not been restricted by quotas in the operation of our business, and customs duties have not comprised a material portion of the total cost of a majority of our products. In addition, we are subject to foreign governmental regulation and trade restrictions, including U.S. retaliation against prohibited foreign practices, with respect to our product sourcing and international sales operations.

We are subject to federal, state, local, and foreign laws and regulations governing environmental matters, including the handling, transportation, and disposal of our products and our non-hazardous and hazardous substances and wastes, as well as emissions and discharges into the environment, including discharges to air, surface water, and groundwater. Failure to comply with such laws and regulations could result in costs for corrective action, penalties, or the imposition of other liabilities. Compliance with environmental laws and regulations has not had a material effect upon our earnings or financial position. If we violate any laws or regulations, however, it could have a material adverse effect on our business or financial performance.

### **Available Information**

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge on our website, [www.verabradley.com](http://www.verabradley.com), as soon as reasonably practicable after they are filed with or furnished to the Securities and Exchange Commission (SEC). No information contained on our website is intended to be included as part of, or incorporated by reference into, this Annual Report on Form 10-K.

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## **Table of Contents**

### **Item 1A. Risk Factors**

*You should carefully consider all of the information in this report, particularly the following factors, which could materially affect our business, financial condition, and results of operations in future periods. The risks described below are not the only risks that we face. Additional risks not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and results of operations in future periods.*

#### **Risks Related to Our Business**

*Changes in general economic conditions, and their impact on consumer confidence and consumer spending, could adversely impact our results of operations.*

Our performance is subject to general economic conditions and their impact on levels of consumer confidence and consumer spending. In recent years, consumer confidence and consumer spending deteriorated significantly, influenced by fluctuating interest rates and credit availability, changing fuel and other energy costs, fluctuating commodity prices, higher levels of unemployment and consumer debt levels, reductions in net worth based on market declines, home foreclosures and reductions in home values, and general uncertainty regarding the overall future economic environment. Consumer purchases of discretionary items, including our merchandise, generally decline during periods when disposable income is adversely affected or there is economic uncertainty, and this could adversely impact our results of operations. In the event of another significant economic downturn, we could experience lower than expected net revenues, which could force us to delay or slow the implementation of our growth strategies and adversely impact our results of operations.

*Our inability to predict and respond in a timely manner to changes in consumer demand could adversely affect our net revenues and results of operations.*

Our success depends on our ability to gauge the fashion tastes of our customers and to provide merchandise that satisfies consumer demand in a timely manner. Our products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to rapid change. We cannot assure you that we will be able to continue to develop appealing patterns and styles or meet changing consumer demands in the future. If we misjudge the market for our products, we may be faced with significant excess inventories for some products and missed opportunities for other products. Merchandise misjudgments could adversely impact our net revenues and results of operations.

*Our results of operations could suffer if we lose key management or design associates or are unable to attract and retain the talent required for our business.*

Our performance depends largely on the efforts and abilities of our senior management and product development teams. These executives and design associates have substantial experience in our business and have made significant contributions to our growth and success. We do not have employment agreements with any of our key executives or design associates. The unexpected loss of services of certain of these individuals could have adverse impacts on our business and results of operations. As our business grows and we open new stores, we will need to attract and retain additional qualified employees and develop, train, and manage an increasing number of management-level, sales, and other employees. Competition for qualified employees is intense. We cannot assure you that we will be able to attract and retain employees as needed in the future.

*Our business depends on a strong brand. If we are unable to maintain and enhance our brand, then we may be unable to sell our products, which could adversely impact our results of operations.*

We believe that the brand image that we have developed has contributed significantly to the success of our business. We also believe that maintaining and enhancing the Vera Bradley brand is critical to maintaining and

## Table of Contents

expanding our customer base. Maintaining and enhancing our brand may require us to make substantial investments in areas such as product design, store operations, and community relations. These investments might not succeed. If we are unable to maintain or enhance our brand image, our results of operations could be adversely impacted.

*If we are unable to successfully implement our growth strategies or manage our growing business, our future operating results could suffer.*

The success of our growth strategies, alone or collectively, will depend on various factors, including the appeal of our product designs, retail presentation to consumers, competitive conditions, and economic conditions. If we are unsuccessful in implementing some or all of our strategies or initiatives, our future operating results could be adversely impacted.

Successful implementation of our strategies will require us to manage our growth. To manage our growth effectively, we will need to continue to increase production while maintaining strict quality control. We also will need to continue to improve and invest in our systems and processes to keep pace with planned increases in demand. We could suffer a decline in sales if our products do not continue to meet our quality control standards or if we are unable to respond adequately to increases in customer demand for our products.

We are continuing to invest in our specialty retailers to support them in growing along with Vera Bradley. This channel will continue to evolve over time as we balance the channel dynamics between the specialty retailer, our Direct stores, and e-commerce.

Additionally, our current growth strategy includes plans to expand internationally. We currently plan to open additional shop-in-shop stores within Japanese department stores. We do not yet have significant experience operating in Japan, and we face established competitors. Furthermore, Japan has different operational characteristics, including but not limited to employment and labor, transportation, logistics, real estate, and local reporting or legal requirements. In addition, consumer demand and behavior, as well as tastes and purchasing trends may differ in Japan, and as a result, sales of our product may not be successful, or the margins on those sales may not be in line with those we currently anticipate. If our international expansion plans are unsuccessful, our financial results could be adversely affected.

*We may not be able to successfully open and operate new stores as planned, which could adversely impact our results of operations.*

Our continued growth will depend on our ability to successfully open and operate new stores. We plan to open 14 to 20 new stores during each of the next five fiscal years. Our ability to successfully open and operate new stores depends on many factors, including our ability to:

identify suitable store locations, the availability of which is outside our control;

negotiate acceptable lease terms, including desired tenant improvement allowances;

hire, train, and retain store personnel and management;

assimilate new store personnel and management into our corporate culture;

source and manufacture inventory; and

successfully integrate new stores into our existing operations and information technology systems.

The success of new store openings may also be affected by our ability to initiate marketing efforts in advance of opening our first store in a particular region. Additionally, we will encounter pre-operating costs and we may encounter initial losses while new stores commence operations, which could strain our resources and adversely impact our results of operations.



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**Table of Contents**

***Our inability to sustain levels of comparable-store sales could cause our stock price to decline.***

We may not be able to sustain the levels of comparable-store sales that we have experienced in the recent past. If our future comparable-store sales decline or fail to meet market expectations, then the price of our common stock could decline. Also, the aggregate results of operations of our stores have fluctuated in the past and will fluctuate in the future. Numerous factors influence comparable-store sales, including fashion trends, competition, national and regional economic conditions, pricing, inflation, the timing of the release of new merchandise and promotional events, changes in our merchandise mix, inventory shrinkage, marketing programs, and weather conditions. In addition, many companies with retail operations have been unable to sustain high levels of comparable-store sales during and after periods of substantial expansion. These factors may cause our comparable-store sales results to be lower in the future than in recent periods or lower than expectations, either of which could result in a decline in the price of our common stock.

***We are subject to risks associated with leasing substantial amounts of space, including future increases in occupancy costs.***

We do not own any real estate other than our warehouse and distribution facility. We lease our corporate headquarters, our other offices, and all of our store locations. We typically occupy our stores under operating leases with terms of ten years. We have been able to negotiate favorable rental rates in recent years due in part to the state of the economy and high vacancy rates within some shopping centers, but there is no assurance that we will be able to continue to negotiate such favorable terms. Some of our leases have early cancellation clauses, which permit the lease to be terminated by us or the landlord if certain sales levels are not met in specific periods or if the shopping center does not meet specified occupancy standards. In addition to requiring future minimum lease payments, some of our store leases provide for the payment of common area maintenance charges, real property insurance, and real estate taxes. Many of our lease agreements have escalating rent provisions over the initial term and any extensions. As we expand our store base, our lease expense and our cash outlays for rent under lease agreements will increase. Our substantial operating lease obligations could have significant negative consequences, including:

requiring that a substantial portion of our available cash be applied to pay our rental obligations, thus reducing cash available for other purposes;

increasing our vulnerability to general adverse economic and industry conditions;

limiting our flexibility in planning for or reacting to changes in our business or industry; and

limiting our ability to obtain additional financing.

Any of these consequences could place us at a disadvantage with respect to our competitors. We depend on cash flow from operating activities to pay our lease expenses and to fulfill our other cash needs. If our business does not generate sufficient cash flow from operating activities to fund these expenses and needs, we may not be able to service our lease expenses, grow our business, respond to competitive challenges, or fund our other liquidity and capital needs, which would harm our business.

Additional sites that we lease may be subject to long-term non-cancelable leases if we are unable to negotiate our current standard lease terms. If an existing or future store is not profitable, and we decide to close it, we may nonetheless be committed to perform our obligations under the applicable lease, including paying the base rent for the balance of the lease term. Moreover, even if a lease has an early cancellation clause, we may not satisfy the contractual requirements for early cancellation under the lease. Our inability to enter new leases or renew existing leases on acceptable terms or be released from our obligations under leases for stores that we close would, in any such case, affect us adversely.

## **Table of Contents**

*We operate in a competitive market. Our competitors might develop products more popular with consumers than our products.*

The market for handbags, accessories, and travel and leisure items is competitive. Our competitive challenges include:

attracting consumer traffic;

sourcing and manufacturing merchandise efficiently;

competitively pricing our products and achieving customer perception of value;

maintaining favorable brand recognition and effectively marketing our products to consumers in diverse market segments;

developing designs that appeal to a broad range of demographic and age segments;

developing high-quality products; and

establishing and maintaining good working relationships with our Indirect retailers.

In our Indirect business, we compete with numerous manufacturers, importers, and distributors of handbags, accessories, and other products for the limited space available for the display of such products to the consumer. In our Direct business, we compete against other gift and specialty retailers, department stores, catalog retailers, and Internet businesses that engage in the retail sale of similar products. Moreover, the general availability of contract manufacturing allows new entrants easy access to the markets in which we compete, which may increase the number of competitors and adversely affect our competitive position and our business.

***We rely on various contract manufacturers to produce a significant majority of our products and generally do not have long-term contracts with our manufacturers. Disruptions in our contract manufacturers' systems, losses of manufacturing certifications, or other actions by these manufacturers could increase our cost of sales, adversely affect our net revenues, and injure our reputation and customer relationships, thereby harming our business.***

Our various contract manufacturers produce a significant majority of our products. We generally do not enter into long-term formal written agreements with our manufacturers and instead transact business with each of them on an order-by-order basis. In the event of a disruption in our contract manufacturers' systems, we may be unable to locate alternative manufacturers of comparable quality at an acceptable price, or at all. Identifying a suitable manufacturer is an involved process that requires us to become satisfied with the prospective manufacturer's quality control, responsiveness and service, financial stability, and labor practices. Any delay, interruption, or increased cost in the manufactured products that might occur for any reason, such as the lack of long-term contracts or regulatory requirements and the loss of certifications, power interruptions, fires, hurricanes, war, or threats of terrorism, could affect our ability to meet customer demand for our products, adversely affect our net revenues, increase our cost of sales, and hurt our results of operations. In addition, manufacturing disruption could injure our reputation and customer relationships, thereby harming our business.

***We rely on various suppliers to supply a significant majority of our raw materials. Disruption in the supply of raw materials could increase our cost of goods sold and adversely affect our net revenues.***

We generally do not enter into long-term formal written agreements with our suppliers and typically transact business with each of them on an order-by-order basis. As a result, we cannot assure that there will be no significant disruption in the supply of fabrics or raw materials from our current sources or, in the event of a disruption, that we would be able to locate alternative suppliers of materials of comparable quality at an acceptable price, or at all.





## **Table of Contents**

***We rely on a single warehouse and distribution facility for all of the products we sell. Disruption to that facility could adversely impact our results of operations, and expansion of that facility could have unpredictable adverse effects.***

Our warehouse and distribution operations are currently concentrated in a single, company-owned distribution center in Fort Wayne, Indiana. Any significant disruption in the operation of the facility due to natural disaster or severe weather, or events such as fire, accidents, power outages, system failures, or other unforeseen causes, could devalue or damage a significant portion of our inventory and could adversely affect our product distribution and sales until such time as we could secure an alternative facility. If we encounter difficulties with our distribution facility or other problems or disasters arise, we cannot ensure that critical systems and operations will be restored in a timely manner or at all, and this would have a material adverse effect on our business. In addition, our growth could require us to further expand our current facility, which could affect us adversely in ways that we cannot predict.

***The cost of raw materials could increase our cost of sales and cause our results of operations to suffer.***

Fluctuations in the price, availability, and quality of fabrics or other raw materials used to manufacture our products, as well as the price for labor, marketing, and transportation, could have adverse impacts on our cost of sales and our ability to meet our customers' demands. In particular, fluctuations in the price of cotton, our primary raw material, could have an adverse impact on our cost of sales. In addition, because a key component of our products is petroleum-based, the cost of oil affects the cost of our products. Upward movement in the price of oil in the global oil markets would also likely result in rising fuel and freight prices, which could increase our shipping costs. In the future, we may not be able to pass all or a portion of higher costs on to our customers.

***Our business is subject to the risks inherent in global sourcing and manufacturing activities.***

We source our fabrics primarily from manufacturers in China and South Korea and outsource the production of a significant majority of our products to companies in Asia. We are subject to the risks inherent in global sourcing and manufacturing, including, but not limited to:

exchange rate fluctuations and trends;

availability of raw materials;

compliance with labor laws and other foreign governmental regulations;

compliance with U.S. import and export laws and regulations;

disruption or delays in shipments;

loss or impairment of key manufacturing sites;

product quality issues;

political unrest; and

natural disasters, acts of war and terrorism, changing macroeconomic trends, and other external factors over which we have no control.

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Significant disruption of manufacturing for any of the above reasons could interrupt product supply and, if not remedied in a timely manner, could have an adverse impact on our results of operations. Additionally, we do not have complete oversight over our contract manufacturers. Violation of labor or other laws by those manufacturers, or the divergence of a contract manufacturer's labor or other practices from those generally accepted as ethical in the United States or in other markets in which we may in the future do business, could also draw negative publicity for us and our brand, diminishing the value of our brand and reducing demand for our products.

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## **Table of Contents**

***Our ability to source our products at favorable prices, or at all, could be harmed, with adverse effects on our results of operations, if new trade restrictions are imposed or if existing trade restrictions become more burdensome.***

A significant majority of our products are currently manufactured for us in Asia. The United States and the countries in which our products are produced have imposed and may impose additional quotas, duties, tariffs, or other restrictions or regulations or may adversely adjust prevailing quotas, duties, or tariffs. Countries impose, modify, and remove tariffs and other trade restrictions in response to a diverse array of factors, including global and national economic and political conditions, which make it impossible for us to predict future developments regarding tariffs and other trade restrictions. Trade restrictions, which include embargoes, safeguards, and customs restrictions, could increase the cost or reduce the supply of products available to us or could require us to modify supply chain organization or other current business practices, any of which could harm our results of operations.

***We may be subject to unionization, work stoppages, slowdowns or increased labor costs, especially if the Employee Free Choice Act is adopted.***

Currently, none of our employees is represented by a union. Nevertheless, our employees have the right at any time under the National Labor Relations Act to organize or affiliate with a union. If some or all of our workforce were to become unionized, our business would be exposed to work stoppages and slowdowns as a unionized business. If, in addition, the terms of the collective bargaining agreement were significantly more favorable to union workers than our current pay-and-benefits arrangements, our costs would increase and our results of operations would suffer.

***Our results of operations are subject to quarterly fluctuations, which could adversely affect the market price of our common stock.***

Our quarterly results of operations may fluctuate significantly as a result of a variety of factors, including, among other things:

the timing of new store openings;

net revenues and profits contributed by new stores;

increases or decreases in comparable-store sales;

shifts in the timing of holidays, particularly in the United States and China;

changes in our merchandise mix;

timing of sales to Indirect retailers; and

the timing of new pattern releases and new product introductions.

As a result of these quarterly fluctuations, we believe that comparisons of our sales and operating results between different quarters within a single fiscal year are not necessarily meaningful and that these comparisons cannot be relied upon as indicators of our future performance. Any quarterly fluctuations that we report in the future may not match the expectations of market analysts and investors. This could cause the trading price of our common stock to fluctuate significantly.

***We rely on independent transportation providers for substantially all of our product shipments.***

We currently rely on independent transportation service providers for substantially all of our product shipments. Our utilization of these delivery services, or those of any other shipping companies that we may elect to use, is subject to risks, including increases in fuel prices, which would increase our shipping costs, and employee strikes and inclement weather, which may impact the shipping company's ability to provide delivery

services sufficient to meet our shipping needs.

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**Table of Contents**

If for any reason we were to change shipping companies, we could face logistical difficulties that might adversely affect deliveries, and we would incur costs and expend resources in the course of making the change. Moreover, we might not be able to obtain terms as favorable as those received from the service providers that we currently use, which in turn would increase our costs. We also would face shipping and distribution risks and uncertainties associated with any expansion of our warehouse and distribution facility and related systems.

***We plan to use cash provided by operating activities to fund our expanding business and execute our growth strategies and may require additional capital, which may not be available to us.***

Our business relies on cash provided by operating activities as our primary source of liquidity. To support our growing business and execute our growth strategies, we will need significant amounts of cash from that source, including funds to pay our lease obligations, build out new store space, purchase inventory, pay personnel, invest further in our infrastructure and facilities, and pay for the costs associated with operating as a public company. If our business does not generate cash flow from operating activities sufficient to fund these activities, and if sufficient funds are not otherwise available to us from our existing revolving credit facility, we will need to seek additional capital, through debt or equity financings, to fund our growth. If new sources of financing are required, but are insufficient or unavailable, then we will be required to modify our growth and operating plans based on available funding, if any, which would inhibit our growth and could harm our business.

***We face various risks as an e-commerce retailer.***

Business risks relating to e-commerce sales include the need to keep pace with rapid technological change, internet security risks, risks of system failure or inadequacy, governmental regulation, and taxation. We have contracted with several different companies to maintain and operate various aspects of our e-commerce business and are reliant on them and their ability to perform their tasks, as well as their operational, privacy, and security procedures and controls as they affect our business. If the independent contractors on which we rely fail to perform their tasks, we could incur liability or suffer damages to our reputation, or both.

***Our copyrights, trademarks and other proprietary rights could conflict with the rights of others, and we may be inhibited from selling some of our products. If we are unable to protect our copyrights and other proprietary rights, others may sell imitation brand products.***

We believe that our registered copyrights, registered and common law trademarks, and other proprietary rights have significant value and are critical to our ability to create and sustain demand for our products. Although we have not been inhibited from selling our products in connection with intellectual property disputes, we cannot assure you that obstacles will not arise as we expand our product line and extend our brand as well as the geographic scope of our sales and marketing. We also cannot assure you that the actions taken by us to establish and protect our proprietary rights will be adequate to prevent imitation of our products or infringement of our rights by others. The legal regimes of some foreign countries, particularly China, may not protect proprietary rights to the same extent as the laws of the United States, and it may be more difficult for us to successfully challenge the use of our proprietary rights by others in these countries. The loss of copyrights, trademarks, and other proprietary rights could adversely impact our results of operations. Any litigation regarding our proprietary rights could be time consuming and costly.

***Prior to the completion of the Reorganization, we were treated as an S Corporation under Subchapter S of the Internal Revenue Code, and claims of taxing authorities related to our prior status as an S Corporation could harm us.***

Upon the completion of the Reorganization in fiscal 2011, our S Corporation status terminated automatically and we became subject to increased federal and state income taxes. If the unaudited, open tax years in which we were an S Corporation are audited by the Internal Revenue Service, and we are determined not to have qualified for, or to have violated, our S Corporation status, we will be obligated to pay back taxes, interest, and

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**Table of Contents**

penalties, and we do not have the right to reclaim tax distributions we have made to our shareholders during those periods. These amounts could include taxes on all of our taxable income while we were an S Corporation. Any such claims could result in additional costs to us and could have a material adverse effect on our results of operations and financial condition.

***Fluctuations in our tax obligations and effective tax rate may result in volatility of our operating results and stock price.***

We are subject to income taxes in many U.S. and certain foreign jurisdictions. We record tax expense based on our estimates of future payments, which includes reserves for uncertain tax positions in multiple tax jurisdictions. At any one time, many tax years are subject to audit by various taxing jurisdictions. Further, possible changes in federal, state, local, and non-U.S. tax laws bearing upon our revenues, income, property, or other aspects of our operations or business would, if enacted, affect our results of operations in ways and to a degree that we cannot currently predict.

***Additional indebtedness incurred in connection with the Reorganization may decrease business flexibility and increase borrowing costs.***

On October 4, 2010, we entered into an amended and restated credit agreement that increased our available credit from \$75 million to \$125 million. Also in October 2010, in connection with the Reorganization, we increased the outstanding borrowings under our amended and restated credit agreement to fund a final S Corporation distribution to our then-shareholders. As of January 28, 2012, we had outstanding borrowings of \$25.0 million under our amended and restated credit agreement, compared to \$66.8 million outstanding under our former credit facility as of January 29, 2011. Our indebtedness could have the effect, among other things, of:

reducing the availability of cash flow from operations to fund working capital, capital expenditures and other general corporate purposes;

increasing our vulnerability to adverse general economic and industry conditions;

limiting our ability to adapt to changes in our business and the industry in which we operate; and

placing us at a competitive disadvantage compared to companies that have less debt.

***Our Indirect business could suffer as a result of bankruptcies or operational or financial difficulties of our Indirect retailers.***

We do not enter into long-term agreements with any of our Indirect retailers. Instead, we enter into a number of purchase order commitments with our customers for each of our lines every season. A decision by a significant number of Indirect retailers, whether motivated by competitive conditions, operational or financial difficulties, reduced access to capital, or otherwise, to decrease or eliminate the amount of merchandise purchased from us or to change their manner of doing business with us could adversely impact our results of operations. Although we recommend retail sale prices for our products to our Indirect retailers, we do not provide dealer allowances or other economic incentives to support those prices. Possible promotional pricing or discounting by Indirect retailers in response to softening retail demand could have a negative effect on our brand image and prestige, which might be difficult to counteract as the economy improves.

We sell our Indirect merchandise primarily to specialty retail stores across the United States and extend trade credit based on an evaluation of each Indirect retailer's financial condition, usually without requiring collateral. Perceived financial difficulties of a customer could cause us to curtail or eliminate business with that customer. Pending the resolution of a relationship with a financially troubled Indirect retailer, we might assume credit risk that we would otherwise avoid relating to our receivables from that customer. Inability to collect on accounts receivable from our Indirect retailers would adversely impact our results of operations.

## **Table of Contents**

*There are claims made against us from time to time that can result in litigation or regulatory proceedings, which could distract management from our business activities and result in significant liability or damage to our brand image.*

As a growing company with expanding operations, we increasingly face the risk of litigation and other claims against us. Litigation and other claims may arise in the ordinary course of our business and include employee claims, custom and duty claims, commercial disputes, intellectual property issues, product-oriented allegations, and slip and fall claims. Often these cases raise complex factual and legal issues, which are subject to risks and uncertainties and which could require significant management time. Litigation and other claims against us could result in unexpected expenses and liability, as well as materially adversely affect our operations and our reputation.

### **Risks Related to the Securities Markets and Ownership of Our Common Stock**

*Our stock price may be volatile or may decline regardless of our operating performance, and you may not be able to resell shares at or above the price at which you purchase them.*

The market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot control, including:

actions by other shopping mall or lifestyle center tenants;

weather conditions, particularly during the holiday shopping period;

the financial projections that we may choose to provide to the public, any changes in these projections or our failure for any reason to meet these projections;

the public's response to press releases or other public announcements by us or others, including our filings with the SEC and announcements relating to litigation;

the speculation about our business in the press or the investment community;

future sales of our common stock by our significant shareholders, officers and directors;

our entry into new markets;

strategic actions by us or our competitors, such as acquisitions or restructurings; and

changes in accounting principles.

These and other factors may result in a lower market price of our common stock, regardless of our actual operating performance. As a result, our common stock may trade at prices significantly below the offering price.

In addition, the stock markets, including The Nasdaq Global Select Market, have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many retail companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were involved in securities litigation, we could incur substantial costs and our resources and the attention of management could be diverted from our business.

## Edgar Filing: Vera Bradley, Inc. - Form 10-K

*Because a limited number of shareholders control a large percentage of the voting power of our common stock, investors may have limited ability to determine the outcome of shareholder votes.*

Barbara Bradley Baekgaard, Patricia R. Miller and P. Michael Miller, directly or indirectly, beneficially own and have the ability to exercise voting control over, in the aggregate, 39.7% of our outstanding shares of common stock. As a result, these shareholders are able to exercise significant influence over all matters requiring shareholder approval, including the election of directors, any amendments to our second amended and restated articles of incorporation and significant corporate transactions. This concentrated ownership of outstanding



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## **Table of Contents**

common stock may limit your ability to influence corporate matters, and the interests of these shareholders may not coincide with our interests or your interests. As a result, we may take actions that you do not believe to be in our interests or your interests and that could depress our stock price. In addition, this significant concentration of stock ownership may adversely affect the trading price of our common stock should investors perceive disadvantages in owning shares of common stock in a company that has such concentrated ownership.

### ***Our actual operating results may differ significantly from our guidance.***

From time to time, we release guidance regarding our future performance that represents our management's estimates as of the date of release. This guidance, which consists of forward-looking statements, is prepared by our management and is qualified by, and subject to, the assumptions and the other information contained or referred to in the release. Our guidance is not prepared with a view toward compliance with published guidelines of the American Institute of Certified Public Accountants, and neither our independent registered public accounting firm nor any other independent expert or outside party compiles or examines the guidance and, accordingly, no such person expresses any opinion or any other form of assurance with respect thereto.

Guidance is based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and are based upon specific assumptions with respect to future business decisions, some of which will change. We generally state possible outcomes as high and low ranges which are intended to provide a sensitivity analysis as variables are changed, but are not intended to represent that actual results could not fall outside of the suggested ranges. The principal reason that we release these data is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such persons.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions of the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results will vary from the guidance and the variations may be material. Investors should also recognize that the reliability of any forecasted financial data diminishes the farther in the future that the data are forecast. In light of the foregoing, investors are urged to put the guidance in context and not to place undue reliance on it.

### ***Anti-takeover provisions in our organizational documents and Indiana law may discourage or prevent a change in control, even if a sale of the company would be beneficial to our shareholders, which could cause our stock price to decline and prevent attempts by shareholders to replace or remove our current management.***

Our second amended and restated articles of incorporation and amended and restated bylaws contain provisions that may delay or prevent a change in control, discourage bids at a premium over the market price of our common stock, harm the market price of our common stock and diminish the voting and other rights of the holders of our common stock. These provisions include:

dividing our board of directors into three classes serving staggered three-year terms;

authorizing our board of directors to issue preferred stock and additional shares of our common stock without shareholder approval;

prohibiting shareholder action by written consent

prohibiting our shareholders from calling a special meeting of shareholders;

prohibiting our shareholders from amending our amended and restated bylaws; and

requiring advance notice for raising business matters or nominating directors at shareholders' meetings.



**Table of Contents**

As permitted by our second amended and restated articles of incorporation and amended and restated bylaws, our board of directors also has the ability, should they so determine, to adopt a shareholder rights agreement, sometimes called a poison pill, providing for the issuance of a new series of preferred stock to holders of common stock. In the event of a takeover attempt, this preferred stock would give rights to holders of common stock (other than the potential acquirer) to buy additional shares of common stock at a discount, leading to the dilution of the potential acquirer's stake. The adoption of a poison pill, or the board's ability to do so, can have negative effects such as those described above.

As an Indiana corporation, we are governed by the Indiana Business Corporation Law (as amended from time to time, the IBCL). Under specified circumstances, certain provisions of the IBCL related to control share acquisitions, business combinations and constituent interests may delay, prevent or make more difficult unsolicited acquisitions or changes of control of us. These provisions also may have the effect of preventing changes in our management. It is possible that these provisions could make it more difficult to accomplish transactions that shareholders might deem to be in their best interest.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

The following table sets forth the location, use, and size of our manufacturing, distribution, and corporate facilities as of January 28, 2012. The leases on the leased properties expire at various times through 2015, subject to renewal options.

| Location             | Primary Use                 | Square Footage | Leased /Owned |
|----------------------|-----------------------------|----------------|---------------|
| Fort Wayne, Indiana  | Corporate headquarters      | 27,287         | Leased*       |
| Roanoke, Indiana     | Design center and showroom  | 39,247         | Leased**      |
| Roanoke, Indiana     | Warehouse and distribution  | 217,320        | Owned***      |
| Fort Wayne, Indiana  | Support staff               | 66,886         | Leased        |
| Fort Wayne, Indiana  | Sewing and quilting         | 125,356        | Leased        |
| New York, New York   | Product design and showroom | 2,505          | Leased        |
| Dongguan City, China | China office                | 6,962          | Leased        |
| Atlanta, Georgia     | Showroom                    | 5,172          | Leased        |
| Dallas, Texas        | Showroom                    | 1,782          | Leased        |

\* This property is owned by Milburn, LLC, a leasing company in which Barbara Bradley Baekgaard owns a 50% interest and Patricia R. Miller and P. Michael Miller each own a 25% interest. See Item 13, Certain Relationships and Related Transactions, and Director Independence, of this report for additional information regarding this property.

\*\* In March 2011, we entered into a lease with Great Dane Realty, LLC, a company owned by Barbara Bradley Baekgaard. See Item 13, Certain Relationships and Related Transactions, and Director Independence, of this report for additional information regarding this property.

\*\*\* The 200,000 square-foot expansion of the distribution facility will be complete in fiscal 2013.

As of January 28, 2012, we also leased 62 store locations in the United States, including six store locations opened or to be opened in fiscal 2013. See Business Our Stores Store Locations for more information regarding the locations of our open stores as of January 28, 2012.

We consider these properties to be in good condition generally and believe that our facilities, including the above-mentioned property under negotiation, are adequate for our operations and provide sufficient capacity to meet our anticipated requirements.

**Table of Contents**

The properties in the above table are used by both the Direct segment and Indirect segment, excluding the two showrooms which are used exclusively by the Indirect segment.

**Item 3. Legal Proceedings**

We may be involved from time to time, as a plaintiff or a defendant, in various routine legal proceedings incident to the ordinary course of our business. In the ordinary course, we are involved in the policing of our intellectual property rights. As part of our policing program, from time to time we file lawsuits in the United States and abroad, alleging acts of trademark counterfeiting, trademark infringement, trademark dilution, and ancillary and pendent state and foreign law claims. These actions often result in seizure of counterfeit merchandise and negotiated settlements with defendants. Defendants sometimes raise as affirmative defenses, or as counterclaims, the purported invalidity or unenforceability of our proprietary rights. We believe that the outcome of all pending legal proceedings in the aggregate will not have a material adverse effect on our business or financial condition.

**Item 4. Mine Safety Disclosure**

Not Applicable

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock has been listed on the NASDAQ Global Select Market under the symbol VRA since our initial public offering on October 21, 2010. The following table sets forth the high and low sales prices of our common stock, as reported by the NASDAQ Global Select Market, during each fiscal quarter since our initial public offering:

|  | High     | Low      |
|--|----------|----------|
| <b>Fiscal 2012 Quarter ended:</b>              |          |          |
| January 28, 2012                               | \$ 45.78 | \$ 28.43 |
| October 29, 2011                               | 45.91    | 24.83    |
| July 30, 2011                                  | 52.36    | 35.66    |
| April 30, 2011                                 | 49.75    | 32.30    |
| <b>Fiscal 2011 Quarter ended:</b>              |          |          |
| January 29, 2011                               | \$ 41.01 | \$ 26.77 |
| October 30, 2010 (commencing October 21, 2010) | 29.74    | 22.00    |

As of March 16, 2012, we had approximately 31 registered shareholders of record. The number of shareholders of record is based upon the actual number of shareholders registered at such date and does not include holders of shares in street names or persons, partnerships, associations, corporations, or other entities identified in security position listings maintained by depositories.

**Dividends**

Our common stock began trading on October 21, 2010, following our initial public offering. Since that time, we have not declared any cash dividends, and we do not anticipate declaring any cash dividends in the foreseeable future.

Prior to our initial public offering, as an S Corporation, we distributed annually to our shareholders amounts sufficient to cover their tax liabilities, due to the income that flowed through the shareholders' tax returns. Additional amounts were distributed from time to time to our shareholders at the discretion of the board of directors. During fiscal 2011, we paid distributions of \$132.8 million to our shareholders, which included a final distribution (resulting from the termination of our S Corporation status) of 100% of our undistributed taxable income from the date of our formation through October 2, 2010.

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table sets forth information regarding equity securities authorized for issuance under our equity compensation plans as of January 28, 2012:

| Plan Category  | Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights (a) | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b) (\$) | Number of Securities Remaining Available for Future Issuance Under the Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c) |
|--|---|--|---|
| Equity compensation plans approved by security holders (1) | 160,463   |  | 5,915,538   |
| Equity compensation plans not approved by security holders |   |  |   |

|              |                |                  |
|--------------|----------------|------------------|
| <b>Total</b> | <b>160,463</b> | <b>5,915,538</b> |
|--------------|----------------|------------------|

(1) Approved before our initial public offering.

**Table of Contents****Stock Performance Graph**

The graph set forth below compares the cumulative shareholder return on our common stock between October 21, 2010 (the date of our initial public offering), and January 28, 2012, to the cumulative return of (i) the S&P 500 Index and (ii) the S&P 500 Apparel, Accessories, and Luxury Goods Index over the same period. This graph assumes an initial investment of \$100 on October 21, 2010, in our common stock, the S&P 500 Index, and the S&P 500 Apparel, Accessories, and Luxury Goods Index and assumes the reinvestment of dividends, if any. The graph also assumes that the initial price of our common stock on October 21, 2010, was the initial public offering price of \$16.00 per share and that the initial prices of the S&P 500 Index and the S&P 500 Apparel, Accessories, and Luxury Goods Index on October 21, 2010, were the closing prices on the previous trading day.

The comparisons shown in the graph below are based on historical data. We caution that the stock price performance presented in the graph below is not necessarily indicative of, or is it intended to forecast, the potential future performance of our common stock. Information used in the graph was obtained from The NASDAQ Stock Market website, but we do not assume responsibility for any errors or omissions in such information.

| <b>Company/Market/Peer Group</b>                     | <b>10/21/2010</b> | <b>10/30/2010</b> | <b>1/29/2011</b> | <b>4/30/2011</b> | <b>7/30/2011</b> | <b>10/29/2011</b> | <b>1/28/2012</b> |
|--|-------------------|-------------------|------------------|------------------|------------------|-------------------|------------------|
| Vera Bradley, Inc.                                   | \$ 100.00         | \$ 170.94         | \$ 211.56        | \$ 304.00        | \$ 226.69        | \$ 278.75         | \$ 214.56        |
| S&P 500 Index  | \$ 100.00         | \$ 100.46         | \$ 108.89        | \$ 116.89        | \$ 111.33        | \$ 111.34         | \$ 114.69        |
| S&P 500 Apparel, Accessories, and Luxury Goods Index | \$ 100.00         | \$ 105.93         | \$ 110.58        | \$ 131.52        | \$ 143.75        | \$ 160.71         | \$ 157.90        |

**Table of Contents****Item 6. Selected Financial Data**

The following tables present selected consolidated financial and other data as of and for the years indicated. The selected income statement data for each of the three fiscal years presented and the selected balance sheet data as of January 28, 2012, and January 29, 2011, are derived from our audited consolidated financial statements included in Item 8 of this report. The selected balance sheet data as of January 30, 2010, and January 31, 2009, and the selected income statement and balance sheet data as of and for the calendar year ended December 31, 2007, are derived from our audited consolidated financial statements that are not included elsewhere in this report. The historical results presented below are not necessarily indicative of the results to be expected for any future period. You should read this selected consolidated financial and other data in conjunction with the consolidated financial statements and related notes and the information under Management's Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this report.

| (\$ in thousands, except per share data and as otherwise indicated) | Fiscal Year Ended <sup>(1)</sup> |                                    |                     |                     | Calendar                              |
|---|----------------------------------|------------------------------------|---------------------|---------------------|---------------------------------------|
|   | January 28,<br>2012              | January 29,<br>2011 <sup>(2)</sup> | January 30,<br>2010 | January 31,<br>2009 | Year<br>Ended<br>December 31,<br>2007 |
| <b>Consolidated Statement of Income Data:</b>                       |                                  |                                    |                     |                     |                                       |
| Net revenues  | \$ 460,843                       | \$ 366,057                         | \$ 288,940          | \$ 238,577          | \$ 281,085                            |
| Cost of sales   | 203,220                          | 156,910                            | 137,803             | 115,473             | 133,522                               |
| Gross profit  | 257,623                          | 209,147                            | 151,137             | 123,104             | 147,563                               |
| Selling, general, and administrative expenses <sup>(2)</sup>        | 169,427                          | 163,053                            | 116,168             | 109,195             | 101,022                               |
| Other income  | 7,975                            | 7,225                              | 10,743              | 13,282              | 7,799                                 |
| Operating income  | 96,171                           | 53,319                             | 45,712              | 27,191              | 54,340                                |
| Interest expense (income), net                                      | 1,147                            | 1,625                              | 1,604               | 2,511               | 2,924                                 |
| Income before income taxes  | 95,024                           | 51,694                             | 44,108              | 24,680              | 51,416                                |
| Income tax expense <sup>(3)</sup>                                   | 37,103                           | 5,496                              | 889                 | 1,009               | 1,185                                 |
| Net income  | \$ 57,921                        | \$ 46,198                          | \$ 43,219           | \$ 23,671           | \$ 50,231                             |
| Basic weighted-average shares outstanding <sup>(4)</sup>            | 40,506,672                       | 36,812,570                         | 35,440,547          | 35,440,547          | 35,440,547                            |
| Diluted weighted-average shares outstanding <sup>(4)</sup>          | 40,542,302                       | 36,850,915                         | 35,440,547          | 35,440,547          | 35,440,547                            |
| Basic net income per share <sup>(4)</sup>                           | \$ 1.43                          | \$ 1.25                            | \$ 1.22             | \$ 0.67             | \$ 1.42                               |
| Diluted net income per share <sup>(4)</sup>                         | 1.43                             | 1.25                               | 1.22                | 0.67                | 1.42                                  |
| <b>Net Revenues by Segment:</b>                                     |                                  |                                    |                     |                     |                                       |
| Direct  | \$ 225,287                       | \$ 151,118                         | \$ 96,111           | \$ 71,123           | \$ 37,697                             |
| Indirect  | 235,556                          | 214,939                            | 192,829             | 167,454             | 243,388                               |
| Total   | \$ 460,843                       | \$ 366,057                         | \$ 288,940          | \$ 238,577          | \$ 281,085                            |
| <b>Store Data <sup>(5)</sup>:</b>                                   |                                  |                                    |                     |                     |                                       |
| Total stores open at end of year                                    | 56                               | 39                                 | 27                  | 21                  | 7                                     |
| Comparable-store sales increase <sup>(6)</sup>                      | 10.9%                            | 25.8%                              | 36.4%               | 8.0%                |                                       |
| Total gross square footage at end of year                           | 113,504                          | 74,426                             | 50,506              | 39,285              | 11,927                                |
| Average net revenues per gross square foot <sup>(7)</sup>           | \$ 1,042                         | \$ 851                             | \$ 615              | \$ 578              | \$                                    |





**Table of Contents**

| <i>(\$ in thousands)</i>                  | January 28,<br>2012 | January 29,<br>2011 | As of<br>January 30,<br>2010 | January 31,<br>2009 | December 31,<br>2007 |
|---|---------------------|---------------------|------------------------------|---------------------|----------------------|
| <b>Consolidated Balance Sheet Data:</b>   |                     |                     |                              |                     |                      |
| Cash and cash equivalents                 | \$ 4,922            | \$ 13,953           | \$ 6,509                     | \$ 776              | \$ 111               |
| Working capital                           | 106,234             | 91,919              | 61,238                       | 62,498              | 15,774               |
| Total assets                              | 219,513             | 206,039             | 153,752                      | 149,931             | 133,482              |
| Long-term debt, including current portion | 25,184              | 67,017              | 30,136                       | 58,825              | 54,901               |
| Shareholders' equity                      | 124,007             | 64,322              | 77,893                       | 57,947              | 49,563               |

- (1) In January 2008, we changed our fiscal year end from December 31 to the Saturday closest to January 31. As a result of this change, fiscal 2009 included activity for more than 52 weeks. This was a one-time occurrence and did not have a material effect on our results of operations. The table below presents selected consolidated financial data as of and for the calendar months ended January 31, 2008, and January 31, 2007. The selected data as of and for the month ended January 31, 2008, are derived from our audited consolidated financial statements, and the selected data as of and for the month ended January 31, 2007, are derived from our unaudited consolidated financial statements.

| <i>(\$ in thousands, except per share data)</i> | Calendar Month Ended<br>January 31,<br>2008 | January 31,<br>2007<br>(unaudited) |
|---|---|------------------------------------|
| <b>Consolidated Statement of Income Data:</b>   |   |                                    |
| Net revenues                                    | \$ 39,621                                   | \$ 34,554                          |
| Net income                                      | 13,607                                      | 6,483                              |
| Net income per basic and diluted common share   | 0.38  | 0.18                               |
| <b>Consolidated Balance Sheet Data:</b>         |   |                                    |
| Total assets                                    | \$ 152,420                                  | \$ 120,290                         |
| Long-term debt, including current portion       | 63,565                                      | 37,830                             |

- (2) Selling, general, and administrative expenses for fiscal 2011 include \$21.9 million of compensation expense related to restricted-stock awards. For additional information, see Note 10 to the Consolidated Financial Statements included in this report.
- (3) On October 3, 2010, we converted from an S Corporation to a C Corporation for income-tax purposes. For additional information, see Note 6 to the Consolidated Financial Statements included in this report.
- (4) On October 18, 2010, we effectuated a 35.437-for-1 stock split of all outstanding shares of our common stock. We have changed all historical share and per share information to reflect this stock split.
- (5) Includes full-price and outlet stores. Our first full-price store opened in mid-September 2007 and our first outlet store opened in November 2009.
- (6) Comparable-store sales are the net revenues of our stores that have been open at least 12 full fiscal months as of the end of the period. Increase or decrease is reported as a percentage of the comparable-store sales for the same period in the prior fiscal year. Remodeled stores are included in comparable-store sales unless the store was closed for a portion of the current or comparable prior period or the remodel resulted in a significant change in square footage.
- (7) Dollars not in thousands. Average net revenues per gross square foot are calculated by dividing total net revenues for our stores that have been open at least 12 full fiscal months as of the end of the period by total gross square footage for those stores.

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## **Table of Contents**

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following discussion in conjunction with the consolidated financial statements and accompanying notes and the information contained in other sections of this report, particularly under the headings Risk Factors, Selected Financial Data and Business. This discussion and analysis is based on the beliefs of our management, as well as assumptions made by, and information currently available to, our management. The statements in this discussion and analysis concerning expectations regarding our future performance, liquidity, and capital resources, as well as other non-historical statements in this discussion and analysis, are forward-looking statements. See Forward-Looking Statements. These forward-looking statements are subject to numerous risks and uncertainties, including those described under Risk Factors. Our actual results could differ materially from those suggested or implied by any forward-looking statements.*

#### **Overview**

Vera Bradley is a leading designer, producer, marketer, and retailer of stylish and highly functional accessories for women. Our products include a wide offering of handbags, accessories, and travel and leisure items. Over our 30-year history, Vera Bradley has become a true lifestyle brand that appeals to a broad range of consumers. Our brand vision is accessible luxury that inspires a casual, fun, and family-oriented lifestyle. We have positioned our brand to highlight the high quality, distinctive and vibrant styling, and functional design of our products. Frequent releases of new designs help keep the brand fresh and our customers continually engaged.

We generate revenues by selling products through two reportable segments: Direct and Indirect. As of January 28, 2012, our Direct business consisted of sales of Vera Bradley products through our 48 full-price stores and eight outlet stores in the United States, seven temporary, pop-up stores in Japan, our websites, verabradley.com and verabradley.co.jp, and our annual outlet sale in Fort Wayne, Indiana. We began selling directly to consumers through verabradley.com in calendar year 2006, opened our first retail stores in calendar year 2007, and entered the Japanese market in calendar year 2011. As of January 28, 2012, our Indirect business consisted of sales of Vera Bradley products to approximately 3,300 specialty retailers, substantially all of which are located in the United States, as well as to select national retailers and independent e-commerce retailers.

In recent years, we have grown rapidly as a result of the successful implementation of strategic initiatives. These initiatives included enhancing our merchandising strategy, establishing a multi-channel distribution sales model, expanding our supply chain capabilities, product development processes, and information systems to improve operational flexibility and profitability.

In fiscal 2012, we continued to experience strong demand for our brand across all of our sales channels, as reflected in our net revenue growth of 26.0%. In our Direct segment, net revenues increased 49.1%, including an increase of \$39.4 million in revenues related to the opening of new stores, a \$28.6 million, or 35.3%, increase in e-commerce revenues, and a comparable-store sales increase of 10.9%. In our Indirect segment, net revenues increased 9.6%, driven primarily by the strength of product offerings, improved productivity through our retail partners, and the sale of certain retired inventory. Additionally, we achieved operating income of \$96.2 million for the fiscal year ended January 28, 2012, compared to an operating income of \$53.3 million in the fiscal year ended January 29, 2011. Operating income for fiscal 2011, included \$21.9 million of compensation expense related to restricted-stock awards.

We remain focused on executing our growth strategies, which includes growing in underpenetrated markets and expanding our store base and product offering. We believe there is a significant opportunity to grow our store base, as we believe the market in the United States can support at least 300 Vera Bradley full-price stores. To that end, in fiscal 2012 we opened 13 full-price stores and four outlet stores and began retail operations in three new states. We partnered with Dillard's to launch our products in 65 locations. We also introduced our brand in Japan through a combination of pop-up stores and the launch of a Japanese-language website. We also began an expansion of approximately 200,000 square-feet of our distribution facility in Roanoke, Indiana. We believe the combination of our expanding product offerings and continued growth in underpenetrated markets will lead to meaningful growth opportunities in the coming years.

## **Table of Contents**

We expect our full-price stores to average approximately 1,800 square feet per store, and we expect to invest approximately \$0.4 million per new store, consisting of inventory costs, pre-opening costs and build-out costs less tenant-improvement allowances. New full-price stores are expected to generate on average between \$1.1 million and \$1.3 million in net revenues during the first twelve months, and the payback on our investment is expected to occur in less than 18 months. Typically, we have found that, as a new store becomes better integrated into its community and brand awareness grows, the store's productivity tends to improve as measured by comparable-store sales.

We believe our business strategy will continue to offer significant opportunity, but it also presents risks and challenges. These risks and challenges include that we may not be able to effectively predict 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. Addressing these risks could divert our attention from continuing to build on the strengths that we believe have driven the growth of our business, but we believe our focus on brand identity, customer loyalty, a distinctive shopping experience, product development expertise, and company culture will contribute positively to our results.

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

In assessing the performance of our business, we consider a variety of performance and financial measures.

#### *Net Revenues*

Net revenues reflect revenues from the sale of our merchandise and from distribution and shipping and handling fees, less returns and discounts. Revenues for the Direct segment reflect sales through our full-price and outlet stores, pop-up stores in Japan, our websites, verabradley.com and verabradley.co.jp, and our annual outlet sale in Fort Wayne, Indiana. Revenues for the Indirect segment reflect sales to Indirect specialty retailers and department stores.

#### *Comparable-Store Sales*

Comparable-store sales are calculated based upon our stores that have been open at least 12 full fiscal months as of the end of the reporting period. Remodeled stores are included in comparable-store sales unless the store was closed for a portion of the current or comparable prior period or the remodel resulted in a significant change in square footage. Some of our competitors and other retailers calculate comparable or same store sales differently than we do. As a result, data in this report regarding our comparable-store sales may not be comparable to similar data made available by other companies. Non-comparable store sales include sales from stores not included in comparable-store sales.

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

Overall economic trends;

Consumer preferences and fashion trends;

Competition;

The timing of our releases of new patterns and collections;

Changes in our product mix;

Pricing;

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The level of customer service that we provide in stores;

Our ability to source and distribute products efficiently;

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**Table of Contents**

The number of stores we open and close in any period; and

The timing and success of promotional and advertising efforts.

*Gross Profit*

Gross profit is equal to our net revenues less our cost of sales. Cost of sales includes the direct cost of purchased and manufactured merchandise, distribution center costs, operations overhead, duty, and all inbound freight costs incurred. The components of our reported cost of sales may not be comparable to those of other retail and wholesale companies.

Gross profit can be impacted by changes in volume, operational efficiencies, such as leveraging of fixed costs, promotional activities, such as free shipping, commodity prices such as cotton, and fluctuations in pricing structures.

Prior to calendar year 2006, we sourced the majority of our finished products domestically. Today, the significant majority of our products are sourced internationally. During this same period, we began direct sourcing of our raw materials and brought management of logistics in-house. These sourcing changes, along with better cost management, contributed to improvements in gross margin over this period. Gross margin measures gross profit as a percentage of our net revenues.

*Selling, General, and Administrative Expenses (SG&A)*

SG&A expenses include selling; advertising, marketing, and product development; and administrative. Selling expenses include Direct business expenses such as store expenses, employee compensation, and store occupancy and supply costs, as well as Indirect business expenses consisting primarily of employee compensation and other expenses associated with sales to Indirect retailers. Advertising, marketing, and product development expenses include employee compensation, media costs, creative production expenses, marketing agency fees, new product design costs, public relations expenses, and market research expenses. A portion of our advertising expenses may be reimbursed by Indirect retailers, and such amount is classified as other income. Administrative expenses include compensation costs for corporate functions, corporate headquarters occupancy costs, consulting and software expenses, and charitable donations. SG&A expenses increase as the number of stores increases, but not in the same proportion as the associated increase in revenues.

*Other Income*

We support many of our Indirect retailers' marketing efforts by distributing certain catalogs and promotional mailers to current and prospective customers. Our Indirect retailers reimburse us for a portion of the cost to produce these materials. Reimbursement received is recorded as other income. The related cost to design, produce, and distribute the catalogs and mailers is recorded as SG&A expense. Other income also includes proceeds from the sales of tickets to our annual outlet sale and the gain on the sale of certain life insurance policies.

*Operating Income*

Operating income equals gross profit less SG&A expenses plus other income. Operating income excludes interest income, interest expense, and income taxes.

*Income Taxes*

Prior to October 3, 2010, 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

**Table of Contents**

(subject to exception in a limited number of state and local jurisdictions that do not recognize the S Corporation status). On October 3, 2010, our S Corporation status automatically terminated and we became subject to corporate-level federal and state income taxes at prevailing corporate rates.

**Results of Operations**

The following tables summarize key components of our consolidated results of operations for the last three fiscal years, both in dollars and as a percentage of our net revenues:

| <i>(\$ in thousands)</i>                      | <b>January 28,<br/>2012</b> | <b>Fiscal Year Ended<br/>January 29,<br/>2011</b> | <b>January 30,<br/>2010</b> |
|---|-----------------------------|---|-----------------------------|
| <b>Statement of Income Data:</b>              |                             |   |                             |
| Net revenues                                  | \$ 460,843                  | \$ 366,057  | \$ 288,940                  |
| Cost of sales                                 | 203,220                     | 156,910   | 137,803                     |
| Gross profit                                  | 257,623                     | 209,147   | 151,137                     |
| Selling, general, and administrative expenses | 169,427                     | 163,053   | 116,168                     |
| Other income                                  | 7,975                       | 7,225   | 10,743                      |
| Operating income                              | 96,171                      | 53,319  | 45,712                      |
| Interest expense, net                         | 1,147                       | 1,625   | 1,604                       |
| Income before income taxes                    | 95,024                      | 51,694  | 44,108                      |
| Income tax expense                            | 37,103                      | 5,496   | 889                         |
| Net income                                    | \$ 57,921                   | \$ 46,198   | \$ 43,219                   |
| <b>Percentage of Net Revenues:</b>            |                             |   |                             |
| Net revenues                                  | 100.0%                      | 100.0%  | 100.0%                      |
| Cost of sales                                 | 44.1%                       | 42.9%   | 47.7%                       |
| Gross profit                                  | 55.9%                       | 57.1%   | 52.3%                       |
| Selling, general, and administrative expenses | 36.8%                       | 44.5%   | 40.2%                       |
| Other income                                  | 1.7%                        | 2.0%  | 3.7%                        |
| Operating income                              | 20.9%                       | 14.6%   | 15.8%                       |
| Interest expense, net                         | 0.3%                        | 0.4%  | 0.6%                        |
| Income before income taxes                    | 20.6%                       | 14.1%   | 15.3%                       |
| Income tax expense                            | 8.1%                        | 1.5%  | 0.3%                        |
| Net income                                    | 12.6%                       | 12.6%   | 15.0%                       |

The following tables present net revenues by operating segment, both in dollars and as a percentage of our net revenues, and full-price store data for the last three fiscal years:

| <i>(\$ in thousands, except as otherwise indicated)</i> | <b>January 28,<br/>2012</b> | <b>Fiscal Year Ended<br/>January 29,<br/>2011</b> | <b>January 30,<br/>2010</b> |
|---|-----------------------------|---|-----------------------------|
| <b>Net Revenues by Segment:</b>                         |                             |   |                             |

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|   |            |            |            |
|---|------------|------------|------------|
| Direct  | 225,287    | 151,118    | 96,111     |
| Indirect                                      | \$ 235,556 | \$ 214,939 | \$ 192,829 |
| Total   | \$ 460,843 | \$ 366,057 | \$ 288,940 |
| <b>Percentage of Net Revenues by Segment:</b> |            |            |            |
| Direct  | 48.9%      | 41.3%      | 33.3%      |
| Indirect                                      | 51.1%      | 58.7%      | 66.7%      |
| Total   | 100.0%     | 100.0%     | 100.0%     |



**Table of Contents**

|   | January 28,<br>2012 | Fiscal Year Ended<br>January 29,<br>2011 | January 30,<br>2010 |
|---|---------------------|--|---------------------|
| <b>Store Data <sup>(1)</sup>:</b>                         |                     |  |                     |
| Total stores open at end of period                        | 56                  | 39                                       | 27                  |
| Comparable-store sales increase <sup>(2)</sup>            | 10.9%               | 25.8%                                    | 36.4%               |
| Total gross square footage at end of period               | 113,504             | 74,426                                   | 50,506              |
| Average net revenues per gross square foot <sup>(3)</sup> | \$ 1,042            | \$ 851                                   | \$ 615              |

- (1) Includes only our full-price and outlet stores. Our first full-price store opened in mid-September 2007 and our first outlet store opened in November 2009.
- (2) Comparable-store sales are the net revenues of our stores that have been open at least 12 full fiscal months as of the end of the period. Increase or decrease is reported as a percentage of the comparable-store sales for the same period in the prior fiscal year. Remodeled stores are included in comparable-store sales unless the store was closed for a portion of the current or comparable prior period or the remodel resulted in a significant change in square footage.
- (3) Dollars not in thousands. Average net revenues per gross square foot are calculated by dividing total net revenues for our stores that have been open at least 12 full fiscal months as of the end of the period by total gross square footage for those stores.

**Fiscal 2012 Compared to Fiscal 2011***Net Revenues*

For fiscal 2012, net revenues increased \$94.8 million, or 26.0%, to \$460.8 million, from \$366.1 million for fiscal 2011, primarily due to increased volume.

*Direct.* For fiscal 2012, net revenues increased \$74.2 million, or 49.1%, to \$225.3 million, from \$151.1 million for fiscal 2011. This growth resulted from a \$28.6 million increase in e-commerce revenues due primarily to greater traffic resulting from marketing initiatives, a \$39.4 million increase in non-comparable store sales, and a \$6.2 million, or 10.9%, increase in comparable-store sales. The number of our stores grew from 39 at the end of fiscal 2011 to 56 at the end of fiscal 2012.

*Indirect.* For fiscal 2012, net revenues increased \$20.6 million, or 9.6%, to \$235.6 million, from \$214.9 million for fiscal 2011, due to increased sales volume to our specialty retailers, driven by strong demand for carryover patterns, fall product assortment, and the launch of rolling luggage.

*Gross Profit*

For fiscal 2012, gross profit increased \$48.5 million, or 23.2%, to \$257.6 million, from \$209.1 million for fiscal 2011. As a percentage of net revenues, gross profit decreased to 55.9% for fiscal 2012, from 57.1% for fiscal 2011. The decrease in gross margin was due primarily to higher cotton and labor costs and higher sales of certain retired inventory sold at lower than normal gross margins, partially offset by an overall revenue mix shift toward higher margin, retail-store sales and e-commerce.

*Selling, General and Administrative Expenses (SG&A)*

For fiscal 2012, SG&A expenses increased \$6.3 million, or 3.9%, to \$169.4 million, from \$163.1 million for fiscal 2011. As a percentage of net revenues, SG&A expenses were 36.8% and 44.5% for fiscal 2012 and fiscal 2011, respectively. The decrease as a percentage of net revenues in SG&A expenses was due primarily to \$21.9 million of compensation expense related to restricted-stock awards and a decline in professional fees related to our transition from a private to a public company both of which were included in fiscal 2011. In addition, SG&A expenses declined as a percentage of net revenues due to leverage of our relatively fixed cost structure of the Indirect segment, partially offset by our investment into the Japanese market.

**Table of Contents***Other Income*

For fiscal 2012, other income increased \$0.8 million, or 10.4%, to \$8.0 million, from \$7.2 million for fiscal 2011, due primarily to increased reimbursement of our advertising expenses by our specialty retailers. The increase was due in part to sales of tickets to our annual outlet sale and the gain on the sale of certain life insurance policies.

*Operating Income*

For fiscal 2012, operating income increased \$42.9 million, or 80.4%, to \$96.2 million, from \$53.3 million for fiscal 2011. As a percentage of net revenues, operating income was 20.9% and 14.6% for fiscal 2012 and fiscal 2011, respectively. This increase as a percentage of net revenues was due primarily to the \$21.9 million of compensation expense related to restricted-stock awards in the prior year. Excluding this compensation expense in the prior year, operating income as a percentage of sales increased due to sales-driven leverage of SG&A on our high growth of net revenues, partially offset by higher cotton and labor prices and our investment into the Japanese market (in thousands):

| (\$ in millions)                     | Fiscal Year Ended   |                     | \$<br>Change | %<br>Change |
|--------------------------------------|---------------------|---------------------|--------------|-------------|
|                                      | January 28,<br>2012 | January 29,<br>2011 |              |             |
| <b>Operating Income:</b>             |                     |                     |              |             |
| Direct                               | \$ 68,097           | \$ 46,443           | \$ 21,654    | 46.6%       |
| Indirect                             | 93,042              | 91,680              | \$ 1,362     | 1.5%        |
|                                      | 161,139             | 138,123             | 23,016       | 16.7%       |
| Less: Unallocated corporate expenses | (64,968)            | (84,803)            | 19,835       | 23.4%       |
| Operating income                     | \$ 96,171           | \$ 53,320           | \$ 42,851    | 80.4%       |

*Direct.* For fiscal 2012, operating income increased \$21.7 million, or 46.6%, due to an increase in gross profit, offset in part by increased selling expenses related to store operational costs and costs associated with our market entry into Japan.

*Indirect.* For fiscal 2012, operating income increased \$1.4 million, or 1.5%, primarily from an increase in revenue and sales-driven leverage of SG&A, offset in part by a decline in gross margin, as previously discussed.

*Corporate Unallocated.* For fiscal 2012, unallocated expenses decreased \$19.8 million, or 23.4%, primarily as a result of stock-based compensation expense and bonuses paid to recipients of restricted-stock awards in the prior-year period.

*Interest Expense, Net*

For the fiscal year ended January 28, 2012, net interest expense decreased \$0.5 million, or 29.5%, to \$1.1 million, from \$1.6 million in the fiscal year ended January 29, 2011. The decrease of \$0.5 million was due primarily to a write off in the same period of the prior-year of \$0.2 million of unamortized debt-issuance costs in connection with the amendment and restatement of the credit agreement. The remaining \$0.3 million was attributable to lower average borrowing rates in the fiscal year ended January 28, 2012.

*Income Tax Expense*

For fiscal 2012, we recorded income tax expense of \$37.1 million at an effective tax rate of 39.0%, which is consistent with U.S. federal and state statutory rates. The change in our effective tax rate from fiscal 2011 reflects a more normalized rate due to being subject to corporate-level U.S. federal and state income taxes for the full fiscal year. The effective tax rate also reflects a loss for the Japanese operations for which a tax benefit was not recognized.

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## **Table of Contents**

For fiscal 2011, we recorded income tax expense of \$5.5 million. This expense was comprised of (1) \$6.8 million of expense related to activity during the portion of fiscal 2011 that we were a C Corporation (October 3, 2010, through January 29, 2011) at an effective tax rate of 51.2% and (2) \$0.5 million of state taxes related to taxing jurisdictions that did not recognize our previous S Corporation status, offset in part by a one-time deferred tax benefit of \$1.8 million recognized upon the termination of our S Corporation status. Included in tax expense for the portion of the fiscal year that we operated as a C Corporation was \$1.2 million related to permanently non-deductible stock-based compensation expense associated with restricted-stock awards that vested in connection with our initial public offering.

### **Fiscal 2011 Compared to Fiscal 2010**

#### *Net Revenues*

For fiscal 2011, net revenues increased \$77.2 million, or 26.7%, to \$366.1 million, from \$288.9 million for fiscal 2010.

*Indirect.* For fiscal 2011, net revenues increased \$22.1 million, or 11.5%, to \$214.9 million, from \$192.8 million for fiscal 2010, due primarily to increased sales volume to our Indirect retailers. The increased sales volume resulted primarily from greater demand for our Signature Collection releases that, in most cases, had more patterns and styles relative to fiscal 2010 releases, increased offerings and sales of non-Signature Collection products, and improved economic conditions.

*Direct.* For fiscal 2011, net revenues increased \$55.0 million, or 57.2%, to \$151.1 million, from \$96.1 million for fiscal 2010. This growth resulted from a \$22.8 million increase in e-commerce revenues due primarily to greater traffic resulting from marketing initiatives, a \$22.6 million increase in non-comparable store sales, and a \$7.3 million, or 25.8%, increase in comparable-store sales due primarily to increased store traffic. The number of our stores grew from 27 at the end of fiscal 2010 to 39 at the end of fiscal 2011. In addition, our annual outlet sale revenues increased by \$2.3 million due to an increase in the number of shoppers that attended the sale and higher average product pricing at the sale.

#### *Gross Profit*

For fiscal 2011, gross profit increased \$58.0 million, or 38.4%, to \$209.1 million, from \$151.1 million for fiscal 2010. As a percentage of net revenues, gross profit increased to 57.1% for fiscal 2011, from 52.3% for fiscal 2010. The increase in gross margin was due primarily to increased leverage of fixed costs as a result of the volume growth, improved efficiency in our utilization of raw materials as a result of our expanding outlet store channel, higher average product pricing at the annual outlet sale, and an overall revenue mix shift toward higher margin, retail-store sales.

#### *Selling, General and Administrative Expenses (SG&A)*

For fiscal 2011, SG&A expenses increased \$46.9 million, or 40.4%, to \$163.1 million, from \$116.2 million for fiscal 2010. As a percentage of net revenues, SG&A expenses were 44.5% and 40.2% for fiscal 2011 and fiscal 2010, respectively.

For fiscal 2011, selling expenses increased \$19.9 million, or 36.0%, to \$75.3 million, from \$55.4 million for fiscal 2010. As a percentage of net revenues, selling expenses were 20.6% and 19.2% for fiscal 2011 and fiscal 2010, respectively. The increase in selling expenses was due primarily to increased store operational costs attributable to new store openings as well as e-commerce and store marketing initiatives to drive increased traffic. The increase in selling expenses also resulted from the company holding two product introduction and educational events (or Premieres) for Indirect retailers during fiscal 2011, compared to only one event during fiscal 2010, and from other increased expenses as a result of the increase in net revenues. These increases were partially offset by a \$1.3 million asset-impairment charge, as further described below, recorded in fiscal 2010. No such charge was recorded in fiscal 2011.

**Table of Contents**

For fiscal 2011, advertising, marketing, and product development expenses decreased \$1.1 million, or 3.7%, to \$28.7 million, from \$29.8 million for fiscal 2010. As a percentage of net revenues, advertising, marketing, and product development expenses were 7.8% and 10.3% for fiscal 2011 and fiscal 2010, respectively. This decrease resulted primarily from reduced expenses associated with our co-op marketing programs as a result of refining the marketing support for our Indirect retailers. These reduced expenses were offset in part by increased spending on non-co-op advertising and marketing efforts and by higher employee and other costs associated with our expanded product design capabilities and with the increase in net revenues.

For fiscal 2011, administrative expenses increased \$28.1 million, or 90.7%, to \$59.0 million, from \$30.9 million for fiscal 2010. As a percentage of net revenues, administrative expenses were 16.1% and 10.7% for fiscal 2011 and fiscal 2010, respectively. This increase was due primarily to \$15.8 million of stock-based compensation expense associated with the vesting of restricted-stock awards in connection with our initial public offering as well as \$6.1 million of expense associated with bonuses paid to recipients of the restricted-stock awards to satisfy tax obligations. In addition, we incurred higher corporate personnel and other costs necessary to support our growth as well as increased professional services fees related in part to our transition from a private to a public company.

*Other Income*

For fiscal 2012, other income decreased \$3.5 million, or 32.7%, to \$7.2 million, from \$10.7 million for fiscal 2010. This decrease was due to the above-discussed refinement of the marketing support for our Indirect retailers, which resulted in decreased reimbursement of our advertising expenses.

*Operating Income*

For fiscal 2011, operating income increased \$7.6 million, or 16.6%, to \$53.3 million, from \$45.7 million for fiscal 2010. As a percentage of net revenues, operating income was 14.6% and 15.8% for fiscal 2011 and fiscal 2010, respectively. This decrease in operating income as a percentage of net revenues was due primarily to the previously discussed \$15.8 million of stock-based compensation expense associated with the vesting of restricted-stock awards in connection with our initial public offering and the \$6.1 million of expense associated with bonuses paid to recipients of the restricted-stock awards.

Operating income for our business segments is provided below.

| (\$ in millions)                     | Fiscal Year Ended   |                     | \$<br>Change | %<br>Change |
|--------------------------------------|---------------------|---------------------|--------------|-------------|
|                                      | January 29,<br>2011 | January 30,<br>2010 |              |             |
| <b>Operating Income:</b>             |                     |                     |              |             |
| Direct                               | \$ 46,443           | \$ 25,285           | \$ 21,158    | 83.7%       |
| Indirect                             | 91,680              | 72,649              | 19,031       | 26.2%       |
|                                      | 138,123             | 97,934              | 40,189       | 41.0%       |
| Less: Unallocated corporate expenses | (84,803)            | (52,222)            | (32,581)     | 62.4%       |
| Operating income                     | \$ 53,320           | \$ 45,712           | \$ 7,608     | 16.6%       |

*Indirect* For fiscal 2011, operating income increased \$19.1 million, or 26.2%, primarily as a result of the previously discussed increase in gross profit. This increase was partially offset by increased selling expenses, as previously discussed.

*Direct.* For fiscal 2011, operating income increased \$21.1 million, or 83.7%, primarily as a result of the previously discussed increase in gross profit. This increase was partially offset by increased selling expenses, as previously discussed.

**Table of Contents**

*Corporate Unallocated.* For fiscal 2011, unallocated expenses increased \$32.6 million, or 62.4%, primarily as a result of increased stock-based and bonus compensation expenses, higher corporate personnel and other costs, and increased professional services fees, as previously discussed.

*Interest Expense, Net*

Net interest expense was consistent for fiscal 2011 and fiscal 2010; a \$0.2 million write off of unamortized debt-issuance costs in connection with the amendment and restatement of our credit agreement was offset by lower average borrowing levels during fiscal 2011.

*Income Tax Expense*

For fiscal 2011, we recorded income tax expense of \$5.5 million. This expense was comprised of (1) \$6.8 million of expense related to activity during the portion of fiscal 2011 that we were a C Corporation (October 3, 2010, through January 29, 2011) at an effective tax rate of 51.2% and (2) \$0.5 million of state taxes related to taxing jurisdictions that did not recognize our previous S Corporation status, offset in part by a one-time deferred tax benefit of \$1.8 million recognized upon the termination of our S Corporation status. Included in tax expense for the portion of the fiscal year that we operated as a C Corporation was \$1.2 million related to permanently non-deductible stock-based compensation expense associated with restricted-stock awards that vested in connection with our initial public offering. For fiscal 2010, our income tax expense of \$0.9 million (calculated at an effective rate of 2.0%) was comprised solely of state taxes related to taxing jurisdictions that did not recognize our previous S Corporation status. The increase in our effective tax rate resulted from our change in tax status.

**Liquidity and Capital Resources***General*

Our primary source of liquidity is cash flow from operations. We also have access to additional liquidity, if needed, through borrowings under our \$125.0 million amended and restated credit agreement. Historically, our primary cash needs have been for merchandise inventories, payroll, store rent, capital expenditures associated with opening new stores, debt repayments, operational equipment, and information technology. The most significant components of our working capital are cash and cash equivalents, merchandise inventories, accounts receivable, accounts payable, and other current liabilities. We do not believe that the expansion of our Direct business will materially alter the nature and levels of our accounts receivable and inventories, or require materially increased borrowings under our amended and restated credit agreement, in the near term.

We believe that cash flows from operating activities and the availability of borrowings under our amended and restated credit agreement or other financing arrangements will be sufficient to meet working capital requirements, anticipated capital expenditures, and debt payments for the foreseeable future.

*Cash Flow Analysis*

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

|   | <b>Fiscal Year Ended</b>    |                             |                             |
|---|-----------------------------|-----------------------------|-----------------------------|
|   | <b>January 28,<br/>2012</b> | <b>January 29,<br/>2011</b> | <b>January 30,<br/>2010</b> |
| Net cash provided by operating activities | \$ 51,516                   | \$ 58,466                   | \$ 66,006                   |
| Net cash used in investing activities     | (18,836)                    | (9,865)                     | (5,844)                     |
| Net cash used in financing activities     | (41,757)                    | (41,157)                    | (54,429)                    |

*Net Cash Provided by Operating Activities*

Net cash provided by operating activities consist primarily of net income adjusted for non-cash items, including depreciation, amortization, deferred taxes, and stock-based compensation, the effect of changes in assets and liabilities, and tenant-improvement allowances received from landlords under our store leases.



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**Table of Contents**

Net cash provided by operating activities was \$51.5 million for the fiscal year ended January 28, 2012 primarily driven by our net income in the current year. This is slightly down from \$58.5 million for the fiscal year ended January 29, 2011, primarily due to additional income tax payments of \$42.9 million in the current year because of the conversion from an S Corporation to a C Corporation in the prior year making us subject to corporate-level U.S. federal and state income taxes. In addition, cash flow decreased due to timing of payments to our vendors, which was more than offset by the improvements in our supply chain and inventory management processes which allowed inventory levels to grow much less than the prior year.

Net cash provided by operating activities declined to \$58.5 million in fiscal 2011, from \$66.0 million in fiscal 2010. This decrease was driven primarily by a \$17.2 million increase in cash outflows related to changes in operating assets and liabilities and a \$5.4 million increase in net deferred tax assets, offset in part by an increase of \$15.9 million in stock-based compensation expense. The increase in cash outflows related to changes in operating assets and liabilities resulted primarily from a \$30.2 million increase in inventories, partially offset by increased current liabilities related in part to inventory purchases and C Corporation tax obligations.

*Net Cash Used in Investing Activities*

Investing activities consist primarily of capital expenditures for growth related to new store openings, operational equipment, and information technology investments.

Net cash used in investing activities was \$18.8 million in fiscal 2012, compared to \$9.9 million in fiscal 2011. The \$8.9 million increase in capital expenditures was driven primarily by the investments in new stores, including the opening of 17 stores during fiscal 2012, expansion of the distribution facility, and information technology investments.

Net cash used in investing activities was \$9.9 million in fiscal 2011, reflecting capital expenditures of \$11.4 million offset in part by \$1.5 million of cash provided as a result of the elimination of a compensating-balance requirement in connection with the amendment and restatement of our credit agreement. Capital expenditures of \$11.4 million for fiscal 2011 were \$5.5 million higher than capital expenditures in fiscal 2010, due primarily to increased investments in new stores, including the opening of twelve stores in fiscal 2011 compared to six stores during fiscal 2010, and incremental investments in information technology and distribution assets.

Net cash used in investing activities was \$5.8 million in fiscal 2010. This was driven by \$3.6 million in investments in six new stores along with improvements in e-commerce, \$0.4 million in information technology investments, and \$1.1 million in production and distribution equipment.

Capital expenditures for fiscal 2013 are expected to be approximately \$36.0 million, including the build-out of new stores and approximately \$19.0 million of spending related to the distribution center expansion.

*Net Cash Used in Financing Activities*

Net cash used in financing activities was \$41.8 million in fiscal 2012, resulting from the net payments under our amended and restated credit agreement.

Net cash used in financing activities was \$41.2 million in fiscal 2011, driven primarily by \$132.8 million of S Corporation distributions (including the final S Corporation distribution of \$106.0 million) and \$1.1 million of debt-issuance costs, offset in part by IPO net proceeds of \$56.3 million and net borrowings of \$36.8 million under the credit agreement or amended and restated credit agreement.

Net cash used in financing activities was \$54.4 million in fiscal 2010. This included \$24.5 million in net repayments of borrowings under our credit agreement, \$4.3 million in repayments of vendor and related-party debt, and \$25.6 million in distributions to our shareholders to fund tax liabilities due to our S Corporation status.

**Table of Contents***Amended and Restated Credit Agreement*

On October 4, 2010, Vera Bradley Designs, Inc. entered into an agreement to amend and restate its credit agreement with JPMorgan Chase Bank, as administrative agent, and certain other lenders. The amended and restated credit agreement provides for a revolving credit commitment of \$125.0 million and matures on October 3, 2015. All borrowings under the amended and restated credit agreement are collateralized by substantially all of the Company's assets. The credit agreement is also guaranteed by the Company. The credit agreement requires the Company to comply with various financial covenants, including a fixed charge coverage ratio of not less than 1.20 to 1.00 and a leverage ratio of not more than 3.50 to 1.00. The agreement also contains various other covenants, including restrictions on the incurrence of certain indebtedness, liens, investments, acquisitions, and asset sales. The Company was in compliance with these covenants as of January 28, 2012.

Borrowings under the amended and restated credit agreement bear interest at either LIBOR plus the applicable margin (ranging from 1.05% to 2.05%) or the alternate base rate (as defined in the agreement) plus the applicable margin (ranging from 0.05% to 1.05%). The applicable margin is tied to the Company's leverage ratio. In addition, the Company is required to pay a quarterly facility fee (as defined in the agreement) ranging from 0.20% to 0.45% of the revolving credit commitment. At January 28, 2012, the weighted-average interest rate on the \$25.0 million of outstanding borrowings under the credit agreement was 1.68%. The Company had borrowing availability of \$100.0 million under the agreement as of January 28, 2012.

*Contractual Obligations*

We enter into long-term contractual obligations and commitments in the normal course of business, primarily debt obligations and non-cancellable operating leases. As of January 28, 2012, our contractual cash obligations over the next several periods are as follows:

| (\$ in thousands)                             | Total             | Payments Due by Period <sup>(5)</sup> |                  |                  | More Than<br>5 Years |
|---|-------------------|---------------------------------------|------------------|------------------|----------------------|
|   |                   | Less Than<br>1 Year                   | 1 - 3 Years      | 3 - 5 Years      |                      |
| Debt to financial institutions <sup>(1)</sup> | \$ 25,000         | \$                                    | \$               | \$ 25,000        | \$                   |
| Debt to others <sup>(2)</sup>                 | 184               | 89                                    | 87               | 8                |                      |
| Operating leases <sup>(3)</sup>               | 118,737           | 14,826                                | 28,803           | 28,017           | 47,091               |
| Purchase obligations <sup>(4)</sup>           | 41,985            | 41,967                                | 18               |                  |                      |
| <b>Total</b>                                  | <b>\$ 185,906</b> | <b>\$ 56,882</b>                      | <b>\$ 28,908</b> | <b>\$ 53,025</b> | <b>\$ 47,091</b>     |

- (1) As of January 28, 2012, we had \$25.0 million principal amount due on October 3, 2015 under our amended and restated credit agreement. Estimated total interest and facility fee payments of \$2.1 million, due through October 3, 2015, based on our outstanding borrowings and the interest rates in effect under our amended and restated credit agreement as of January 28, 2012, have been excluded.
- (2) We have entered into financing agreements with certain vendors. The amounts listed represent the outstanding balances under these agreements.
- (3) Our store leases generally have initial lease terms of 10 years and provide us with the option to renew the leases upon substantially the same terms and conditions as the original leases. Our future operating lease obligations would change if we were to exercise these options, or if we were to enter into new operating leases.
- (4) Purchase obligations consist primarily of inventory purchase orders and include the expansion of our distribution facility in Roanoke, Indiana.
- (5) In addition, due to the uncertainty with respect to the timing of future cash flows associated with our uncertain tax positions at January 28, 2012, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authorities. Therefore, \$0.9 million of uncertain tax positions have been excluded from the contractual obligations table above.



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## **Table of Contents**

### **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet financing or unconsolidated special purpose entities.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States ( GAAP ) requires management to make estimates and assumptions that affect the reported amounts of our assets, liabilities, revenues, and expenses, as well as the disclosures relating to contingent assets and liabilities at the date of the consolidated financial statements. We evaluate our accounting policies, estimates, and judgments on an on-going basis. We base our estimates and judgments on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions and conditions.

We evaluate the development and selection of our critical accounting policies and estimates and believe that the following policies and estimates involve a higher degree of judgment or complexity and are most significant to reporting our results of operations and financial position, and are therefore discussed as critical. The following critical accounting policies reflect the significant estimates and judgments used in the preparation of our consolidated financial statements. With respect to critical accounting policies, even a relatively minor variance between actual and expected experience can potentially have a materially favorable or unfavorable impact on subsequent results of operations. Our historical results for the periods presented in the consolidated financial statements, however, have not been materially impacted by such variances. More information on all of our significant accounting policies can be found in Note 2, Summary of Significant Accounting Policies, to the consolidated financial statements.

#### *Revenue Recognition*

Revenue from the sale of our products is recognized upon customer receipt of the product when collection of the associated receivables is reasonably assured, persuasive evidence of an arrangement exists, the sales price is fixed and determinable, and ownership and risk of loss have been transferred to the customer, which, for e-commerce and most Indirect sales, reflects an estimate of shipments that customers have not yet received. The estimate of these shipments is based on shipping terms and historical delivery times. Significant changes in shipping terms or delivery times could materially impact our revenues in a given period.

We reserve for projected merchandise returns based on historical experience and other assumptions that we believe to be reasonable. Merchandise returns are often resalable merchandise and in the Direct business are refunded by issuing the same payment tender of the original purchase and in the Indirect business the customer is issued a credit to its account to apply to outstanding invoices. Merchandise exchanges of the same product at the same price are not considered merchandise returns. Product returns are often resalable through our annual outlet sale or other channels. Additionally, we reserve for other potential product credits and for customer shipments not yet received. The total reserve for returns, customer shipments not yet received, and general credits was \$2.6 million and \$1.7 million at January 28, 2012, and January 29, 2011, respectively. This represents a reduction to operating income of \$1.8 million and \$1.2 million, respectively.

#### *Inventories*

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out ( FIFO ) method. Market is determined based on net realizable value, which includes costs to dispose. Appropriate consideration is given to obsolescence, excess quantities, and other factors, including the popularity of a pattern or product, in evaluating net realizable value. We record valuation adjustments to our inventories, which are reflected in cost of sales, if the cost of specific inventory items on hand exceeds the amount we expect to realize from the ultimate sale or disposal of the inventory. This adjustment calculation requires us to make assumptions and estimates, which are based on factors such as merchandise seasonality, historical trends, and estimated sales

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## **Table of Contents**

and inventory levels, including sell-through of remaining units. In addition, as part of inventory adjustments, we provide for inventory shrinkage based on historical trends from our physical inventory counts. We perform physical inventory counts throughout the year and adjust the shrink provision accordingly.

Inventory adjustments of \$3.3 million and \$5.1 million were recorded for these matters as of January 28, 2012, and January 29, 2011, respectively. These adjustments related primarily to raw materials of discontinued patterns, as we have the ability to move discontinued finished goods through a number of channels, including the annual outlet sale, our website and outlet stores, and through liquidators as needed. The decrease in the valuation adjustments during fiscal 2012 resulted primarily from our expanding outlet store channel, which we launched in November 2009 which has enabled us to increase our use of raw materials of discontinued patterns as well as an improved cycle counting process resulting in less shrink.

### *Income Taxes*

Prior to October 3, 2010, 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 exception in a limited number of state and local jurisdictions that do not recognize the S Corporation status). On October 3, 2010, our S Corporation status automatically terminated and we became subject to corporate-level federal and state income taxes at prevailing corporate rates.

Our effective tax rate is based on our pre-tax income, statutory tax rates, tax laws and regulations, and tax planning opportunities available in the jurisdictions in which we operate. Significant judgment is required in determining our annual tax expense and in evaluating our tax positions. We establish reserves to remove some or all of the tax benefit of any of our tax positions at the time we determine that the positions become uncertain based upon one of the following: (1) the tax position is not more likely than not to be sustained; (2) the tax position is more likely than not to be sustained, but for a lesser amount; or (3) the tax position is more likely than not to be sustained, but not in the financial period in which the tax position was originally taken. Taxing authorities periodically audit our income tax returns. We believe that our tax filing positions are reasonable and legally supportable. Taxing authorities, however, may take a contrary position. Our results of operations and effective tax rate in a given period could be impacted if, upon final resolution with taxing authorities, we prevail in positions for which we have established reserves, or are required to pay amounts in excess of established reserves.

### *Valuation of Long-lived Assets*

Property, plant, and equipment assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In evaluating an asset for recoverability, we estimate the future cash flows expected to result from the use of the asset at the store level, the lowest identifiable level of cash flow, if applicable. If the sum of the estimated undiscounted future cash flows related to the asset is less than the carrying value, we recognize a loss equal to the difference between the carrying value and the fair value, usually determined by an estimated discounted cash flow analysis of the asset. Factors used in the valuation of long-lived assets include, but are not limited to, our plans for future operations, brand initiatives, recent operating results, and projected future cash flows. With respect to our stores, we analyze store economics, location within the shopping center, the size and shape of the space, and desirable co-tenancies in our selection process. Impairment charges are classified in SG&A expenses.

The discounted cash flow models used to estimate the applicable fair values involve numerous estimates and assumptions that are highly subjective. Changes to these estimates and assumptions could materially impact the fair value estimates. The estimates and assumptions critical to the overall fair value estimates include: (1) estimated future cash flow generated at the store level; and (2) discount rates used to derive the present value factors used in determining the fair values. These and other estimates and assumptions are impacted by economic conditions and our expectations and may change in the future based on period-specific facts and circumstances. If economic conditions were to deteriorate, future impairment charges may be required.

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**Table of Contents**

**Recently Issued Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-05,

*Comprehensive Income Presentation of Comprehensive Income.* This guidance eliminates the option to present the components of other comprehensive income as part of the Statement of Shareholders' Equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. The guidance is effective for fiscal years beginning after December 15, 2011. As this guidance only amends the presentation of the components of comprehensive income, the adoption will not have an impact on the Company's consolidated financial position, results of operations, or cash flows. Early adoption is permitted, but full retrospective application is required under both sets of accounting standards. The guidance also previously required the presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented; however, this portion of the guidance has been deferred through an ASU issued in September 2011. Upon adoption, the Company will elect to present items of net income and other comprehensive income in one continuous statement, the statement of comprehensive income.

In May 2011, the FASB issued ASU 2011-4, *Fair Value Measurement Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS.* The guidance requires additional disclosures, including disclosures related to the measurement of level 3 assets. The guidance is effective for interim and annual periods beginning after December 15, 2011 and is applied prospectively. The Company is currently evaluating this guidance, but does not expect its adoption will have a material effect on its consolidated financial statements.

**Transactions with Related Parties**

See Item 13, Certain Relationships and Related Transactions, and Director Independence, of this report for information regarding transactions with related parties.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

*Interest Rate Risk*

We are subject to interest rate risk in connection with borrowings under our amended and restated credit agreement, which bear interest at variable rates. The amended and restated credit agreement allows for a revolving credit commitment of \$125.0 million, bearing interest at a variable rate, based on either LIBOR plus the applicable margin (ranging from 1.05% to 2.05%) or the alternate base rate (as defined in the agreement) plus the applicable margin (ranging from 0.05% to 1.05%). Assuming the amended and restated credit agreement is fully drawn, each quarter point increase or decrease in the interest rate would change our annual interest expense by approximately \$0.3 million.

From time to time, we utilize interest rate swaps to hedge our interest rate risk. We had no open derivative instruments at January 28, 2012.

*Impact of Inflation*

Our results of operations and financial condition are presented based on historical cost. Although it is difficult to accurately measure the impact of inflation due to the imprecise nature of the estimates required, we believe the effects of inflation, if any, on our results of operations and financial condition have been immaterial.

*Foreign Exchange Rate Risk*

We source a substantial majority of our materials from various suppliers in China and South Korea. Substantially all purchases and sales involving foreign persons are denominated in U.S. dollars, and therefore we do not hedge using any derivative instruments. Historically, we have not been impacted materially by changes in exchange rates.



**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**  
**Vera Bradley, Inc.**

**Index to Consolidated Financial Statements**

|  |    |
|--|----|
| <u>Report of Independent Registered Public Accounting Firm</u>   | 47 |
| <u>Consolidated Balance Sheets as of January 28, 2012, and January 29, 2011</u>  | 48 |
| <u>Consolidated Statements of Income for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010</u>               | 49 |
| <u>Consolidated Statements of Shareholders' Equity for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010</u> | 50 |
| <u>Consolidated Statements of Cash Flows for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010</u>           | 51 |
| <u>Notes to Consolidated Financial Statements</u>  | 52 |

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**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of

Vera Bradley, Inc.

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Vera Bradley, Inc. and its subsidiaries at January 28, 2012 and January 29, 2011, and the results of their operations and their cash flows for each of the three years in the period ended January 28, 2012 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 28, 2012, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company’s internal control over financial reporting based on our audits (which was an integrated audit in 2012). We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Indianapolis, Indiana

March 27, 2012

**Table of Contents****Vera Bradley, Inc.****Consolidated Balance Sheets**

(\$ in thousands, except share data)

|   | January 28,<br>2012 | January 29,<br>2011 |
|---|---------------------|---------------------|
| <b>Assets</b>   |                     |                     |
| Current assets:   |                     |                     |
| Cash and cash equivalents   | \$ 4,922            | \$ 13,953           |
| Accounts receivable, net  | 38,097              | 34,300              |
| Inventories   | 106,967             | 96,717              |
| Prepaid expenses and other current assets   | 8,343               | 6,754               |
| Deferred income taxes   | 8,010               | 8,743               |
| Total current assets  | 166,339             | 160,467             |
| Property, plant, and equipment, net   | 52,312              | 42,984              |
| Other assets  | 862                 | 2,588               |
| Total assets  | \$ 219,513          | \$ 206,039          |
| <b>Liabilities and Shareholders' Equity</b>   |                     |                     |
| Current liabilities:  |                     |                     |
| Accounts payable  | \$ 27,276           | \$ 30,012           |
| Accrued employment costs  | 15,738              | 17,892              |
| Other accrued liabilities   | 15,297              | 10,551              |
| Income taxes payable  | 1,705               | 10,010              |
| Current portion of long-term debt   | 89                  | 83                  |
| Total current liabilities   | 60,105              | 68,548              |
| Long-term debt  | 25,095              | 66,934              |
| Deferred income taxes   | 4,205               | 3,300               |
| Other long-term liabilities   | 6,101               | 2,935               |
| Total liabilities   | 95,506              | 141,717             |
| Commitments and contingencies   |                     |                     |
| Shareholders' equity:   |                     |                     |
| Preferred stock; 5,000,000 shares authorized, no shares issued or outstanding   |                     |                     |
| Common stock; without par value; 200,000,000 shares authorized, 40,506,720 and 40,506,670 shares issued and outstanding, respectively |                     |                     |
| Additional paid-in capital  | 73,590              | 71,923              |
| Retained earnings (accumulated deficit)   | 50,320              | (7,601)             |
| Accumulated other comprehensive income  | 97                  |                     |
| Total shareholders' equity  | 124,007             | 64,322              |
| Total liabilities and shareholders' equity  | \$ 219,513          | \$ 206,039          |

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





**Table of Contents****Vera Bradley, Inc.****Consolidated Statements of Income**

(\$ in thousands, except share data)

|  | January 28,<br>2012 | Fiscal Year Ended<br>January 29,<br>2011 | January 30,<br>2010 |
|--|---------------------|--|---------------------|
| Net revenues                                       | \$ 460,843          | \$ 366,057                               | \$ 288,940          |
| Cost of sales                                      | 203,220             | 156,910                                  | 137,803             |
| Gross profit                                       | 257,623             | 209,147                                  | 151,137             |
| Selling, general, and administrative expenses      | 169,427             | 163,053                                  | 116,168             |
| Other income                                       | 7,975               | 7,225                                    | 10,743              |
| Operating income                                   | 96,171              | 53,319                                   | 45,712              |
| Interest expense, net                              | 1,147               | 1,625                                    | 1,604               |
| Income before income taxes                         | 95,024              | 51,694                                   | 44,108              |
| Income tax expense                                 | 37,103              | 5,496                                    | 889                 |
| Net income   | \$ 57,921           | \$ 46,198                                | \$ 43,219           |
| Basic weighted-average shares outstanding          | 40,506,672          | 36,812,570                               | 35,440,547          |
| Diluted weighted-average shares outstanding        | 40,542,302          | 36,850,915                               | 35,440,547          |
| Basic net income per share                         | \$ 1.43             | \$ 1.25                                  | \$ 1.22             |
| Diluted net income per share                       | 1.43                | 1.25                                     | 1.22                |
| Basic distributions per share                      |                     | 3.58                                     | 0.66                |
| Pro forma income information <sup>(Note 1)</sup> : |                     |  |                     |
| Income before income taxes                         |                     | \$ 51,694                                | \$ 44,108           |
| Pro forma income tax expense (unaudited)           |                     | 22,791                                   | 17,643              |
| Pro forma net income (unaudited)                   |                     | \$ 28,903                                | \$ 26,465           |
| Basic weighted-average shares outstanding          |                     | 36,812,570                               | 35,440,547          |
| Diluted weighted-average shares outstanding        |                     | 36,850,915                               | 35,440,547          |
| Pro forma basic net income per share (unaudited)   |                     | \$ 0.79                                  | \$ 0.75             |
| Pro forma diluted net income per share (unaudited) |                     | 0.78                                     | 0.75                |

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

**Table of Contents****Vera Bradley, Inc.****Consolidated Statements of Shareholders' Equity**

(\$ in thousands, except share data)

|   | Number of Shares                          |  | Common<br>Stock   | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings<br>(Accumulated<br>Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Equity   |
|---|---|--|-------------------|-----------------|----------------------------------|--|---|-------------------|
|   | Common<br>Stock<br>(Class<br>A)<br>Voting | Common<br>Stock<br>(Class B)<br>Non-Voting |                   |                 |                                  |  |   |                   |
| <b>Balance at January 31, 2009</b>                      | <b>2,835</b>                              | <b>35,437,712</b>                          |                   | <b>\$ 1</b>     | <b>\$</b>                        | <b>\$ 57,946</b>                                 | <b>\$</b>                                       | <b>\$ 57,947</b>  |
| Net income  |   |  |                   |                 |                                  | 43,219   |   | 43,219            |
| Distributions of retained earnings                      |   |  |                   |                 |                                  | (23,273)   |   | (23,273)          |
| <b>Balance at January 30, 2010</b>                      | <b>2,835</b>                              | <b>35,437,712</b>                          |                   | <b>1</b>        |                                  | <b>77,892</b>                                    |   | <b>77,893</b>     |
| Net income  |   |  |                   |                 |                                  | 46,198   |   | 46,198            |
| Distributions of retained earnings                      |   |  |                   |                 |                                  | (131,691)  |   | (131,691)         |
| Issuance of stock upon vesting of<br>stock-based awards |   | 28,881                                     | 1,066,123         |                 |                                  |  |   |                   |
| Repurchase and retirement of stock                      |   | (28,881)                                   |                   |                 | (304)                            |  |   | (304)             |
| Reorganization (Note 1)                                 | (2,835)                                   | (35,437,712)                               | 35,440,547        | (1)             | 1                                |  |   |                   |
| Issuance of stock in IPO, net of<br>costs               |   |  | 4,000,000         |                 | 56,337                           |  |   | 56,337            |
| Stock-based compensation                                |   |  |                   |                 | 15,889                           |  |   | 15,889            |
| <b>Balance at January 29, 2011</b>                      |   |  | <b>40,506,670</b> |                 | <b>71,923</b>                    | <b>(7,601)</b>                                   |   | <b>64,322</b>     |
| Net income  |   |  |                   |                 |                                  | 57,921   |   | 57,921            |
| Recovery of short-swing profit                          |   |  |                   |                 | 76                               |  |   | 76                |
| Translation adjustments                                 |   |  |                   |                 |                                  |  | 97  | 97                |
| Shares issued for employee benefit<br>plans             |   |  | 50                |                 | 1                                |  |   | 1                 |
| Stock-based compensation                                |   |  |                   |                 | 1,590                            |  |   | 1,590             |
| <b>Balance at January 28, 2012</b>                      |   |  | <b>40,506,720</b> | <b>\$</b>       | <b>\$ 73,590</b>                 | <b>\$ 50,320</b>                                 | <b>\$ 97</b>                                    | <b>\$ 124,007</b> |

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

**Table of Contents****Vera Bradley, Inc.****Consolidated Statements of Cash Flows**

(\$ in thousands)

|   | January 28,<br>2012 | Fiscal Year Ended<br>January 29,<br>2011 | January 30,<br>2010 |
|---|---------------------|--|---------------------|
| <b>Cash flows from operating activities</b>                                       |                     |  |                     |
| Net income  | \$ 57,921           | \$ 46,198                                | \$ 43,219           |
| Adjustments to reconcile net income to net cash provided by operating activities: |                     |  |                     |
| Depreciation and amortization of property, plant, and equipment                   | 9,457               | 8,411                                    | 10,666              |
| Provision for doubtful accounts   | 553                 | 256                                      | 858                 |
| Loss on disposal of property, plant, and equipment                                | 51                  | 278                                      | 1,462               |
| Write-off of unamortized debt-issuance costs                                      |                     | 227                                      |                     |
| Stock-based compensation  | 1,591               | 15,889                                   |                     |
| Deferred income taxes   | 1,638               | (5,443)                                  |                     |
| Changes in assets and liabilities:  |                     |  |                     |
| Accounts receivable   | (4,350)             | (3,543)                                  | (1,230)             |
| Inventories   | (10,199)            | (30,182)                                 | (2,059)             |
| Other assets  | 137                 | (393)                                    | (1,806)             |
| Accounts payable  | (2,736)             | 10,791                                   | 3,150               |
| Income taxes payable  | (8,305)             | 10,010                                   |                     |
| Accrued and other liabilities   | 5,758               | 5,967                                    | 11,746              |
| Net cash provided by operating activities   | 51,516              | 58,466                                   | 66,006              |
| <b>Cash flows from investing activities</b>                                       |                     |  |                     |
| Purchases of property, plant, and equipment                                       | (18,836)            | (11,365)                                 | (5,844)             |
| Restricted cash on deposit  |                     | 1,500                                    |                     |
| Net cash used in investing activities   | (18,836)            | (9,865)                                  | (5,844)             |
| <b>Cash flows from financing activities</b>                                       |                     |  |                     |
| Payments on financial-institution debt  | (76,200)            | (68,923)                                 | (54,800)            |
| Borrowings on financial-institution debt  | 34,450              | 105,673                                  | 30,300              |
| Payments on vendor-financed debt  | (83)                | (54)                                     | (237)               |
| Payments on related-party debt  |                     |  | (3,488)             |
| Payments on cash surrender value - life insurance                                 |                     |  | (600)               |
| Payments of debt-issuance costs   |                     | (1,104)                                  |                     |
| Issuance of stock, net of costs   |                     | 56,337                                   |                     |
| Repurchase of stock   |                     | (304)                                    |                     |
| Payments of distributions   |                     | (132,782)                                | (25,604)            |
| Other   | 76                  |  |                     |
| Net cash used in financing activities   | (41,757)            | (41,157)                                 | (54,429)            |
| Effect of exchange rate changes on cash and cash equivalents                      | 46                  |  |                     |
| Increase (decrease) in cash and cash equivalents                                  | (9,031)             | 7,444                                    | 5,733               |
| Cash and cash equivalents, beginning of period                                    | 13,953              | 6,509                                    | 776                 |
| Cash and cash equivalents, end of period  | \$ 4,922            | \$ 13,953                                | \$ 6,509            |

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**Supplemental disclosure of cash-flow information**

|                   |           |          |          |
|-------------------|-----------|----------|----------|
| Income taxes paid | \$ 43,850 | \$ 921   | \$ 412   |
| Interest paid     | \$ 956    | \$ 1,117 | \$ 1,782 |

**Supplemental disclosure of non-cash activity**

|   |    |        |        |
|---|----|--------|--------|
| Vendor-financed purchases of property, plant, and equipment | \$ | \$ 185 | \$ 136 |
|---|----|--------|--------|

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

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**Table of Contents**

**Vera Bradley, Inc.**

**Notes to Consolidated Financial Statements**

**1. Description of the Company**

Vera Bradley, Inc. was formed as an Indiana corporation on June 23, 2010, for the purpose of reorganizing the corporate structure of Vera Bradley Designs, Inc. On October 3, 2010, the shareholders of Vera Bradley Designs, Inc. contributed all of their shares of Class A Voting Common Stock and Class B Non-Voting Common Stock of Vera Bradley Designs, Inc. to Vera Bradley, Inc. in return for shares of Vera Bradley, Inc. Class A Voting Common Stock and Class B Non-Voting Common Stock on a one-for-one basis. In addition, effective October 3, 2010, Vera Bradley Designs, Inc. converted from an S Corporation to a C Corporation for income-tax purposes. Further, on October 18, 2010, Vera Bradley, Inc. recapitalized all of its Class A Voting Common Stock and Class B Non-Voting Common Stock into a single class of common stock and effectuated a 35.437-for-1 stock split of all outstanding shares of its common stock. These events collectively are referred to as the Reorganization. As a result of the Reorganization, Vera Bradley Designs, Inc. became a wholly owned subsidiary of Vera Bradley, Inc. Except where context requires or where otherwise indicated, the terms Company and Vera Bradley refer to Vera Bradley Designs, Inc. and its subsidiaries before the Reorganization and to Vera Bradley, Inc. and its subsidiaries, including Vera Bradley Designs, Inc., after the Reorganization. All historical common stock and per share common stock information has been changed to reflect the stock split.

Vera Bradley is a leading designer, producer, marketer, and retailer of stylish, highly functional accessories for women. The Company's products include a wide offering of handbags, accessories, and travel and leisure items. The Company generates net revenues by selling products through two reportable segments: Direct and Indirect. The Direct business consists of sales of Vera Bradley products through the Company's full-price stores, outlet stores, verabradley.com, and an annual outlet sale in Fort Wayne, Indiana. As of January 28, 2012, the Company operated 48 full-price stores and eight outlet stores in the United States, seven pop-up stores in Japan, our websites, verabradley.com and verabradley.co.jp, and our annual outlet sale in Fort Wayne, Indiana. The Indirect business consists of sales of Vera Bradley products to approximately 3,300 specialty retailers, substantially all of which are located in the United States, as well as select national retailers and third-party e-commerce sites.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The Company has eliminated intercompany balances and transactions in consolidation.

**Fiscal Periods**

The Company's fiscal year ends on the Saturday closest to January 31.

**Unaudited Pro Forma Income Information**

Prior to the Reorganization, the Company was taxed as an S Corporation for purposes of federal and state income taxes. Accordingly, each of the Company's then-shareholders was required to include his or her portion of the Company's taxable income or loss on his or her federal and state income tax returns. As part of the Reorganization, effective October 3, 2010, the Company's S Corporation status automatically terminated and the Company became subject to corporate-level federal and state income taxes at prevailing corporate rates.

The unaudited pro forma income information gives effect to an adjustment for income tax expense as if the Company had been a C Corporation at the beginning of each period presented at an assumed combined federal, state, and local income tax rate of 41.7% for the period from January 31, 2010, through October 2, 2010, and 40% for the fiscal year ended January 30, 2010. These rates approximate the calculated effective tax rates for the periods presented.

**Table of Contents**

**Vera Bradley, Inc.**

**Notes to Consolidated Financial Statements**

**2. Summary of Significant Accounting Policies**

**Use of Significant Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires management to make estimates and assumptions that affect the reported amounts of the Company s assets, liabilities, revenues, and expenses, as well as the disclosures relating to contingent assets and liabilities at the date of the consolidated financial statements. Significant areas requiring the use of management estimates include the valuation of inventories, accounts receivable valuation allowances, sales return allowances, and the useful lives of assets for depreciation or amortization. Actual results could differ from these estimates. The Company revises its estimates and assumptions as new information becomes available.

**Cash and Cash Equivalents**

Cash and cash equivalents represent cash on hand, deposits with financial institutions, and investments with an original maturity of three months or less.

**Restricted Cash**

At January 30, 2010, the Company maintained \$1.5 million in an account with one of its lenders as a compensating balance in connection with the credit agreement entered into during the fiscal year ended January 31, 2009. In October 2010, as part of the amendment and restatement of the Company s credit agreement (see Note 5), this compensating-balance requirement was eliminated.

**Concentration of Credit Risk**

The Company maintains nearly all of its cash and cash equivalents with one financial institution. The Company monitors the credit standing of this financial institution on a regular basis.

**Inventories**

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out ( FIFO ) method. Market is determined based on net realizable value, which includes costs to dispose. Appropriate consideration is given to obsolescence, excess quantities, and other factors, including the popularity of a pattern or product, in evaluating net realizable value.

**Property, Plant, and Equipment**

Property, plant, and equipment are carried at cost and depreciated or amortized over the following estimated useful lives using the straight-line method:

|  |              |
|--|--------------|
| Buildings and building improvements                | 39.5 years   |
| Furniture and fixtures, and leasehold improvements | 5 - 10 years |
| Computer equipment                                 | 3 years      |
| Software   | 3 - 5 years  |
| Production equipment                               | 7 years      |
| Vehicles   | 5 years      |

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

Leasehold improvements are amortized over the shorter of the life of the asset or the lease term. Lease terms typically range from five to ten years.

When a decision is made to abandon property, plant, and equipment prior to the end of the previously estimated useful life, depreciation or amortization estimates are revised to reflect the use of the asset over the shortened estimated useful life. At the time of disposal, the cost of assets sold or retired and the related accumulated depreciation or amortization are removed from the accounts and any resulting loss is included in the Consolidated Statements of Income.

Property, plant, and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. The reviews are conducted at the lowest identifiable level of cash flows. If the estimated undiscounted future cash flows related to the property, plant, and equipment are less than the carrying value, the Company recognizes a loss equal to the difference between the carrying value and the fair value, as further defined below in Fair Value of Financial Instruments.

Routine maintenance and repair costs are expensed as incurred.

The Company capitalizes certain costs incurred in connection with acquiring, modifying, and installing internal-use software. Capitalized costs are included in property, plant, and equipment and are amortized over three to five years. Software costs that do not meet capitalization criteria are expensed as incurred.

**Revenue Recognition and Accounts Receivable**

Revenue from the sale of the Company's products is recognized upon customer receipt of the product when collection of the associated receivables is reasonably assured, persuasive evidence of an arrangement exists, the sales price is fixed and determinable, and ownership and risk of loss have been transferred to the customer, which, for e-commerce and most Indirect sales, reflects an estimate of shipments that customers have not yet received. The estimate of these shipments is based on shipping terms and historical delivery times.

Included in net revenues are product sales to Direct and Indirect customers, including amounts billed to customers for shipping fees. Costs related to shipping of product are classified in cost of sales in the Consolidated Statements of Income. Net revenues exclude sales taxes collected from customers and remitted to governmental authorities.

Historical experience provides the Company the ability to estimate reasonably the amount of product sales that customers will return. Product returns are often resalable through the Company's annual outlet sale or other channels. The Company accounts for anticipated returns by reducing net revenues, cost of sales, and accounts receivable and increasing inventories, essentially reversing the effects of the original sales transactions. Additionally, the Company reserves for other potential product credits granted to Indirect retailers. The returns and credits reserve and the related activity for each fiscal year presented were as follows (in thousands):

|                                    | <b>Balance at<br/>Beginning of Year</b> | <b>Provision<br/>Charged to<br/>Net Revenues</b> | <b>Allowances<br/>Taken</b> | <b>Balance at End<br/>of Year</b> |
|------------------------------------|---|--|-----------------------------|-----------------------------------|
| Fiscal year ended January 28, 2012 | \$ 1,265                                | \$ 20,804  | \$ (20,262)                 | \$ 1,807                          |
| Fiscal year ended January 29, 2011 | 891                                     | 14,343   | (13,969)                    | 1,265                             |
| Fiscal year ended January 30, 2010 | 528                                     | 10,530   | (10,167)                    | 891                               |

**Table of Contents**

**Vera Bradley, Inc.**

**Notes to Consolidated Financial Statements**

The Company establishes an allowance for doubtful accounts based on historical experience and customer-specific identification and believes that collections of receivables, net of the allowance for doubtful accounts, are reasonably assured. The allowance for doubtful accounts was approximately \$0.6 million and \$0.3 million at January 28, 2012, and January 29, 2011, respectively.

**Cost of Sales**

Cost of sales includes material and labor costs, freight, inventory shrinkage, operating lease costs, duty, and other operating expenses, including depreciation of the Company's distribution center, warehouse and manufacturing facilities, and equipment. Costs and related expenses to manufacture and distribute the products are recorded as cost of sales when the related revenues are recognized.

**Operating Leases and Tenant-Improvement Allowances**

The Company has leases that contain rent holidays and predetermined, fixed escalations of minimum rentals. For each of these leases, the Company recognizes the related rent expense on a straight-line basis commencing on the date of initial possession of the leased property. The Company records the difference between the recognized rent expense and the amount payable under the lease as a deferred lease credit.

The Company receives tenant-improvement allowances from some of the landlords of its leased properties. These allowances generally are in the form of cash received by the Company from its landlords as part of the negotiated lease terms. The Company records each tenant-improvement allowance as a deferred credit and amortizes the allowance on a straight-line basis as a reduction to rent expense over the term of the lease, commencing on the possession date.

**Store Pre-Opening, Occupancy, and Operating Costs**

The Company charges costs associated with the opening of new stores to selling, general, and administrative expenses as incurred. Selling, general, and administrative expenses also include store operating costs, store employee compensation, and store occupancy and supply costs.

**Stock-Based Compensation**

The Company accounts for stock-based compensation using the fair-value recognition provisions of ASC 718, Stock Compensation. Under these provisions, for its awards of restricted stock and restricted-stock units, the Company recognizes stock-based compensation expense in an amount equal to the fair market value of the underlying stock on the grant date of the respective award. The Company recognizes this expense, net of estimated forfeitures, on a straight-line basis over the requisite service period. For restricted-stock awards granted prior to its initial public offering, the Company recognized stock-based compensation expense over the period the restrictions were to lapse and, then, in full upon the initial public offering.

**Other Income and Advertising Costs**

The Company expenses advertising costs at the time the promotion first appears in media, in stores, or on the website, and includes those costs in selling, general, and administrative expenses in the Consolidated Statements of Income. The Company classifies the related recovery of a portion of such costs from Indirect retailers as other income in the Consolidated Statements of Income.



**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

Total advertising expense was as follows (in thousands):

|                                    |           |
|------------------------------------|-----------|
| Fiscal year ended January 28, 2012 | \$ 20,154 |
| Fiscal year ended January 29, 2011 | 20,149    |
| Fiscal year ended January 30, 2010 | 23,004    |

Total recovery from Indirect retailers was as follows (in thousands):

|                                    |          |
|------------------------------------|----------|
| Fiscal year ended January 28, 2012 | \$ 7,692 |
| Fiscal year ended January 29, 2011 | 6,966    |
| Fiscal year ended January 30, 2010 | 10,743   |

**Debt-Issuance Costs**

During the fiscal year ended January 29, 2011, in connection with the amendment and restatement of the credit agreement (see Note 5), the Company incurred debt-issuance costs of \$1.1 million and wrote off, to interest expense, \$0.2 million of unamortized debt-issuance costs relating to certain portions of the original credit agreement. The Company is amortizing the remaining debt-issuance costs to interest expense over the five-year term of the amended and restated credit agreement. Debt-issuance costs, net of accumulated amortization, totaled \$0.9 million and \$1.2 million at January 28, 2012, and January 29, 2011, respectively, and are included in other current assets and other assets on the Consolidated Balance Sheets. Amortization expense of \$0.3 million, \$0.3 million, and \$0.3 million is included in interest expense in the Consolidated Statements of Income for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010, respectively.

**Derivative Instruments**

To protect against the risk of adverse interest rate movement, the Company entered into two interest rate swap agreements in the fiscal year ended January 30, 2010, swapping its variable LIBOR-based interest rate on its line of credit with a fixed rate ranging from 0.79% to 1.20%. The Company did not elect hedge accounting and marked these derivative instruments to market, resulting in an insignificant liability and insignificant expense included in other accrued liabilities and selling, general, and administrative expenses as of and for the fiscal year ended January 30, 2010. The interest rate swap agreements had a total notional amount of \$20 million, of which \$10 million expired on February 2, 2010, and \$10 million was terminated on November 8, 2010. The Company recognized insignificant losses upon this expiration and termination of these agreements in the fiscal year ended January 29, 2011.

**Fair Value of Financial Instruments**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities measured at fair value are classified using the following hierarchy, which is based upon the transparency of inputs to the valuation as of the measurement date:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly

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Level 3 Unobservable inputs based on the Company's own assumptions

56

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**Table of Contents**

**Vera Bradley, Inc.**

**Notes to Consolidated Financial Statements**

The classification of fair value measurements within the hierarchy is based upon the lowest level of input that is significant to the measurement.

The carrying amounts reflected on the Consolidated Balance Sheets for cash and cash equivalents, receivables, other current assets, debt, and payables as of January 28, 2012, and January 29, 2011, approximated their fair values.

**Income Taxes**

The Company accounts for income taxes and the related accounts using the liability method in accordance with ASC 740, Income Taxes. Under this method, the Company accrues income taxes payable or refundable and recognizes deferred tax assets and liabilities based on differences between the GAAP and tax bases of assets and liabilities. The Company measures deferred tax assets and liabilities using enacted rates in effect for the years in which the differences are expected to reverse, and recognizes the effect of a change in enacted rates in the period of enactment.

The Company establishes assets and liabilities for uncertain positions taken or expected to be taken in income tax returns, using a more-likely-than-not recognition threshold. The Company includes in income tax expense any interest and penalties related to uncertain tax positions.

**Recently Issued Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-05,

*Comprehensive Income Presentation of Comprehensive Income*. This guidance eliminates the option to present the components of other comprehensive income as part of the Statement of Shareholders' Equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. The guidance is effective for fiscal years beginning after December 15, 2011. As this guidance only amends the presentation of the components of comprehensive income, the adoption will not have an impact on the Company's consolidated financial position, results of operations, or cash flows. Early adoption is permitted, but full retrospective application is required under both sets of accounting standards. The guidance also previously required the presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented; however, this portion of the guidance has been deferred through an ASU issued in September 2011. Upon adoption, the Company will elect to present items of net income and other comprehensive income in one continuous statement, the statement of comprehensive income.

In May 2011, the FASB issued ASU 2011-4, *Fair Value Measurement Amendments to Achieve Common Fair Value*

*Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. The guidance requires additional disclosures, including disclosures related to the measurement of level 3 assets. The guidance is effective for interim and annual periods beginning after December 15, 2011 and is applied prospectively. The Company is currently evaluating this guidance, but does not expect its adoption will have a material effect on its consolidated financial statements.

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements****3. Inventories**

The components of inventories were as follows (in thousands):

|                   | January 28,<br>2012 | January 29,<br>2011 |
|-------------------|---------------------|---------------------|
| Raw materials     | \$ 10,748           | \$ 9,695            |
| Work in process   | 692                 | 829                 |
| Finished goods    | 95,527              | 86,193              |
| Total inventories | \$ 106,967          | \$ 96,717           |

**4. Property, Plant, and Equipment**

Property, plant, and equipment consisted of the following (in thousands):

|  | January 28,<br>2012 | January 29,<br>2011 |
|--|---------------------|---------------------|
| Land   | \$ 2,145            | \$ 2,145            |
| Building and building improvements                                 | 16,182              | 16,182              |
| Furniture, fixtures, leasehold improvements and computer equipment | 56,510              | 43,665              |
| Production equipment and vehicles                                  | 12,685              | 12,187              |
| Construction in progress   | 6,662               | 1,613               |
|  | 94,184              | 75,792              |
| Less: Accumulated depreciation and amortization                    | (41,872)            | (32,808)            |
| Property, plant, and equipment, net                                | \$ 52,312           | \$ 42,984           |

Property, plant, and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. The reviews are conducted at the lowest identifiable level of cash flows. If the estimated undiscounted future cash flows related to the property, plant, and equipment are less than the carrying value, the Company recognizes a loss equal to the difference between the carrying value and the fair value, as further defined in Note 2. An impairment charge of \$1.3 million was recognized in the fiscal year ended January 30, 2010, for assets related to underperforming stores and is included in selling, general, and administrative expenses in the Consolidated Statements of Income and in depreciation and amortization of property, plant, and equipment in the Consolidated Statements of Cash Flows.

Depreciation and amortization expense associated with property, plant, and equipment (in thousands):

|                                    |          |
|------------------------------------|----------|
| Fiscal year ended January 28, 2012 | \$ 9,457 |
| Fiscal year ended January 29, 2011 | 8,411    |
| Fiscal year ended January 30, 2010 | 10,666   |



**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements****5. Debt**

Long-term debt consisted of the following (in thousands):

|                            | January 28,<br>2012 | January 29,<br>2011 |
|----------------------------|---------------------|---------------------|
| Financial-institution debt | \$ 25,000           | \$ 66,750           |
| Other borrowings           | 184                 | 267                 |
|                            | 25,184              | 67,017              |
| Less: Current maturities   | 89                  | 83                  |
|                            | \$ 25,095           | \$ 66,934           |

Future principal payments during the next five years are as follows (in thousands and by fiscal year):

|              |                  |
|--------------|------------------|
| 2013         | \$ 89            |
| 2014         | 57               |
| 2015         | 30               |
| 2016         | 25,008           |
| 2017         |                  |
| Thereafter   |                  |
| <b>Total</b> | <b>\$ 25,184</b> |

*Credit Agreement*

On October 4, 2010, Vera Bradley Designs, Inc. entered into an agreement to amend and restate its credit agreement with JPMorgan Chase Bank, as administrative agent, and certain other lenders. The amended and restated credit agreement provides for a revolving credit commitment of \$125.0 million and matures on October 3, 2015. All borrowings under the amended and restated credit agreement are collateralized by substantially all of the Company's assets. The credit agreement is also guaranteed by the Company. The credit agreement requires the Company to comply with various financial covenants, including a fixed charge coverage ratio of not less than 1.20 to 1.00 and a leverage ratio of not more than 3.50 to 1.00. The agreement also contains various other covenants, including restrictions on the incurrence of certain indebtedness, liens, investments, acquisitions, and asset sales. The Company was in compliance with these covenants as of January 28, 2012.

Borrowings under the amended and restated credit agreement bear interest at either LIBOR plus the applicable margin (ranging from 1.05% to 2.05%) or the alternate base rate (as defined in the agreement) plus the applicable margin (ranging from 0.05% to 1.05%). The applicable margin is tied to the Company's leverage ratio. In addition, the Company is required to pay a quarterly facility fee (as defined in the agreement) ranging from 0.20% to 0.45% of the revolving credit commitment. At January 28, 2012, the interest rate on the \$25.0 million of outstanding borrowings under the credit agreement was 1.36%. The Company had borrowing availability of \$100.0 million under the agreement as of January 28, 2012.

**6. Income Taxes**

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On October 3, 2010, as part of the Reorganization described in Note 1, the Company's S Corporation status automatically terminated and the Company became subject to corporate-level federal and state income taxes at prevailing corporate rates.

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

The components of income tax expense were as follows (in thousands):

|                                 | January 28,<br>2012 | January 29,<br>2011 |
|---------------------------------|---------------------|---------------------|
| Current:                        |                     |                     |
| Federal                         | \$ 31,437           | \$ 8,881            |
| Foreign                         | 38                  |                     |
| State                           | 3,990               | 2,058               |
|                                 | 35,465              | 10,939              |
| Deferred:                       |                     |                     |
| Federal                         | 1,591               | (4,497)             |
| Foreign                         |                     |                     |
| State                           | 47                  | (946)               |
|                                 | 1,638               | (5,443)             |
| <b>Total income tax expense</b> | <b>\$ 37,103</b>    | <b>\$ 5,496</b>     |

For the fiscal years ended January 30, 2010, the Company's income tax expense of \$0.9 million was comprised solely of current state taxes related to jurisdictions that did not recognize the Company's previous S Corporation status.

A breakdown of the Company's income before income taxes is as follows (in thousands):

|   | January 28,<br>2012 | January 29,<br>2011 |
|---|---------------------|---------------------|
| Domestic                                | \$ 96,370           | \$ 51,578           |
| Foreign                                 | (1,346)             | 116                 |
| <b>Total income before income taxes</b> | <b>\$ 95,024</b>    | <b>\$ 51,694</b>    |

A reconciliation of income tax expense to the amount computed at the federal statutory rate is as follows for the fiscal year ended January 29, 2011 (in thousands):

|   | January 28,<br>2012 |       | January 29,<br>2011 |        |
|---|---------------------|-------|---------------------|--------|
| Federal taxes at statutory rate   | \$ 33,258           | 35.0% | \$ 18,093           | 35.0%  |
| State and local income taxes, net of federal benefit                        | 2,624               | 2.8   | 1,243               | 2.4    |
| Impact of change in tax status  |                     |       | (1,760)             | (3.4)  |
| Tax effect of earnings not subject to federal inc. tax due to S-Corp status |                     |       | (13,464)            | (26.0) |
| Nondeductible stock-based compensation                                      |                     |       | 1,198               | 2.3    |
| Impact of foreign operations  | (75)                | (0.1) |                     |        |



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|                                     |           |       |          |       |
|-------------------------------------|-----------|-------|----------|-------|
| Foreign valuation allowance         | 600       | 0.6   |          |       |
| Valuation allowance on capital loss | 194       | 0.2   |          |       |
| Other                               | 502       | 0.5   | 186      | 0.3   |
| Total income tax expense            | \$ 37,103 | 39.0% | \$ 5,496 | 10.6% |

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

During fiscal year 2012, the Company began retail operations in Japan. During the first 12 months of operations, these retail activities incurred a loss. The Company has not recorded a tax benefit for this loss due to the uncertainty regarding the future realizability of the tax benefit of this loss. Accordingly, a valuation allowance of \$0.6 million was recorded for the Japanese entity. If not used, this carryforward will expire in fiscal year 2019.

Prior to October 3, 2010, Vera Bradley Designs, Inc. 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 exception in a limited number of state and local jurisdictions that do not recognize the S Corporation status). As a result of the conversion to a C Corporation, the Company recorded a net deferred tax asset and one-time deferred tax benefit of \$1.8 million. This benefit of \$1.8 million reflects the company's original estimate of the one-time benefit as well as changes to that estimate resulting from intervening enactments of depreciation-related tax legislation and the Company's completion of its final S Corporation tax return. In addition, during the portion of the year in which it operated as a C Corporation, the company recognized stock-based compensation expense associated with restricted-stock awards, a portion of which was permanently non-deductible, the tax impact of which was \$1.2 million.

Deferred income taxes reflect the net tax effects of temporary differences between the GAAP and tax bases of assets and liabilities. Significant components of deferred tax assets and liabilities were as follows (in thousands):

|                                 | January 28,<br>2012 | January 29,<br>2011 |
|---------------------------------|---------------------|---------------------|
| Deferred tax assets:            |                     |                     |
| Compensation and benefits       | \$ 3,572            | \$ 3,042            |
| Inventories                     | 4,255               | 4,946               |
| Deferred credits from landlords | 2,406               | 1,409               |
| Foreign operating loss          | 600                 |                     |
| Other                           | 1,595               | 1,155               |
| Subtotal deferred tax assets    | 12,428              | 10,552              |
| Less: valuation allowances      | (794)               |                     |
| Total deferred tax assets       | 11,634              | 10,552              |
| Deferred tax liabilities:       |                     |                     |
| Property, plant, and equipment  | (6,943)             | (4,263)             |
| Other                           | (886)               | (846)               |
| Total deferred tax liabilities  | (7,829)             | (5,109)             |
| Net deferred tax assets         | \$ 3,805            | \$ 5,443            |

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements***Uncertain Tax Positions*

A reconciliation of the beginning and ending gross amount of unrecognized tax benefits (excluding interest and penalties) for the fiscal years ended January 28, 2012, and January 29, 2011, is as follows (in thousands):

|   | January 28,<br>2012 | January 29,<br>2011 |
|---|---------------------|---------------------|
| Beginning balance   | \$ 441              | \$                  |
| Increases in unrecognized tax benefits as a result of current-year activity | 446                 | 441                 |
| Increases for unrecognized tax benefits of prior years                      |                     |                     |
| Reductions for tax positions of prior years                                 |                     |                     |
| Settlements   |                     |                     |
| Ending balance  | \$ 887              | \$ 441              |

As of January 28, 2012, of the \$887,000 of total unrecognized tax benefits, \$576,550, which is net of federal benefit, would, if recognized, favorably affect the effective tax rate in future periods. It is unlikely that any of total unrecognized tax benefits as of January 28, 2012, will change in the next twelve months. The Company recognized \$22,137 of interest only, no penalties, related to unrecognized tax benefits in the fiscal year ended January 29, 2011.

The Company files income tax returns in the U.S. federal jurisdiction and in various state and foreign jurisdictions. Income tax returns for calendar year 2008 to present are open for examination in the federal jurisdiction and in significant state jurisdictions. The tax returns in foreign jurisdictions are not material.

**7. Comprehensive Income**

The components of comprehensive income were as follows (in thousands):

|                                   | January 28,<br>2012 | January 29,<br>2011 | January 30,<br>2010 |
|-----------------------------------|---------------------|---------------------|---------------------|
| Net income                        | \$ 57,921           | \$ 46,198           | \$ 43,219           |
| Cumulative translation adjustment | 97                  |                     |                     |
| Comprehensive income              | \$ 58,018           | \$ 46,198           | \$ 43,219           |

**8. Leases**

The Company is party to non-cancellable operating leases. Future minimum lease payments under the non-cancelable operating leases through expiration are as follows (in thousands and by fiscal year):

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|            | <b>Non-Related<br/>Party</b> | <b>Related<br/>Party</b> |
|------------|------------------------------|--------------------------|
| 2013       | \$ 14,036                    | \$ 789                   |
| 2014       | 13,909                       | 635                      |
| 2015       | 13,742                       | 518                      |
| 2016       | 13,954                       |                          |
| 2017       | 14,063                       |                          |
| Thereafter | 47,091                       |                          |
|            | \$ 116,795                   | \$ 1,942                 |

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

Rental expense for all leases was as follows (in thousands):

|                                    |           |
|------------------------------------|-----------|
| Fiscal year ended January 28, 2012 | \$ 15,358 |
| Fiscal year ended January 29, 2011 | 10,337    |
| Fiscal year ended January 30, 2010 | 6,985     |

Lease terms generally range from five to ten years with options to renew for varying terms. Future minimum lease payments relate primarily to the lease of retail space. Additionally, several lease agreements contain a provision for payments based on a percentage of sales in addition to the stated lease payments. Percentage rent was \$1.6 million and \$0.7 million for fiscal years ended January 28, 2012, and January 29, 2011, respectively. Percentage rent for the fiscal year ended January 30, 2010 was insignificant.

The Company leases two of its facilities from leasing companies owned by certain shareholders and directors. In March 2011 we extended our lease with Milburn LLC. Lease expense related to this arrangement with Milburn, LLC, was \$168,000 in each of the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010, respectively. In March 2011, we entered into a lease with Great Dane Realty, LLC, a company owned by Barbara Bradley Baekgaard. Lease expense for fiscal year ended January 28, 2012, related to this arrangement with Great Dane Realty, LLC, was approximately \$369,000.

**9. Shareholders Equity**

On July 1, 2010, the Company initially filed its Registration Statement with the SEC. The Registration Statement, as amended, became effective on October 20, 2010, and the initial public offering ( IPO ) closed on October 26, 2010. As part of the IPO, the Company sold 4,000,000 shares of its common stock, raising net proceeds of approximately \$56.3 million, after deducting the underwriting discount and costs incurred related to the IPO.

In conjunction with the Reorganization described in Note 1, on October 3, 2010, the Company distributed to its then-shareholders, in proportion to their share ownership, notes in an aggregate principal amount of \$106.0 million, or 100% of the Company's undistributed taxable income from the date of formation through October 2, 2010, the day prior to the date on which Vera Bradley Designs, Inc. terminated its S Corporation status. The Company recorded this distribution through an adjustment to retained earnings. On October 29, 2010, using the net proceeds from the IPO together with borrowings under the amended and restated credit agreement, the Company paid in full the principal amount of, and the interest due on, the notes.

Also in conjunction with the Reorganization, on October 18, 2010, the Company recapitalized all of its Class A Voting Common Stock and Class B Non-Voting Common Stock into a single class of common stock and effectuated a 35.437-for-1 stock split of all outstanding shares of its common stock. The Company's articles of incorporation, as amended on October 18, 2010, authorize 200,000,000 shares of common stock and 5,000,000 shares of preferred stock. No preferred stock was issued or outstanding as of January 28, 2012, or January 29, 2011.

**10. Stock-Based Compensation**

The Company's stock-based compensation consists of awards of restricted stock and restricted stock units. The Company recognized stock-based compensation expense of \$1.6 million, in the fiscal year ended January 28, 2012. The Company recognized stock-based compensation expense of \$15.9 million, and a related tax benefit of \$3.1 million, in the fiscal year ended January 29, 2011. The Company did not recognize any stock-based compensation expense in fiscal year ended January 30, 2010.

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements***Awards of Restricted-Stock Units*

The Company reserved 6,076,001 shares of common stock for issuance or transfer under the 2010 Equity and Incentive Plan, which allows for grants of restricted stock units as well as other equity awards.

During the fiscal year ended January 28, 2012, the Company granted a total of 117,631 restricted stock units to certain employees under the 2010 Equity and Incentive Plan with an aggregate fair value of \$4.8 million. These restricted stock units vest and settle in shares of the Company's common stock, on a one-for-one basis, in equal installments on each of the first three anniversaries of the grant date. The Company is recognizing the expense relating to these awards, net of estimated forfeitures, on a straight-line basis over three years. The Company determined the fair value of the awards based on the closing price of the Company's common stock on the grant date.

In connection with its IPO in October 2010, the Company granted a total of 56,675 restricted-stock units with an aggregate grant-date fair value of \$0.9 million to all of its employees under the 2010 Equity and Incentive Plan. These units vest on the second anniversary of the grant date, provided that the respective award recipient continues to be employed by the Company on that date. The Company is recognizing the expense relating to these awards, net of estimated forfeitures of \$0.2 million, on a straight-line basis over two years. The Company recognized \$0.4 million and \$0.1 million of compensation expense related to these awards in fiscal years ended January 28, 2012, and January 29, 2011, respectively. As of January 28, 2012, and January 29, 2011, the Company had \$0.3 million and \$0.6 million, respectively, of unrecognized compensation expense related to these awards, which it expects to recognize over the remaining nine months of the vesting period.

The following table summarizes information about restricted-stock units as of and for the year ended January 28, 2012:

| <b>Restricted-Stock Units</b>                   | <b>Number of<br/>Units</b> | <b>Weighted-Average<br/>Grant Date Fair<br/>Value (per unit)</b> |
|---|----------------------------|--|
| Nonvested units outstanding at January 31, 2010 |                            | \$   |
| Granted   | 56,675                     | 16.00  |
| Vested  |                            |  |
| Forfeited                                       | (2,450)                    | 16.00  |
| Nonvested units outstanding at January 29, 2011 | 54,225                     | \$ 16.00   |
| Granted   | 117,631                    | 40.93  |
| Vested  | (50)                       | 16.00  |
| Forfeited                                       | (11,343)                   | 27.05  |
| Nonvested units outstanding at January 28, 2012 | 160,463                    | \$ 33.49   |

*Pre-IPO Awards of Restricted Stock*

In July 2010, the Company granted a total of 1,095,004 restricted-stock awards with an aggregate grant-date fair value of \$15.8 million to certain management-level employees and non-employee directors under the 2010 Restricted Stock Plan. The restrictions on these awards were to lapse after one year or upon an IPO.

In August 2010, the Company repurchased 28,881 of these awards to fund tax payments made by certain award recipients. In October 2010, upon the commencement of the IPO, all of the remaining awards outstanding became fully vested. Accordingly, the Company recognized \$15.8 million of compensation expense related to these awards in the fiscal year ended January 29, 2011. This expense is included in selling, general, and administrative expenses in the Consolidated Statement of Income.



**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

The following table summarizes information about restricted-stock awards as of and for the year ended January 29, 2011:

| <b>Restricted-Stock Awards</b>                   | <b>Number of<br/>Shares</b> | <b>Weighted-Average<br/>Grant Date Fair<br/>Value<br/>(per share)</b> |
|--|-----------------------------|---|
| Nonvested awards outstanding at January 31, 2010 |                             | \$  |
| Granted  | 1,095,004                   | 14.42   |
| Vested   | (1,095,004)                 | 14.42   |
| Forfeited  |                             |   |
| Nonvested awards outstanding at January 29, 2011 |                             | \$  |

No restricted-stock awards were granted, vested, or forfeited for the year ended January 28, 2012.

**11. Commitments and Contingencies**

The Company is subject to various claims and contingencies arising in the normal course of business, including those relating to product liability, legal, employee benefit, regulatory, environmental, and other matters. Management believes that it is not reasonably possible that any of these claims will have a material adverse effect on the Company's financial condition, results of operations, or cash flows.

**12. 401(k) Profit Sharing Plan and Trust**

The Company has a 401(k) profit sharing plan and trust for all qualified employees and provides a 50% match of an employee's contribution to the plan up to a maximum employer contribution of either 10% of the employee's annual compensation or the annual legal allowable contribution limit, whichever is lower. Additionally, the Company has the option of making discretionary profit sharing payments to the plan as approved by the board of directors. As of January 28, 2012, and January 29, 2011, no discretionary profit sharing payments had been approved. Total Company contributions to the plan were as follows (in thousands):

|                                    |          |
|------------------------------------|----------|
| Fiscal year ended January 28, 2012 | \$ 1,231 |
| Fiscal year ended January 29, 2011 | 1,019    |
| Fiscal year ended January 30, 2010 | 800      |

**13. Related-Party Transactions**

The Company leases two of its facilities from a leasing company owned by certain shareholders and directors, as described further in Note 8.

In June 2011, the Company sold certain life insurance policies on the lives of its founders, who are also directors and officers of the Company, to the insureds at the fair market value of \$0.7 million. The cash surrender value of the policies was \$0.6 million, resulting in a \$0.1 million gain. The cash surrender value was included in other assets prior to the sale and the gain on the sale was recorded in other income. Other life insurance policies not purchased by the insureds were terminated.



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For each of the periods presented, the Company made charitable contributions of 10% of the net proceeds from the sale of inventory of certain designated patterns to the Vera Bradley Foundation for Breast Cancer (the Foundation ). The Foundation was founded by two of the Company's directors, who are also on the board of directors of the Foundation. The liability associated with this commitment was approximately \$0.3

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

million and \$0.4 million at January 28, 2012, and January 29, 2011, respectively, which is included in other accrued liabilities in the Consolidated Balance Sheets. The associated expense, which is included in selling, general, and administrative expenses, was as follows (in thousands):

|                                    |          |
|------------------------------------|----------|
| Fiscal year ended January 28, 2012 | \$ 1,046 |
| Fiscal year ended January 29, 2011 | 1,259    |
| Fiscal year ended January 30, 2010 | 694      |

**14. 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. Dilutive potential common shares include outstanding restricted stock and restricted-stock units. The components of basic and diluted net income per share are as follows (\$ in thousands, except per share data):

|  | January 28,<br>2012 | Fiscal Year Ended<br>January 29,<br>2011 | January 30,<br>2010 |
|--|---------------------|--|---------------------|
| <i>Numerator:</i>                                  |                     |  |                     |
| Net income   | \$ 57,921           | \$ 46,198                                | \$ 43,219           |
| <i>Denominator:</i>                                |                     |  |                     |
| Weighted-average number of common shares (basic)   | 40,506,672          | 36,812,570                               | 35,440,547          |
| Dilutive effect of stock-based awards              | 35,630              | 38,345                                   |                     |
| Weighted-average number of common shares (diluted) | 40,542,302          | 36,850,915                               | 35,440,547          |
| <i>Earnings per share:</i>                         |                     |  |                     |
| Basic  | \$ 1.43             | \$ 1.25                                  | \$ 1.22             |
| Diluted  | \$ 1.43             | \$ 1.25                                  | \$ 1.22             |

**15. Segment Reporting**

The Company has two operating segments, which are also its reportable segments, Indirect and Direct. These operating segments are components of the Company for which separate financial information is available and for which operating results are evaluated on a regular basis by the chief operating decision maker in deciding how to allocate resources and in assessing the performance of the segments.

The Indirect segment represents revenues generated through the distribution of Company-branded products to approximately 3,300 specialty Indirect retailers across the United States. The Direct segment includes the Company's full-price and outlet stores, e-commerce activity driven by the Company's website, and the annual outlet sale. Revenues generated through this segment are driven through the sale of Company-branded products from Vera Bradley to end consumers.

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Corporate costs represent the Company's administrative expenses, which include, but are not limited to: human resources, legal, finance, information technology, and various other corporate-level-activity-related expenses. All intercompany-related activities are eliminated in consolidation and are excluded from the segment reporting.

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

Company management evaluates segment operating results based on several indicators. The primary or key performance indicators for each segment are net revenues and operating income. The table below represents key financial information for each of the Company's operating and reportable segments, Direct and Indirect.

The accounting policies of the segments are the same as those described in Note 2. The Company does not report depreciation or amortization expense, total assets, or capital expenditures by segment as such information is neither used by management nor accounted for at the segment level. Net revenues and operating income information for the Company's reportable segments consisted of the following (in thousands):

|                                  | January 28,<br>2012 | Fiscal Year Ended<br>January 29,<br>2011 | January 30,<br>2010 |
|----------------------------------|---------------------|--|---------------------|
| <b>Segment net revenues:</b>     |                     |  |                     |
| Direct                           | \$ 225,287          | \$ 151,118                               | \$ 96,111           |
| Indirect                         | 235,556             | \$ 214,939                               | 192,829             |
| <b>Total</b>                     | <b>\$ 460,843</b>   | <b>\$ 366,057</b>                        | <b>\$ 288,940</b>   |
| <b>Segment operating income:</b> |                     |  |                     |
| Direct                           | \$ 68,097           | \$ 46,443                                | \$ 25,285           |
| Indirect                         | 93,042              | 91,690                                   | 72,649              |
| <b>Total</b>                     | <b>\$ 161,139</b>   | <b>\$ 138,133</b>                        | <b>\$ 97,934</b>    |
| <b>Reconciliation:</b>           |                     |  |                     |
| Segment operating income         | \$ 161,139          | \$ 138,133                               | \$ 97,934           |
| <b>Less:</b>                     |                     |  |                     |
| Unallocated corporate expenses   | (64,968)            | (84,814)                                 | (52,222)            |
| <b>Operating income</b>          | <b>\$ 96,171</b>    | <b>\$ 53,319</b>                         | <b>\$ 45,712</b>    |

Sales outside of the United States were included in the Direct segment.

**16. Quarterly Financial Information (Unaudited)**

The table below sets forth selected quarterly financial data for each of the last two fiscal years (in thousands, except per share data). Each of the quarters presented was thirteen weeks in duration.

|                  | Fiscal Year Ended January 28, 2012 |                                  |                                 |                                  |
|------------------|------------------------------------|----------------------------------|---------------------------------|----------------------------------|
|                  | First<br>Quarter<br>(unaudited)    | Second<br>Quarter<br>(unaudited) | Third<br>Quarter<br>(unaudited) | Fourth<br>Quarter<br>(unaudited) |
| Net revenues     | \$ 101,390                         | \$ 103,789                       | \$ 121,149                      | \$ 134,515                       |
| Gross profit     | 56,444                             | 59,628                           | 65,678                          | 75,873                           |
| Operating income | 19,060                             | 22,926                           | 21,519                          | 32,666                           |

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|                                     |        |        |        |        |
|-------------------------------------|--------|--------|--------|--------|
| Net income                          | 11,224 | 13,633 | 12,962 | 20,102 |
| Basic net income per common share   | 0.28   | 0.34   | 0.32   | 0.50   |
| Diluted net income per common share | 0.28   | 0.34   | 0.32   | 0.50   |

**Table of Contents****Vera Bradley, Inc.****Notes to Consolidated Financial Statements**

|                                     | <b>Fiscal Year Ended January 29, 2011</b> |   |   |   |
|-------------------------------------|---|---|---|---|
|                                     | <b>First<br/>Quarter<br/>(unaudited)</b>  | <b>Second<br/>Quarter<br/>(unaudited)</b> | <b>Third<br/>Quarter <sup>(1)</sup><br/>(unaudited)</b> | <b>Fourth<br/>Quarter<br/>(unaudited)</b> |
| Net revenues                        | \$ 85,002                                 | \$ 80,076                                 | \$ 91,595   | \$ 109,385                                |
| Gross profit                        | 48,813                                    | 46,823                                    | 51,674  | 61,837                                    |
| Operating income (loss)             | 17,301                                    | 9,662                                     | (192)   | 26,547                                    |
| Net income                          | 16,794                                    | 9,170                                     | 5,999   | 14,235                                    |
| Basic net income per common share   | 0.47                                      | 0.26                                      | 0.17  | 0.35                                      |
| Diluted net income per common share | 0.47                                      | 0.26                                      | 0.17  | 0.35                                      |

- (1) As discussed in Notes 2 and 6, during the third quarter of the fiscal year ended January 29, 2011, the Company converted from an S Corporation to a C corporation for income-tax purposes. Also during that quarter, as discussed in Note 10, the Company recognized \$21.9 million of compensation expense related to restricted-stock awards.

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**Table of Contents**

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

***Disclosure Controls and Procedures***

Based on the evaluation of the Company's disclosure controls and procedures, as that term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), each of Michael C. Ray, the Chief Executive Officer of the Company, and Jeffrey A. Blade, the Chief Financial and Administrative Officer of the Company, has concluded that the Company's disclosure controls and procedures are effective as of January 28, 2012.

***Management's Report on Internal Control over Financial Reporting***

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles. Management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission in *Internal Control-Integrated Framework*. Based on the results of that evaluation, management has concluded that such internal control over financial reporting was effective as of January 28, 2012.

The effectiveness of the Company's internal control over financial reporting as of January 28, 2012 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears on page 47 of this Annual Report on Form 10-K.

***Changes in Internal Control over Financial Reporting***

There were no changes in internal control over financial reporting that occurred during the fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

None.

**Table of Contents****PART III****Item 10. Executive Officers and Corporate Governance  
Directors and Executive Officers**

The following table sets forth certain information concerning each of our executive officers:

| <b>Name</b>               | <b>Age</b> | <b>Position(s)</b>  |
|---------------------------|------------|---|
| Michael C. Ray            | 51         | Chief Executive Officer and Director                                |
| Barbara Bradley Baekgaard | 73         | Co-Founder, Chief Creative Officer, and Director                    |
| Patricia R. Miller        | 73         | Co-Founder, National Spokesperson, and Director                     |
| Jeffrey A. Blade          | 50         | Executive Vice President Chief Financial and Administrative Officer |
| Kimberly F. Colby         | 50         | Executive Vice President Design                                     |
| C. Roddy Mann             | 42         | Executive Vice President Strategy & Business Development            |
| Jill A. Nichols           | 51         | Executive Vice President Philanthropy and Community Relations       |
| Matthew C. Wojewuczki     | 42         | Executive Vice President Operations                                 |

*Michael C. Ray* has served as our Chief Executive Officer since 2007 and as a director since June 2010. From 2004 to 2007, Mr. Ray served as our Executive Vice President of Sales and Marketing. From 1999 to 2004, he served as our National Sales Director. Mr. Ray joined Vera Bradley in 1998 as Director of Finance and served us in that capacity until being promoted to National Sales Director in 1999. He is a board member of the Riley Children's Foundation in Indianapolis, Indiana.

Mr. Ray has been instrumental in our growth and the development and execution of our long-term strategic plans. He provides our board of directors with an in-depth knowledge of our products, industry, challenges, and opportunities, and he communicates management's perspective on important matters.

*Barbara Bradley Baekgaard* co-founded Vera Bradley in 1982 and has served as a director since then. From 1982 through June 2010, she also served as Co-President. From the outset, Ms. Bradley Baekgaard has provided leadership and strategic direction in our brand's development by providing creative vision to areas such as marketing, product design, assortment planning, and the design and visual merchandising of our stores. In May 2010, she was appointed Chief Creative Officer. She currently serves as a board member of the Indiana University Cancer Center Development and the Vera Bradley Foundation for Breast Cancer. Ms. Bradley Baekgaard's most recent personal awards include 2007 Country Living Entrepreneur Award and 2006 Gifts and Decorative Accessories Industry Achievement Award.

As Co-Founder of Vera Bradley, Ms. Bradley Baekgaard serves a key leadership role on our board of directors and provides the board with a broad array of institutional knowledge and historical perspective as well as an in-depth knowledge of business strategy, branding, product development, and store design.

*Patricia R. Miller* co-founded Vera Bradley in 1982 and has served as a director since then. From 1982 through June 2010, she also served as Co-President. From the outset, Ms. Miller has provided leadership and strategic direction to the business, guiding the development of our operations and supply chain infrastructure and the growth of our employee base. Ms. Miller has also regularly provided a face for Vera Bradley. In June 2010, she was appointed National Spokesperson for the company where she will continue to promote our brand. Ms. Miller served as the first Secretary of Commerce for the State of Indiana and the Chief Executive Officer of the Indiana Economic Development Corporation from 2005 to 2006. Her most recent personal awards include the Ball State University Indiana Women of Achievement Award for Entrepreneurship in 2006 and the Indiana Historical Society Indiana Living Legend Award in 2008. Ms. Miller serves as a director for the Indiana University Foundation and for the Vera Bradley Foundation for Breast Cancer.



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**Table of Contents**

As Co-Founder of Vera Bradley, Ms. Miller brings to our board of directors a broad array of institutional knowledge and historical perspective. Ms. Miller also provides insight and perspective on general strategic and business matters, stemming from her executive and finance experience as Secretary of Commerce for the State of Indiana and as Chief Executive Officer of the Indiana Economic Development Corporation.

*Jeffrey A. Blade* has served as our Executive Vice President – Chief Financial and Administrative Officer since May 2010. Prior to joining Vera Bradley, from 2009 to January 2010 Mr. Blade served as Senior Vice President – Chief Financial Officer and Secretary of Central Garden and Pet Company, a publicly traded consumer goods retailer. Mr. Blade previously served in various roles at Steak 'n Shake from 2004 to 2008, including Interim President, Executive Vice President – Chief Financial and Administrative Officer, and Senior Vice President and Chief Financial Officer. From 1999 to 2004, Mr. Blade was Vice President of Finance for the U.S. operations of Cott Corporation. He served in various financial roles for Kraft Foods Corporation from 1988 to 1999.

*Kimberly F. Colby* has served as our Executive Vice President – Design since 2005. From 2003 through 2005, she served as our Vice President of Design. From 1989 to 2003, Ms. Colby served as our Design Director responsible for Marketing and Product Development. Ms. Colby's professional history includes retail advertising, public relations, direct mail creative direction and management, special event planning, and interior design.

*C. Roddy Mann* has served as our Executive Vice President – Strategy and Business Development since April 2010 and is responsible for the development of our strategies and new business opportunities in both our Indirect and Direct channels. From 2007 to April 2010, Mr. Mann served as our Vice President – Strategy, Sales and Marketing. From 2006 to 2007, he served as Vice President – Strategic Initiatives. Prior to joining Vera Bradley, Mr. Mann was a Vice President at LakeWest Group, a consulting firm based in Cleveland, Ohio, from 1999 to 2006. In 2006, in a consulting capacity, Mr. Mann assisted us with the development of our Direct retail store strategy and execution plans.

*Jill A. Nichols* has served as our Executive Vice President – Philanthropy and Community Relations since April 2010. From 1997 to April 2010, Ms. Nichols served as our Executive Vice President and Chief Operating Officer. From 1992 to 1997, she served as our Director of Operations and, from 1989 to 1992, she served as our Controller and Operations Manager. Prior to joining Vera Bradley, Ms. Nichols held finance positions with the YWCA and Coopers & Lybrand (which later merged with Price Waterhouse to become PricewaterhouseCoopers). She became a Certified Public Accountant in 1986. Ms. Nichols serves as the treasurer and a director of the Vera Bradley Foundation for Breast Cancer.

*Matthew C. Wojewuczki* has served as our Executive Vice President – Operations since April 2010. From 2003 to April 2010, Mr. Wojewuczki served as our Vice President – Operations. Prior to joining Vera Bradley, he served as Vice President of Manufacturing and Supply Chain Management of Wabash Alloys, a secondary aluminum producer, from 2000 to 2003. From 1997 to 2000, he served as a principal consultant in the Management Consulting Services Group of PricewaterhouseCoopers. In addition, Mr. Wojewuczki is a Commissioned Officer in the U.S. Air Force Reserves, where he holds the rank of Major.

The information set forth in the Proxy Statement for the 2012 Annual Meeting of Shareholders under the headings – Family Relationships, Section 16(a) Beneficial Ownership Reporting Compliance, Code of Ethics, and Committees – Audit Committee is incorporated herein by reference. The Proxy Statement will be filed with the Commission within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

**Table of Contents**

**Item 11. Executive Compensation**

The information set forth in the Proxy Statement for the 2012 Annual Meeting of Shareholders under the heading "Executive Compensation Discussion and Analysis" is incorporated herein by reference. The Proxy Statement will be filed with the Commission within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information set forth in the Proxy Statement for the 2012 Annual Meeting of Shareholders under the heading "Share Ownership by Certain Beneficial Owners and Management" is incorporated herein by reference. The Proxy Statement will be filed with the Commission within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information set forth in the Proxy Statement for the 2012 Annual Meeting of Shareholders under the headings "Certain Relationships and Related Party Transactions" and "Board Independence" is incorporated herein by reference. The Proxy Statement will be filed with the Commission within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

**Item 14. Principal Accounting Fees and Services**

The information required by this item is incorporated herein by reference to our 2012 Proxy Statement under the caption "Principal Accounting Fees and Services." The Proxy Statement will be filed with the Commission within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

**Table of Contents**

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

**(1) Consolidated Financial Statements**

The following consolidated financial statements of Vera Bradley, Inc. are filed as part of this report under Item 8. Financial Statements and Supplementary Data:

|  |    |
|--|----|
| <u>Report of Independent Registered Public Accounting Firm</u>   | 47 |
| <u>Consolidated Balance Sheets as of January 28, 2012, and January 29, 2011</u>  | 48 |
| <u>Consolidated Statements of Income for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010</u>               | 49 |
| <u>Consolidated Statements of Shareholders' Equity for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010</u> | 50 |
| <u>Consolidated Statements of Cash Flows for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010</u>           | 51 |
| <u>Notes to Consolidated Financial Statements</u>  | 52 |

**(2) Financial Statement Schedules**

Financial statement schedules have been omitted because they are not required or are not applicable or because the information required in those schedules either is not material or is included in the consolidated financial statements or the accompanying notes.

**(3) List of Exhibits**

The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference as part of this Form 10-K.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 27, 2012.

Vera Bradley, Inc.

/s/ Jeffrey A. Blade  
 Jeffrey A. Blade  
 Executive Vice President Chief Financial and

Administrative Officer

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Jeffrey A. Blade and Michael C. Ray, and each of them, as his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place, and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on March 27, 2012.

| <b>Signature</b>   | <b>Title</b>   |
|--|--|
| /s/ Michael C. Ray<br>Michael C. Ray                       | Director and Chief Executive Officer (principal executive officer)                                   |
| /s/ Barbara Bradley Baekgaard<br>Barbara Bradley Baekgaard | Director   |
| /s/ Patricia R. Miller<br>Patricia R. Miller               | Director   |
| /s/ Jeffrey A. Blade<br>Jeffrey A. Blade                   | Executive Vice President Chief Financial and Administrative Officer<br>(principal financial officer) |
| /s/ Richard Baum<br>Richard Baum                           | Director   |
| /s/ Stephen J. Hackman                                     | Director   |

Stephen J. Hackman

**Table of Contents**

| <b>Signature</b>       | <b>Title</b>  |
|------------------------|---|
| /s/ Robert J. Hall     | Director  |
| Robert J. Hall         |   |
| /s/ John E. Kyees      | Director  |
| John E. Kyees          |   |
| /s/ Matthew McEvoy     | Director  |
| Matthew McEvoy         |   |
| /s/ P. Michael Miller  | Director  |
| P. Michael Miller      |   |
| /s/ Frances P. Philip  | Director  |
| Frances P. Philip      |   |
| /s/ Edward M. Schmults | Director  |
| Edward M. Schmults     |   |
| /s/ Kevin J. Sierks    | Vice President    Controller (chief accounting officer) |
| Kevin J. Sierks        |   |

**Table of Contents**

**EXHIBIT INDEX**

**Description**

and Restated Articles of Incorporation (Incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1, Registration No. 333-167934)

Restated Bylaws (Incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-1, Registration No. 333-167934)

Common Stock Certificate (Incorporated by reference to Exhibit 4.1 to the Registration Statement on Form S-1, Registration No. 333-167934)

2010 Equity and Incentive Plan (Incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-1, Registration No. 333-167934)

with Jeffrey A. Blade (Incorporated by reference to Exhibit 10.2 to the Registration Statement on Form S-1, Registration No. 333-167934)

Vera Bradley Designs, Inc. 2010 Restricted Stock Plan (Incorporated by reference to Exhibit 10.3 to the Registration Statement on Form S-1, Registration No. 333-167934)

Stock Award Agreement under Vera Bradley Designs, Inc. 2010 Restricted Stock Plan (Incorporated by reference to Exhibit 10.4 to the Registration Statement on Form S-1, Registration No. 333-167934)

License Agreement (Incorporated by reference to Exhibit 10.5 to the Registration Statement on Form S-1, Registration No. 333-167934)

Restated Credit Agreement dated as of October 4, 2010 among Vera Bradley Designs, Inc. and JPMorgan Chase Bank, N.A. (Incorporated by reference to Exhibit 10.6 to the Registration Statement on Form S-1, Registration No. 333-167934)

Letter of Intent dated as of October 4, 2010 made by Vera Bradley, Inc. in favor of JPMorgan Chase Bank, N.A. (Incorporated by reference to Exhibit 10.7 to the Registration Statement on Form S-1, Registration No. 333-167934)

Guaranty and Security Documents dated as of October 4, 2010 by Vera Bradley Designs, Inc., Vera Bradley Retail Stores, LLC and Vera Bradley International, LLC (Incorporated by reference to Exhibit 10.13 to the Registration Statement on Form S-1, Registration No. 333-167934)

License Agreement (filed as Exhibit D to Exhibit 1.1) (Incorporated by reference to Exhibit 10.15 to the Registration Statement on Form S-1, Registration No. 333-167934)

License Agreement (Incorporated by reference to Exhibit 10.16 to the Registration Statement on Form S-1, Registration No. 333-167934)

Purchase Agreement (Incorporated by reference to Exhibit 10.17 to the Registration Statement on Form S-1, Registration No. 333-167934)

Stock Unit Terms And Conditions for Employees (Incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2011)

Stock Unit Terms And Conditions for Non-Employee Directors (Incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2011)

Lease Agreement dated as of March 28, 2011, by and between Vera Bradley Designs, Inc., as tenant, and Great Dane Realty, LLC, as landlord (Incorporated by reference to Exhibit 10.8 to the Registration Statement on Form S-1, Registration No. 333-167934)

**Table of Contents**

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 10.15              | Lease Extension, dated April 19, 2011, by and between Vera Bradley, Inc., as tenant, and Milburn, LLC, as landlord (Incorporated by reference to Exhibit 10.5 to the Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2011)   |
| 10.16              | Underwriting Agreement, dated April 13, 2011, with Robert W. Baird & Co. Incorporated, Piper Jaffray & Co. and the underwriters named therein (Incorporated by reference to Exhibit 10.6 to the Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2011)  |
| 21.1*              | Subsidiaries of Vera Bradley, Inc.  |
| 23.1*              | Consent of PricewaterhouseCoopers LLP   |
| 31.1*              | Rule 13a-14(a)/15d-4(a) Certification of Chief Executive Officer  |
| 31.2*              | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer   |
| 32.1*              | Section 1350 Certifications   |
| 101                | The following materials from the Vera Bradley, Inc. s Annual Report on Form 10-K for the year ended January 28, 2012 formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Statements of Operations and Comprehensive Income for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010; (ii) Consolidated Balance Sheets as of January 28, 2012, and January 29, 2011; (iii) Consolidated Statements of Shareholders Equity for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010; (iv) Consolidated Statements of Cash Flows for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010; and (v) related notes, tagged as blocks of text. ** |

\* Filed herewith

\*\* Pursuant to Rule 406T of SEC Regulation S-T, the Interactive Data Files included as Exhibit 101 hereto 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, 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 these Sections.