

bebe stores, inc.
Form 10-Q
February 10, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2016

OR

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

Commission File Number 0-24395

bebe stores, inc.
(Exact name of registrant as specified in its charter)

California 94-2450490
(State or Jurisdiction of (IRS Employer
Incorporation or Organization) Identification Number)
400 Valley Drive
Brisbane, California 94005
(Address of principal executive offices)
Telephone: (415) 715-3900

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

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

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

Large accelerated filer Accelerated filer

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

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

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The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of January 31, 2017 was 8,066,805.

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PART I. FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements

bebe stores, inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(unaudited)

	As of December 31, 2016	As of July 2, 2016	As of January 2, 2016
Assets:			
Current assets:			
Cash and equivalents	\$66,792	\$55,525	\$43,372
Available for sale securities	—	—	5,070
Receivables	8,411	8,502	6,055
Inventories, net	23,250	28,736	28,282
Prepaid and other	5,166	10,498	14,665
Total current assets	103,619	103,261	97,444
Available for sale securities	—	—	5,166
Property and equipment, net	62,585	72,623	83,306
Other assets	2,681	3,561	3,673
Total assets	\$168,885	\$179,445	\$189,589
Liabilities and Shareholders' Equity:			
Current liabilities:			
Accounts payable	\$12,987	\$11,263	\$14,760
Accrued liabilities and other	24,027	21,510	25,407
Total current liabilities	37,014	32,773	40,167
Deferred rent and other lease incentives	15,977	17,983	20,741
Uncertain tax positions	86	85	83
Total liabilities	53,077	50,841	60,991
Commitments and contingencies			
Shareholders' equity:			
Preferred stock-authorized 1,000,000 shares at \$0.001 par value per share; no shares issued and outstanding	—	—	—
Common stock-authorized 14,000,000 shares at \$0.001 par value per share; issued and outstanding 8,067,174; 8,005,116 and 8,002,444 shares	8	8	8
Additional paid-in capital	147,966	147,585	147,001
Accumulated other comprehensive income (loss)	561	728	(3,577)
Retained earnings (accumulated deficit)	(32,727)	(19,717)	(14,834)
Total shareholders' equity	115,808	128,604	128,598
Total liabilities and shareholders' equity	\$168,885	\$179,445	\$189,589

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except per share data)

(unaudited)

	Three Months Ended		Six Months Ended	
	December	January 2,	December	January 2,
	31, 2016	2016	31, 2016	2016
Net sales	\$101,931	\$122,447	\$189,169	\$218,730
Cost of sales, including production and occupancy	66,903	80,767	126,647	149,188
Gross margin	35,028	41,680	62,522	69,542
Selling, general and administrative expenses	41,399	47,116	77,119	92,006
Operating loss	(6,371)	(5,436)	(14,597)	(22,464)
Interest and other income (loss), net	121	8	136	(79)
Loss from operations, before income taxes	(6,250)	(5,428)	(14,461)	(22,543)
Income tax provision (benefit)	10	30	27	57
Earnings in equity method investment	\$1,029	\$—	\$1,479	\$—
Net loss	\$(5,231)	\$(5,458)	\$(13,009)	\$(22,600)
Net Loss per share amounts:				
Basic	\$(0.65)	\$(0.68)	\$(1.62)	\$(2.83)
Diluted	\$(0.65)	\$(0.68)	\$(1.62)	\$(2.83)
Basic weighted average shares outstanding	8,040	7,989	8,023	7,981
Diluted weighted average shares outstanding	8,040	7,989	8,023	7,981
Other comprehensive income (loss)				
Unrealized loss on available for sale securities	\$—	\$(124)	\$—	\$(75)
Foreign currency translation adjustments	(101)	(678)	(168)	(1,726)
Other comprehensive income (loss)	(101)	(802)	(168)	(1,801)
Comprehensive loss	\$(5,332)	\$(6,260)	\$(13,177)	\$(24,401)

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Six Months Ended	
	December 31, 2016	January 2, 2016
Cash flows from operating activities:		
Net loss	\$(13,009)	\$(22,600)
Adjustments to reconcile net loss to cash used by operating activities:		
Stock compensation expense	602	1,421
Depreciation and amortization	8,527	10,302
Non-cash charge for asset impairment	2,673	3,493
Earnings in equity method investment	(1,479)	—
Cash receipt from equity method investment	1,850	—
Other	(259)) 130
Changes in operating assets and liabilities:		
Receivables	91	1,058
Inventories	5,470	2,980
Prepaid expenses and other	5,796	(3,687)
Accounts payable	1,607	2,365
Deferred rent and other lease incentives	(1,542)) (3,082)
Accrued liabilities	2,755	(2,110)
Net cash provided (used) by operating activities	13,082	(9,730)
Cash flows from investing activities:		
Purchase of property and equipment and store construction deposits	(1,723)) (5,134)
Proceeds from sales of investment securities	—	11,411
Net cash provided (used) by investing activities	(1,723)) 6,277
Cash flows from financing activities:		
Proceeds from issuance of common stock	2	8
Net cash provided (used) by financing activities	2	8
Net decrease in cash and equivalents	11,361	(3,445)
Effect of exchange rate changes on cash	(94)) (130)
Cash and equivalents:		
Beginning of period	55,525	46,947
End of period	\$66,792	\$43,372
See accompanying notes to condensed consolidated financial statements.		

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
INTERIM FINANCIAL STATEMENTS

The accompanying condensed consolidated balance sheets of bebe stores, inc. (the "Company") as of December 31, 2016 and January 2, 2016, the condensed consolidated statements of operations and comprehensive loss for the three and six months ended December 31, 2016 and January 2, 2016 and the condensed consolidated statements of cash flows for the six months ended December 31, 2016 and January 2, 2016 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, without audit. Accordingly, they do not include all of the information required by accounting principles generally accepted in the United States of America for annual financial statements. Therefore, these condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended July 2, 2016.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to present fairly the financial position at the balance sheet dates and the results of operations for the periods presented have been included. The condensed consolidated balance sheet at July 2, 2016, presented herein, was derived from the audited balance sheet included in the Company's Annual Report on Form 10-K for the fiscal year ended July 2, 2016. The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. The results for the periods presented are not necessarily indicative of future financial results.

The Company has incurred net losses and cash used in operating activities in fiscal 2016, 2015 and 2014. Cash and equivalents were \$55.5 million as of July 2, 2016. During the six months ended December 31, 2016, net loss was \$13.0 million however the Company generated net cash from operating activities totaling \$13.1 million. As a result, cash and equivalents were \$66.8 million as of December 31, 2016.

The Company used, \$38.6 million, \$25.0 million and \$30.3 million net of cash in operating activities in the fiscal years 2016, 2015 and 2014 respectively. The Company's liquidity is dependent upon its ability to generate cash from operations along with usage of existing cash and cash equivalents. The strategic focus for the remainder of fiscal 2017 is to close unprofitable stores or negotiate rent reductions for stores with kickout rights or where the store lease is up for renewal. In addition, the Company continues to limit the size of the investment in inventory and capital expenditures. The Company is also expecting significant savings in selling, general and administrative expenses as compared with the prior year from the corporate restructuring activities which occurred in fiscal 2016 including headcount reductions. The Company believes its cash and equivalents, together with cash flows from operations, will be sufficient to meet its operating and capital requirements for at least the next twelve months. Future operating and capital requirements, however, will depend on numerous factors, including without limitation, investment costs for management information systems, potential investments and/or licensing arrangements, and future results of operations. The inability to generate positive cash flow from operations could have a material adverse effect on the Company's business and financial conditions.

FISCAL YEAR

The Company's fiscal year is a 52 or 53 week period, each period ending on the first Saturday on or after June 30. Fiscal years 2017 and 2016 both include 52 weeks.

The three month periods ended December 31, 2016 and January 2, 2016 each include 13 weeks. The six month periods ended December 31, 2016 and January 2, 2016 each included 26 weeks.

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

RECENT ACCOUNTING PRONOUNCEMENTS

Stock Compensation

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09, "Compensation - Stock Compensation (Topic 718)", which is part of the FASB's Simplification

Initiative. The updated guidance simplifies the accounting for share-based payment transactions. The amended guidance is effective for fiscal

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years, and interim periods within those years, beginning with fiscal 2018, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

Leases
In February 2016 the FASB issued ASU 2016-02, "Leases". This standard requires lessees to put most leases on their balance sheets as a right-to-use asset and a lease liability, but to continue to recognize expenses in the statements of operations in a manner similar to current accounting. The Company will adopt this standard at the beginning of fiscal year 2020 and is currently assessing the impact to the consolidated financial statements, but due to the number of leases the Company has, adoption of the standard will result in an increase in long-term assets and liabilities.

Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers", or ASU 2014-09, which states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this, an entity will need to: identify the contract with a customer; identify the separate performance obligations in the contract; determine the transaction price; allocate the transaction price to the separate performance obligation in the contract; and recognize revenue when (or as) the entity satisfies each performance obligation. ASU No. 2014-09 will be effective beginning with fiscal year 2019. The Company is currently assessing its approach to the adoption of this standard and the impact on the results of operations and financial position.

Inventory

In July 2015, the FASB issued ASU No. 2015-11, "Simplifying the Measurement of Inventory". The new standard amends the guidelines for the measurement of inventory from lower of cost or market to the lower of cost and net realizable value (NRV). NRV is defined as the estimated selling prices in the ordinary course of business less reasonably predictable costs of completion, disposal and transportation. Under existing standards, inventory is measured at lower of cost or market, which requires the consideration of replacement cost, NRV and NRV less an amount that approximates a normal profit margin. This ASU eliminates the requirement to determine and consider replacement cost or NRV less an approximately normal profit margin for inventory measurement. The new standard is effective prospectively at the beginning of fiscal year 2018. The Company is currently evaluating the impact, if any, of adopting this new accounting guidance on its results of operations and financial position.

INVESTMENTS

As of December 31, 2016, the Company held no investments in auction rate securities nor any other marketable securities. As of January 2, 2016, the Company's investment portfolio consisted of certificates of deposit and auction rate securities. The Company held short term available for sale securities totaling \$5.1 million as of January 2, 2016, that consisted entirely of certificates of deposit at cost which approximates fair value. The Company also held long term available for sale securities at fair value totaling \$5.2 million as of January 2, 2016, that consisted entirely of interest bearing auction rate securities ("ARS").

The Company held interest bearing ARS consisting of federally insured student loan backed securities. As of January 2, 2016, the Company's ARS portfolio totaled approximately \$9.0 million and was classified as available for sale securities, net of a temporary impairment charge of \$3.8 million. As of that date, the Company's ARS portfolio consisted of approximately 22% A rated investments and 78% CCC rated investments. The Company's ARS were sold during the third quarter of fiscal 2016.

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

The following is a summary of the Company's available for sale securities:

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As of January 2, 2016				
Cost	Unrealized Losses		Estimated Fair Value	
	Less Than 12 Months	Months or Greater		
(In thousands)				
Short term certificates of deposit	\$ 5,070	\$ —	\$ 5,070	
Long term auction rate securities	\$ 9,000	\$ 3,834	\$ 5,166	

FAIR VALUE MEASUREMENTS

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

As of December 31, 2016, the Company held financial instruments that are measured at fair value on a recurring basis. These included cash equivalents consisting of money market funds.

The Company determined the estimated fair value of its investment in ARS by reviewing trading activity for similar securities in secondary markets as well as by using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for liquidity (average of LIBOR +6.09%), interest rates (weighted average of 0.2%), timing (range from 9 – 13 years), credit ratings and amount of cash flows and expected holding periods of the ARS and recent trading activity in the secondary marketplace.

The following items are measured at fair value on a recurring basis as of December 31, 2016:

Description	December 31, 2016	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements at reporting date				
(In thousands)				
Cash equivalents	\$ 236	\$ 236	\$ —	\$ —
Total	\$ 236	\$ 236	\$ —	\$ —

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The following items are measured at fair value on a recurring basis as of July 2, 2016:

Description	July 2, 2016	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements at reporting date (In thousands)				
Cash equivalents	\$ 236	\$ 236	\$ —	\$ —
Total	\$ 236	\$ 236	\$ —	\$ —

The following items are measured at fair value on a recurring basis as of January 2, 2016:

Description	January 2, 2016	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements at reporting date (In thousands)				
Cash equivalents	\$ 426	\$ 426	\$ —	\$ —
Current available for sale securities	5,070	—	5,070	—
Non-current available for sale securities	5,166	—	—	5,166
Total	\$ 10,662	\$ 426	\$ 5,070	\$ 5,166

During the quarter ended December 31, 2016, there were no transfers of assets and liabilities between Level 1 (quoted prices in active markets for identical assets) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy. An impairment charge was recorded in accumulated other comprehensive income that reduced the carrying amount of the applicable non-current assets of \$9.0 million to their fair value of \$5.2 million as of January 2, 2016.

Non-Financial Assets:

The Company measures certain non-financial assets and liabilities, including long-lived assets, at fair value on a non-recurring basis. During the three months ended December 31, 2016 and January 2, 2016, the Company recorded impairment charges of approximately \$1.9 million and \$2.0 million, respectively, related to under-performing stores. During the six months ended December 31, 2016 and January 2, 2016, the Company recorded impairment charges of approximately \$2.7 million and \$3.5 million, respectively, related to under-performing stores.

The following table presents the Company's considerations of at-risk assets for the three month and six month periods ended December 31, 2016 and January 2, 2016, respectively (amounts in millions, except for store count):

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	Three Months Ended		Six Months Ended	
	December 31, 2016	January 2, 2016	December 31, 2016	January 2, 2016
Number of stores identified as at risk and evaluated for impairment	9	14	13	21
Number of stores identified as at risk, but not impaired	(2)	(3)	(2)	(4)
Number of stores identified as at risk with impairment	7	11	11	17
Total carrying amount of stores identified as at risk prior to any impairment charges taken	\$2.4	\$ 2.9	\$3.2	\$ 4.7
Total carrying amount of stores identified as at risk, but not impaired	(0.3)	(0.9)	(0.3)	(1.2)
Total carrying amount of stores identified for impairment	2.1	2.0	2.9	3.5
Impairment charges recorded during the period	(1.9)	(2.0)	(2.7)	(3.5)
Remaining carrying amount of stores identified for impairment after impairment charges taken	\$0.2	\$ —	\$0.2	\$ —

The fair market value of these assets was determined using the income approach and level 3 inputs, which require management to make significant estimates about future operating plans and projected cash flows. Management estimates the amount and timing of future cash flows based on its experience and knowledge of the retail market in which each store operates. The assumptions used in preparing the discounted cash flow model and the related sensitivity analysis around the discounted cash flow model include estimates for weighted average cost of capital 11.0% and annual revenue growth rates (range from 0.0% – 5.0%). The stores not impaired had undiscounted cash flows that exceeded their net carrying amount at a weighted average of 101% and 180% for the three and six month periods ended December 31, 2016, respectively. For the three and six month periods ended January 2, 2016, the stores not impaired had undiscounted cash flows that exceeded their net carrying amount at a weighted average of 453% and 340%, respectively.

The impairment charge is included in selling, general and administrative expenses (“SG&A”) in the accompanying condensed consolidated statements of operations and comprehensive loss. The Company was not required to measure any other significant non-financial assets and liabilities at fair value.

INVENTORIES

The Company’s inventories consisted of:

	As of		
	December 31, 2016	July 2, 2016	January 2, 2016
	(In thousands)		
Raw materials	\$1,060	\$903	\$833
Merchandise available for sale	22,190	27,833	27,449
Inventories, net	\$23,250	\$28,736	\$28,282

LETTERS OF CREDIT

The Company has a secured stand-by letter of credit agreement which provides for issuance of one or more stand-by and commercial letters of credit. As of December 31, 2016, the Company had \$4.9 million outstanding, related to four stand-by letters of credit. To date, no beneficiary has drawn upon any stand-by letters of credit.

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Deferred income taxes arise from temporary differences between the tax and financial statement recognition of revenue and expenses. The Company regularly assesses the need for a valuation allowance against its deferred tax assets. In evaluating whether it is more likely than not that some or all of the Company's deferred tax assets will not be realized, it considers all available positive and negative evidence, including recent year's operational results which is objectively verifiable evidence. As a result of its evaluation of the realizability of its deferred tax assets as of December 31, 2016, the Company continues to believe, based upon all available evidence, that it is more likely than not that the majority of its deferred tax assets will continue to not be realized. Accordingly, the tax benefit related to the current quarter losses is not recognized. The Company will continue to maintain a valuation allowance against its deferred tax assets until the Company believes it is more likely than not that these assets will be realized in the future. If sufficient positive evidence arises in the future indicating that all or a portion of the deferred tax assets meet the more likely than not standard, the valuation allowance will be reversed accordingly in the period that such determination is made.

EARNINGS PER SHARE

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

There is no difference between the number of shares used in the basic and diluted earnings per share computations. Excluded from the computation of the number of diluted weighted average shares outstanding were options and awards to purchase 389,453 and 388,846 shares of common stock for the three months ended December 31, 2016 and January 2, 2016, respectively, and 312,572 and 395,102, for the six months ended December 31, 2016 and January 2, 2016, respectively, which would have been anti-dilutive.

REVERSE

STOCK SPLIT

Pursuant to the authorization provided in the 2016 Annual Meeting of the Shareholders on December 6th, 2016 the Company completed a 10 for 1 reverse stock split of the shares of the Company's common stock on December 8th, 2016.

As a result of the reverse stock split every 10 shares of issued and outstanding common stock were combined into one issued and outstanding share of common stock of without any change in the par value per share. No fractional shares were issued as a result of the reverse stock split and any fractional shares that would have resulted from the reverse stock split was paid in cash.

The reverse stock split reduced the number of shares of common stock outstanding from approximately 80 million shares to approximately 8 million shares. Prior periods have been adjusted to reflect the effect of the reverse split.

The Company's common stock began trading on a reverse stock split-adjusted basis on the NASDAQ on December 9th, 2016. Since the par value of the Common Stock remained at .001 per share the value for the "Common Stock" recorded to the Company's Balance Sheet has been retroactively reduced to reflect the par value of restated outstanding shares with a corresponding increase to "Additional Paid in Share Capital".

STOCK BASED COMPENSATION

The following table summarizes the stock based compensation expense recognized under the Company's stock plan during the three and six months ended December 31, 2016 and January 2, 2016:

	Three Months Ended	Six Months Ended
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Unrecognized compensation cost related to nonvested stock options and nonvested stock awards/units totaled approximately \$0.0 million and \$0.6 million, respectively, as of December 31, 2016. This cost is expected to be recognized over a weighted average period of 0.8 years and 2.24 years, respectively. There were no stock options granted during the three and six months ended December 31, 2016 and during the three and six months ended January 2, 2016.

LEGAL MATTERS

Legal Proceedings:

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

A former employee filed a complaint against the Company on November 2, 2010, in the Superior Court of California, San Bernardino County (Case No. CIVRS1011823) alleging failure to pay wages, failure to provide meal and rest periods, and other violations of the California Labor Code and Business & Professions Code §17200 et. seq. The plaintiff purported to bring the action on behalf of current and former California bebe stylists and sales associates who are similarly situated. The complaint sought damages, civil penalties, and injunctive relief among other remedies. The Company continues to defend itself against the claims. Discovery is continuing. Trial is set for September 11, 2017. The Company is unable to estimate an amount or range of any reasonably possible losses.

A customer served the Company with a complaint on January 31, 2014, in the United States District Court for the Northern District of California (Civil Action No. C14-267 DMR) alleging various violations of the Telephone Consumer Protection Act (47 U.S.C. §§227 et seq.) and violations of California's unfair competition law (California Business and Professions Code §§ 17200, et seq.) stemming from an alleged failure to obtain customer consent prior to sending text messages. The plaintiff purported to bring the action on behalf of others similarly situated. The complaint sought damages and injunctive relief among other remedies. Discovery is continuing. There is no trial date set. The Company continues to defend itself against the claims. The Company is unable to estimate an amount or range of any reasonably possible losses. A companion proceeding, previously reported, in the United States District Court for the Northern District of California (Civil Action No. 3:14-CV-01968)) was consolidated with this action.

The Company is subject to various other legal proceedings and claims arising in the ordinary course of business. Regarding all matters referenced herein, the Company intends to defend itself vigorously and has accrued estimated amounts of liability where required, appropriate and determinable. Any such estimates may be revised as further information becomes available. The results of any litigation are inherently uncertain and as such the Company cannot assure that it will be able to successfully defend itself in these lawsuits nor that any amounts accrued are sufficient. The Company believes that the legal proceedings referenced herein, as well as the amounts accrued as of this filing, either individually or in the aggregate, will not have a material adverse effect on our business, financial condition or results of operations.

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

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

OVERVIEW

We design, develop and produce a distinctive line of contemporary women's apparel and accessories that is unique, sophisticated and timelessly sexy. Today bebe continues to define next-generation chic while staying true to its assertive, provocative origins. Inspired by Shakespeare's immortal words "To be, or not to be", the brand is, at its essence, about living, standing out and truly existing.

Our distinctive product offering includes a full range of separates, tops, dresses, active wear and accessories to satisfy our customers' every day wardrobe needs for a variety of occasions. We design and develop the majority of our merchandise in-house, which is manufactured to our specifications. However, we also source directly from third-party manufacturers. In fiscal 2017, we began to start selling co-branded and third-party labeled product as well, although we expect the majority of our product to continue to have the bebe brand. We also sell licensed product through a strategic partnership.

We market our products under the bebe and BEBE SPORT brand names through our 180 retail stores, of which 142 are bebe stores, including an on-line store at www.bebe.com, and 38 are bebe outlet stores. Our 81 international licensees operated stores in 22 countries and, pursuant to our product licensing, through certain select domestic and international retailers. During the three months ended December 31, 2016, we closed 1 bebe store, and during the six months ended December 31, 2016, we closed 4 bebe stores and 1 outlet store. Continuing our previous efforts to rightsize our store fleet, we anticipate closing up to 25 stores during fiscal 2017.

bebe. We were founded by Manny Mashouf, our CEO and Chairman of the Board. We opened our first store in San Francisco, California in 1976, which was also the year we incorporated in California. As of December 31, 2016, we operated 142 bebe stores in 31 states, Puerto Rico, and Canada and on-line. www.bebe.com is our bebe on-line retail store and an extension of the bebe store experience that provides a complete assortment of bebe and BEBE SPORT merchandise and is used as a vehicle to communicate with our customers.

bebe outlet. Our bebe outlet stores are an extension of the full-price bebe store and provide everyday lifestyle offerings for our aspirational buyers. As of December 31, 2016, we operated a total of 38 bebe outlet stores.

Strategic partnership During the fourth quarter of fiscal 2016, we entered into a strategic joint venture arrangement with Bluestar Alliance LLC (Bluestar). Under this partnership, bebe contributed all of its trademarks, trademark license arrangements (described in the next paragraph) and related intellectual property, including certain domain names, to a newly formed joint venture (the Joint Venture) and received just over 50% ownership interest in the joint venture. Bluestar contributed \$35 million to the newly formed joint venture that was then paid to bebe and received just under 50% ownership interest in the joint venture. Bluestar will leverage its existing brand management organization and infrastructure to develop a wholesale domestic and international lifestyle licensing business for the joint venture and will manage its day-to-day operations. During fiscal 2017 and in future years, the Joint Venture will

aggressively pursue a licensing strategy designed to capitalize on the value of our brand in all categories and channels on a global scale. We expect the Joint Venture to generate long-term, committed royalties from prospective licensees of the bebe brand name. In connection with this initiative, bebe retained a royalty-free perpetual license to utilize the bebe brand and trademarks within the United States, including its territories and possessions, and Canada which enables us to continue our existing business.

Table of Contents**CRITICAL ACCOUNTING POLICIES**

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

The preparation of these financial statements requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the financial statements. We believe our application of accounting policies, and the estimates inherently required therein, are reasonable. Our most critical accounting policies are those related to revenue recognition, stock based compensation, inventories, marketable securities, impairment of long lived assets and income taxes. We continually evaluate these accounting policies and estimates, and we make adjustments when facts and circumstances dictate a change. Our accounting policies are described in Note 1 to the consolidated financial statements in our annual report on Form 10-K for the fiscal year ended July 2, 2016. This discussion and analysis should be read in conjunction with such discussion and with our condensed consolidated financial statements and related notes included in Part 1, Item 1 of this quarterly report.

RESULTS OF OPERATIONS

Our fiscal year is a 52 or 53 week period, each period ending on the first Saturday on or after June 30. Both fiscal 2017 and fiscal 2016 include 52 weeks. The three months ended December 31, 2016 and January 2, 2016 each include 13 weeks. The six months ended December 31, 2016 and January 2, 2016 each include 26 weeks.

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

	Three Months Ended		Six Months Ended	
	December 31, 2016	January 2, 2016	December 31, 2016	January 2, 2016
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales, including production and occupancy (1)	65.6	66.0	66.9	68.2
Gross margin	34.4	34.0	33.1	31.8
Selling, general and administrative expenses (2)	40.6	38.5	40.8	42.1
Operating loss	(6.2)	(4.5)	(7.7)	(10.3)
Interest and other income, net	0.1	—	0.1	—
Loss from operations before income taxes	(6.1)	(4.5)	(7.6)	(10.3)
Income tax (benefit)/provision	—	—	—	—
Earnings in equity method investment	1.0	—	0.8	—
Net loss	(5.1)%	(4.5)%	(6.9)%	(10.3)%

(1) Cost of sales includes the cost of merchandise, occupancy costs, distribution center costs and production costs.

(2) Selling, general and administrative expenses primarily consist of non-occupancy store costs, corporate overhead and advertising costs.

Net Sales. Net sales decreased to \$101.9 million during the three months ended December 31, 2016 from \$122.4 million for the comparable period of the prior year, a decrease of \$20.5 million, or 16.8%. The decrease in net sales was primarily due to the effects of negative comparable store sales in the second quarter of fiscal 2017 compared with the same period in the prior year coupled with a reduction in total number of stores. Comparable store sales decreased 10.5% compared with a 2.5% decrease in the same period in the prior year. The decrease in comparable store sales was primarily the result of reduced store traffic.

For the six months ended December 31, 2016, net sales decreased to \$189.2 million from \$218.7 million for the comparable period of the prior year, a decrease of \$29.6 million, or 13.5%. The decrease reflects the effects of negative comparable store sales along with a reduction in the total number of stores.

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	Three Months Ended		Six Months Ended	
	December 31, 2016	January 2, 2016	December 31, 2016	January 2, 2016
Net sales (In thousands)	\$101,931	\$122,447	\$189,169	\$218,730
Net sales decrease percentage	(16.8)%	(5.0)%	(13.5)%	(5.3)%
Comparable store percentage (1)	(10.5)%	(2.5)%	(7.4)%	(3.2)%
Net sales per average square foot (2)	\$107	\$115	\$196	\$207
Square footage at end of period (In thousands)	707	791	707	791
Number of store locations:				
Beginning of period	182	201	186	201
New store locations	—	4	—	5
Closed store locations	1	2	5	3
Number of stores open at end of period	181	203	181	203

- We calculate comparable store sales by including the net sales of stores that have been open at least one year. Therefore, a store is included in the comparable store sales base beginning with its thirteenth month. Stores that have been expanded or remodeled by 15 percent or more or have been permanently relocated are excluded from the comparable store sales base. In addition, we calculate comparable store sales using a same day sales comparison.
- (1) Our e-commerce store sales are also included in our comparable store sales base. For the three months ended December 31, 2016 and January 2, 2016, the inclusion of our e-commerce store sales increased the comparable store sales 0.0% and 4.5%, respectively. For the six months ended December 31, 2016 and January 2, 2016, the inclusion of our e-commerce store sales increased the comparable store sales 1.0% and 4.1%, respectively.
- (2) We calculate net sales per average square foot using net store sales less e-commerce net sales and monthly average store square footage.

Gross Margin. Gross margin decreased to \$35.0 million during the three months ended December 31, 2016 from \$41.7 million for the comparable period of the prior year, a decrease of \$6.7 million, or 16.0%. As a percentage of net sales, gross margin increased to 34.4% for the three months ended December 31, 2016 from 34.0% in the comparable period of the prior year. The increase in margin primarily reflected reduced promotional activity and partially offset by reduced store leverage.

For the six months ended December 31, 2016, gross margin decreased to \$62.5 million from \$69.5 million for the comparable period of the prior year, a decrease of \$7.0 million, or 10.1%. As a percentage of net sales, gross margin was 33.1% for the six months ended December 31, 2016 compared to 31.8% in the comparable period of the prior year. The increase in margin primarily reflected reduced promotional activity and partially offset by reduced store leverage.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased to \$41.4 million during the three months ended December 31, 2016 from \$47.1 million for the comparable period of the prior year, a decrease of \$5.7 million, or 12.1%. SG&A for the second quarter benefited from broad reductions across most categories including compensation expense, depreciation and repairs and maintenance reflecting the effects of the corporate restructuring that occurred in fiscal 2016, and ongoing efforts to rationalize the store fleet. As a percentage of net sales, selling, general and administrative expenses increased to 40.6% during the three months ended December 31, 2016 from 38.5% in the comparable period of the prior year.

For the six months ended December 31, 2016, selling, general and administrative expenses decreased to \$77.1 million from \$92.0 million for the comparable period of the prior year, a decrease of \$14.9 million or 16.2%. As a percentage of net sales, selling, general and administrative expenses decreased to 40.8% during the six months ended December 31, 2016 from 42.1% in the comparable period of the prior year. The decrease was primarily the result of the corporate restructuring that occurred in 2016 and the reduction in store fleet. This resulted in reductions in most categories of expense including compensation cost, depreciation and repairs and maintenance.

Provision for Income Taxes. The tax rate for the second quarter of fiscal 2017 was (0.2)% compared to (0.6)% for the comparable period of the prior year. The effective tax rate in both periods primarily reflected the effects of state and

foreign income taxes and the continuing impact of maintaining a valuation allowance against net deferred tax assets recorded in the third quarter of fiscal 2013.

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For the six months ended December 31, 2016, effective tax rate was (0.2)% compared to (0.3)% for the comparable period of the prior year. Due to the existence of the valuation allowance, most of the tax benefit related to the current fiscal year to date losses has not been recognized. Our effective tax rate for both fiscal year 2017 and 2016 continues to approximate 0% due to the impact of the valuation allowance.

SEASONALITY OF BUSINESS AND QUARTERLY RESULTS

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

LIQUIDITY AND CAPITAL RESOURCES

Our working capital requirements vary widely throughout the year and generally peak during the first and second fiscal quarters. As of December 31, 2016, we had approximately \$66.8 million of cash and equivalents on hand. As of December 31, 2016, we had cash and equivalents of \$66.8 million held in accounts managed by third-party financial institutions consisting of invested cash and cash in our operating accounts. The invested cash is invested in interest bearing funds managed by third-party financial institutions. These funds invest in direct obligations of the government of the United States. To date, we have experienced no loss or lack of access to our invested cash or equivalents; however, we can provide no assurances that access to our invested cash and equivalents will not be impacted by adverse conditions in the financial markets.

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

Net cash provided by operating activities for the six months ended December 31, 2016 was \$13.1 million compared to net cash used by operating activities of \$9.7 million for the six months ended January 2, 2016. The improvement of \$22.8 million from the comparable period was due to decreased net loss and the effects of changes in working capital including reductions in the amount of cash investment in inventory, along with a reduction in prepaid and other reflecting the timing of store rent payments for the month of January 2017. The decrease of \$3.9 million in working capital from July 2, 2016 was primarily related to increased cash and cash equivalents and reduced current liabilities. Net cash used by investing activities for the six months ended December 31, 2016 was \$1.7 million compared to \$6.3 million provided by investing activities for the six months ended January 2, 2016. The \$8.0 million change versus the prior year comparable period was primarily due to the effect of net proceeds from sale of investment securities in the prior year, partially offset by decreased capital expenditures compared with the prior year. Total capital expenditures for the year are anticipated to be approximately \$6 million for stores remodels and information technology systems net.

Net cash used by financing activities was \$0.0 million for the six months ended December 31, 2016 compared to \$0.0 million used by financing activities for the six months ended January 2, 2016.

In October 2015, our board of directors authorized a program to repurchase up to \$5 million of our common stock. We intend, from time to time, as business conditions warrant, to purchase stock in the open market or through private transactions. Purchases may be increased, decreased or discontinued at any time without prior notice. The plan does not obligate us to repurchase any specific number of shares and may be suspended at any time at our discretion. No shares were repurchased during the six months ended December 31, 2016 and none are currently planned.

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

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

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

Interest Rate Risk

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

The following table lists our cash, cash equivalents and investments as of December 31, 2016:

	Fair Value (Dollars in thousands)	
Cash	\$ 66,556	
Weighted average interest rate	0.13	%
Cash equivalents	\$ 236	
Weighted average interest rate	0.22	%
Total	\$ 66,792	

Foreign Currency Risks

We enter into a significant amount of purchase obligations outside of the United States, substantially all of which are negotiated and settled in U.S. Dollars and, therefore, have only minimal exposure to foreign currency exchange risks. We also operate a subsidiary for which the functional currency is the Canadian Dollar. We translate assets and liabilities of Canada’s operations into U.S. dollars at month-end rates, while we translate income and expenses at the weighted average exchange rates for the month. We record the related translation adjustments in accumulated other comprehensive income as a separate component of shareholders’ equity. Fluctuations in exchange rates therefore impact our financial condition and results of operations, as reported in U.S. Dollars. We may from time to time hedge against foreign currency risks through the purchase of forward contracts however we believe that foreign currency exchange risk is immaterial.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report at the reasonable assurance level. There has been no change in our internal control over financial reporting during the quarter ended December 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Our past performance may not be a reliable indicator of future performance because actual future results and trends may differ materially depending on a variety of factors, including, but not limited to, the risks and uncertainties discussed below. In addition, historical trends should not be used to anticipate results or trends in future periods. Factors that might cause our actual results to differ materially from the forward looking statements discussed elsewhere in this report, as well as affect our ability to achieve our financial and other goals, include, but are not limited to, those set forth below.

Risks Related to Our Business

1. The success of our business depends in large part on our ability to identify fashion trends as well as to react to changing customer demand in a timely manner and to generate positive cash from operations as a result. Our future success depends, in part, upon our ability to anticipate, identify and respond effectively to changing customer demands and fashion trends in a timely manner. The specialty retail apparel business fluctuates according to changes in customer preferences directed by trends and fashions. If we miscalculate our customers' product preferences or the demand for our products, we may be faced with excess inventory. Historically, this has resulted in excess fabric for some products and markdowns and/or write-offs of raw materials as well as finished goods, which has impaired our profitability, and may do so in the future. Similarly, any failure on our part to anticipate, identify and respond effectively to changing customer demands and fashion trends will adversely affect our business. In addition, from time to time, we may pursue new concepts, and if the new concepts are not successful, our business could be harmed. Starting the first quarter of fiscal 2016, the Company undertook a restructuring process in the design, merchandising and production functions, which could impact our domestic and international product assortment and selling. In the fourth quarter of fiscal 2016 the Company entered into a strategic joint venture arrangement with Bluestar Alliance LLC (Bluestar). Under this partnership, bebe contributed all of its trademarks, trademark license arrangements and related intellectual property, including certain domain names to a newly formed joint venture (the Joint Venture) and received just over 50% ownership in the Joint Venture. Bluestar contributed the \$35 million to the Joint Venture, and received just under 50% of the joint venture. This \$35 million was paid to bebe at the time that the joint venture was formed.

We generated \$13.1 million during the first half of fiscal 2017 and used \$38.6 million and \$25.0 million net of our cash in operating activities in the fiscal years 2016 and 2015 respectively. Our liquidity is dependent upon our ability to generate cash from operations along with usage of our existing cash and cash equivalents. Our strategic focus for the remainder of fiscal 2017 is to continue implementing our strategy to streamline the production cycle for our product, make improvements to our product assortment, further rationalize our store fleet and inventory levels, and continued focus on discretionary spending. We believe our cash and equivalents, together with our cash flows from operations, will be sufficient to meet our operating and capital requirements for at least the next twelve months, provided that we can achieve the financial results anticipated as a result of the restructuring and cost-saving measures. Our future operating and capital requirements, however, will depend on numerous factors, including without limitation, the size and number of new and expanded stores and/or store concepts, investment costs for management information systems, the success of initiatives in the Joint Venture, potential investments and/or licensing arrangements, and future results of operations. The inability to generate positive cash flow from operations could have a material adverse effect on our business and financial conditions. In addition, if additional financing is needed, we may not be able to secure such financing on favorable terms, or at all.

2. The success of our business depends in large part on our ability to maintain our brand, image and reputation. Our ability to maintain our brand image and reputation is integral to our business as well as the implementation of strategies to expand it. Maintaining, promoting and growing our brand will depend largely on the success of our design, merchandising and marketing efforts and our ability to provide a consistent, high-quality client experience. In addition, while our brand is mature, our success depends on our ability to retain existing customers and attract new customers to shop our brand. Our business would be adversely affected if we fail to achieve these objectives for our brand. In addition, failure to achieve consistent, positive performance or the receipt of any negative publicity could adversely impact our brand and the brand loyalty of our customers, which would adversely impact our business. Finally, our brand's image could be impacted by initiatives within the Joint Venture.

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3. We face significant competition in the retail and apparel industries, which could harm our business. The retail and apparel industries are highly competitive and are characterized by low barriers to entry. We expect competition in our markets to increase. The primary competitive factors in our markets are: brand name recognition and appeal, sourcing, product styling, quality, presentation and pricing, timeliness of product development and delivery, store ambiance, customer service and convenience. We compete with traditional department stores, specialty store retailers, lower price point retailers, business-to-consumer websites, off-price retailers and direct marketers for, among other things, raw materials, market share, retail space, finished goods, sourcing and personnel. Because many of these competitors are larger and have substantially greater financial, distribution and marketing resources than we do or maintain comparatively lower cost of operations, we may lack the resources to effectively compete with them. If we fail to remain competitive in any way, it could harm our business, financial condition and results of operations. In addition, if we are unable to address the challenges of declining store traffic in a highly promotional, low growth environment, our business will be negatively affected.

4. Our business has recently undergone significant changes, including management, personnel and business changes. If we do not effectively and successfully adapt to these changes, it could have a material adverse effect on our business.

During our third fiscal quarter of 2016, we replaced our Chief Executive Officer and our Chief Financial Officer. In addition, we eliminated approximately 81 other positions in an effort to streamline our business and control costs. As a result, we have also made significant operational changes. These significant changes have created additional pressures on existing personnel, and we have been working to adapt to operating our business in a manner that differs meaningfully from prior periods. We cannot assure that these changes will lead to the desired improvement in our business and results of operations. If we do not effectively and successfully adapt to these changes, it could have a material adverse effect on our business.

5. General economic conditions, including increases in energy and commodity prices, that are largely out of our control, may adversely affect our financial condition and results of operations.

The demand for our products is influenced by national and local economic factors that may affect consumer spending or buying habits. Factors that could adversely affect the demand for our products include recessionary economic cycles, higher interest rates, higher fuel and other energy costs, inflation, deflation, increases in commodity prices, higher levels of unemployment, higher consumer debt levels, higher tax rates and other changes in tax laws. A decline in economic conditions could also result in reduced traffic in our stores or limitations on the prices we can charge for our products, either of which could adversely affect our business. We can provide no assurance that demand for our products will not be adversely affected by national or local economic conditions, thereby harming our business. In addition, economic factors such as those listed above and increased transportation costs, inflation, higher costs of labor, insurance and healthcare, and changes in other laws and regulations may increase our cost of sales and our operating, selling, general and administrative expenses. Any such increase would also negatively impact our business, including our financial results.

6. We cannot assure you that future store openings will be successful and new store openings may impact existing stores.

We cannot provide assurance that the stores we opened in fiscal 2016, or any other stores that we might open in the future, will be successful or that our overall results will improve as a result of opening these stores. In addition, new store openings have the potential to cannibalize the net sales and profitability of other existing stores, and can take time to achieve positive financial results.

The success of a future store depends on our ability to effectively obtain real estate that meets our criteria, including traffic, square footage, co-tenancies, average sales per square foot, lease economics, demographics and other factors. In addition, continued consolidation in the commercial retail real estate market could affect our ability to successfully negotiate favorable rental terms for our stores in the future. Should significant consolidation continue, a

large proportion of our store base could be concentrated with one or a few landlords that would then be in a position to dictate unfavorable terms to us due to their significant negotiating leverage. For example we have approximately 35 stores with lease renewals in fiscal 2017, which are currently being negotiated. If we are unable to negotiate favorable lease terms with these entities, this could affect our ability to profitably operate our stores, which would adversely impact our business.

7. We are dependent on the success of shopping malls in which our stores are located.

Many of our stores are located in shopping malls and other retail centers that benefit from the ability of “anchor” retail tenants, generally large department stores, and other attractions, to generate sufficient levels of consumer traffic in the vicinity of our stores. Any decline in the volume of consumer traffic at shopping centers, whether because of the economic slowdown, a decline in the popularity of shopping centers, the closing of anchor stores, consumer preferences to shop on the internet or at large warehouse stores or otherwise, could result in reduced sales at our stores and excess inventory. We may have to respond by increasing markdowns or initiating marketing promotions to reduce excess inventory, which could have a material adverse effect on our financial results or business.

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8. We may be forced to close stores or write down store assets that are not able to achieve planned financial performance, which may force us to record losses in future quarters.

The results achieved by our stores may not be indicative of long-term performance or the potential performance of stores in other locations. The failure of stores to achieve acceptable results could result in additional store asset impairment charges, which could adversely affect our business. In the past, we have had to close stores as a result of poor performance. For example, in fiscal year 2016, we closed 21 stores. Additionally, a limited number of stores are not performing to our expected levels, and we may choose to close these stores in the future. If we choose to close these stores, but cannot negotiate favorable terms with the landlords of these stores regarding the remaining lease obligations, our financial results could be adversely affected. Closing stores because of poor performance could have a material adverse effect on our business, and the resulting impairment and other charges would have an adverse impact on our financial results.

9. Our sales, margins and operating results are subject to seasonal and quarterly fluctuations.

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

In addition, our quarterly comparable store sales have fluctuated significantly in the past, and we expect that they will continue to fluctuate in the future. A variety of factors affect comparable store sales, including fashion trends, competition, current economic conditions, the timing of release of new merchandise and promotional events, changes in our merchandise mix, the success of marketing programs and weather conditions. Our ability to deliver strong comparable store sales results and margins depends in large part on accurately forecasting demand and fashion trends, selecting effective marketing techniques, providing an appropriate mix of merchandise for our customer base, managing inventory effectively and optimizing store performance by closing under-performing stores. Such fluctuations may adversely affect the market price of our common stock.

10. Our success depends on our ability to attract and retain key employees in order to support our existing businesses and future expansion.

From time to time we actively recruit qualified candidates to fill key executive positions within our Company. There is substantial competition for experienced personnel, which we expect will continue. We compete for experienced personnel with companies who may have greater financial resources than we do. During fiscal 2014, 2015 and 2016 we experienced significant turnover of our executive management team as part of several restructurings. In light of these changes in people and processes, we might continue to experience turnover. We are also exposed to employment litigation due to our large number of employees and high turnover of our sales associates. If we fail to attract, motivate and retain qualified personnel, it could harm our business and limit our ability to expand.

11. Our business could be adversely impacted by unfavorable international political conditions.

Our sales and operating results are, and will continue to be, affected by international social, political, legal and economic conditions. In particular, our business could be adversely impacted by instability or changes resulting in the disruption of trade with the countries in which our contractors, suppliers, licensees or customers are located, significant fluctuations in the value of the dollar against foreign currencies or restrictions on the transfer of funds, or additional trade restrictions imposed by the United States and other foreign governments. We can provide no assurance that our business will not be adversely affected by such international events.

In addition, trade restrictions, including increased tariffs or quotas, embargoes and customs restrictions could increase the cost or reduce the supply of merchandise available to us and adversely affect our business. We also purchase a substantial amount of our raw materials from China, and our business and operating results may be affected by changes in the political, social or economic environment in China.

12. Our ability to conduct business could be negatively impacted by the effects of natural disasters, war, terrorism, public health concerns or other catastrophes.

We operate a corporate office in Brisbane, California, a distribution facility in Benicia, California, a design studio in Los Angeles, California and a distribution facility in Hong Kong. Any serious disruption at these facilities whether due to construction, relocation, fire, flood, earthquake, terrorist acts or otherwise could harm our business. Natural disasters, extreme weather and public health concerns, including severe infectious diseases, could impact our ability to open and run our corporate offices, distribution center, stores and other operations in affected areas and/or negatively impact our foreign sourcing offices and the operations of our vendors. In addition, our ability to continue to operate our business without significant interruption in the event of a disaster or other disruption depends, in part, on the ability of our information systems to operate in accordance with our disaster recovery and business continuity plans. Lower client traffic due to the effect of natural disasters or extreme

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weather, security concerns, war or the threat of war and public health concerns could result in decreased sales that could have a material adverse effect on our business. In addition, threat of terrorist attacks or actual terrorist events in the United States and world-wide could cause damage or disruption to international commerce and the global economy, disrupt the production, shipment or receipt of our merchandise or lead to lower client traffic. Our ability to mitigate the adverse impact of these events depends, in part, upon the effectiveness of our disaster preparedness and response planning as well as business continuity planning. However, we cannot be certain that our plans will be adequate or implemented properly in the event of an actual disaster or other catastrophic situation. In addition, although we maintain business interruption and property insurance, we cannot assure you that our insurance coverage will be sufficient or that insurance proceeds will be timely paid to us.

13. If we, through our interest in the Joint Venture, are not able to protect our intellectual property our business may be harmed.

Although we and the Joint Venture take actions to protect our trademarks and other proprietary rights, we cannot assure you that we will be successful or that others will not imitate our products or infringe upon our intellectual property rights. In addition, we cannot assure that others will not resist or seek to block the sale of our products as infringements of their trademark and proprietary rights. Historically, we have sought to register our trademarks domestically and internationally and the Joint Venture will continue to do so in the future. Obstacles may exist that may prevent the Joint Venture from obtaining a trademark for the bebe and BEBE SPORT brand names or related names. The Joint Venture may not be able to register certain trademarks, purchase the right or obtain a license to use these names or related names on commercially reasonable terms. If the Joint Venture fails to obtain trademarks of, or ownership or license of the requisite rights, it would limit the ability to expand the business under the bebe brand. In some jurisdictions, despite successful registration of bebe's trademarks, third parties may allege infringement and bring actions against us and or the Joint Venture. In addition, if our licensees fail to use the bebe intellectual property correctly, the reputation and value associated with the trademarks may be diluted. Furthermore, if we or the Joint Venture do not demonstrate use of our trademarks, our trademark rights may lapse over time. In addition, we face the potential of receiving claims that the technology we use or license infringes on another's proprietary rights. In certain circumstances, we may be subject to having to defend ourselves from such claims and/or be subject to unanticipated license fees or the necessity to transition away from technology we are using or abandon such use altogether.

14. Our business may be negatively impacted by any failure to comply with regulatory requirements.

As a public company, we are subject to numerous regulatory requirements, including those imposed by the Sarbanes-Oxley Act of 2002, the SEC and The NASDAQ Capital Market. In addition, we are subject to numerous domestic and foreign laws and regulations affecting our business, including those related to labor, employment, worker health and safety, competition, privacy, consumer protection, credit cards, import/export and anti-corruption, including the Foreign Corrupt Practices Act and the Telephone Consumer Protection Act. Our employees, subcontractors, vendors and suppliers could take actions that violate these requirements and/or our compliance policies and procedures, which could have a material adverse effect on our reputation, financial condition and on the market price of our common stock. Regulatory developments regarding the use of "conflict minerals," certain minerals originating from the Democratic Republic of Congo and adjoining countries, could affect the sourcing and availability of raw materials used by suppliers and subject us to costs associated with the relevant regulations, including for diligence pertaining to the presence of any conflict minerals used in our products, possible changes to products, processes or sources of our inputs and reporting requirements.

15. There are litigation and other claims against us from time to time, which could distract management from our business activities and could lead to adverse consequences to our business and financial condition.

We are involved from time to time with litigation and other claims against us. Often these cases can raise complex factual and legal issues, which are subject to risks and uncertainties and which could require significant management time. Although we do not currently believe that the outcome of any current litigation or claim against us will have a material adverse effect on our overall financial condition, we have, in the past, incurred unexpected expense in

connection with litigation matters. In the future, adverse settlements, judgments or resolutions may negatively impact our business. Injunctions against us could have an adverse effect on our business by requiring us to do, or prohibiting us from engaging in, certain activities. We may in the future be the target of material litigation, which could result in substantial costs and divert our management's attention and resources.

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16. We rely on third-party manufacturers to manufacture all of our products.

Our future success depends, in part, on our ability to find manufacturing facilities that perform acceptably. We do not own any manufacturing facilities and therefore depend on third parties to manufacture our products. In addition, we place all of our orders for production by purchase order and do not have long-term contracts with any manufacturers. If we fail to maintain favorable relationships with our manufacturers, our business could be materially and adversely affected. We cannot assure you that third-party manufacturers (1) will not supply similar products to our competitors, (2) will not stop supplying products to us completely or (3) will supply products in a timely manner. Untimely receipt of products may result in lower than anticipated sales and markdowns which would have a negative impact on our business. Furthermore, we have received in the past, and may receive in the future, shipments of products from manufacturers that fail to conform to our quality control standards. In such event, unless we are able to obtain replacement products in a timely manner, we may lose sales.

17. We face fluctuating and generally increasing product costs from our manufacturing partners, which could result in margin erosion.

Fluctuations in the cost, availability and quality of the fabrics or other raw materials used to manufacture our merchandise could have a material adverse effect on our cost of goods, or our ability to meet customer demand. The prices for such fabrics depend largely on the market prices for the raw materials used to produce them, particularly cotton, as well as the cost of compliance with sourcing laws. The price of such raw materials has been increasing and the price and availability of such raw materials may fluctuate significantly, depending on many factors, including crop yields and weather patterns. Such factors may be exacerbated by legislation and regulations associated with global climate change. Additionally, clothing manufacturers in China, where a significant percentage of our apparel products are manufactured, are experiencing increased costs due to labor shortages and the fluctuation of the Chinese Yuan in relation to the U.S. dollar, and these increased costs are often passed on to us. We are also susceptible to fluctuations in the cost of transportation. We may not be able to pass all or a portion of higher raw materials prices or labor or transportation costs on to our customers, which could adversely affect our business.

18. If we are unable to obtain raw materials for our products, our business could be materially adversely affected.

We place all of our orders for raw materials by purchase order and do not have any long-term contracts with any supplier. If we fail to maintain favorable relationships with our suppliers or are unable to obtain sufficient quantities of quality raw materials on commercially reasonable terms, it could harm our business. Finally, certain of our third-party manufacturers store our raw materials. In the event our inventory was damaged or destroyed and we were unable to obtain replacement raw materials, our earnings and our business could be materially and adversely impacted.

19. If we are unable to receive product or if our receipt of product is delayed due to unforeseen events, such as port closures, we may not be able to stock our stores, or may have to take unexpected markdowns to clear product that missed their seasonal window.

We time receipt of our products such that they are in our stores at the appropriate time to meet desired in-stock levels and the appropriate season. If we are unable to receive product due port closures, for example, we may not have sufficient stock at our stores which could impact store traffic and sales. Or if such delays cause us to receive product after the season is over, we may have to take significant unforeseen markdowns.

20. If an independent manufacturer violates labor or other laws, or is accused of violating any such laws, or if their labor practices diverge from those generally accepted as ethical, it could harm our business and brand image . Our success depends, in part, on our ability to find and contract with independent manufacturers which conduct their businesses using ethical or legal labor practices. While we maintain a policy to monitor the operations of our independent manufacturers by having an independent firm inspect these manufacturing sites, and our manufacturers are contractually required to comply with such labor practices, we cannot assure the compliance of these manufacturers. In addition, we cannot control the public's perceptions of such manufacturers or their practices, even if

they are compliant with law but are viewed in a negative light by the public. Because manufacturers act in their own interests, they may act in a manner that results in negative public perceptions of us. Moreover, in certain circumstances, we may be subject to liability or negative publicity that could adversely affect our brand and our business as a result of actions taken by these manufacturers.

21. We are subject to cyber-security risks and may incur increasing costs in an effort to minimize those risks and to respond to cyber incidents.

Our business involves the storage and transmission of customers' personal information, consumer preferences and credit card information. We also use mobile devices, social networking and other on-line activities to connect with our customers. If we experience a significant data security breach or fail to detect and appropriately respond to a significant data security breach, we could be exposed to government enforcement actions and private litigation, and our business could be adversely affected. For example, in November 2014, we detected suspicious activity on computers that operate the payment

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processing system for our stores, which appeared to be limited to data from payment cards swiped in the United States and its territories between November 8, 2014 and November 26, 2014. The data may have included cardholder name, account number, expiration date and verification codes, although we have no indication of fraudulent charges to date. We cannot assure you that we will not suffer future breaches of the portion of our network that handles payment card data, with further payment card and client information being stolen. These sorts of breaches might cause our customers to lose confidence in our ability to protect their personal information, which could cause them to discontinue usage of our club bebe loyalty program, or stop shopping with us altogether. The loss of confidence from a significant data security breach involving our employees could also hurt our reputation, cause employee recruiting and retention challenges, increase our labor costs and adversely affect our business and financial results.

22. We rely on information technology to help manage our operations and our e-commerce store, the disruption of which could adversely impact our business.

We rely on various information systems to help manage our operations and regularly assess the cost-benefit analysis associated with making additional investments to upgrade, enhance or replace such systems. If at any time we experience any disruptions affecting our information systems we could experience a material adverse impact on our business.

In addition, we operate an e-commerce store at www.bebe.com to sell our merchandise. Our on-line operations are subject to numerous risks, including unanticipated operating problems, reliance on third-party computer software providers and system failures. If at any time we experience any disruptions affecting our e-commerce store, we could experience a material adverse impact on our business. Our e-commerce operations also involve other risks that could have an adverse impact on our results of operations, including diversion of sales from our other stores, rapid technological change, liability for on-line content, credit card fraud and loss of sensitive data. We cannot assure you that our e-commerce store will continue to achieve sales growth or that it will not experience a decline in sales.

23. We are responsible for maintaining the privacy of personally identifiable information of our customers.

Through our sale transactions, loyalty programs and other methods, we obtain personally identifiable information about our customers which is subject to federal, state and international privacy laws. These laws are constantly changing. If we fail to comply with these laws, we may be subject to fines, penalties or other adverse actions. We are highly dependent on the use of credit cards to complete sale transactions in our stores and through our websites, and if we fail to comply with Payment Card Industry Data Security Standards, we may become subject to limitations on our ability to accept credit cards. Moreover, third parties may seek to access this information through improper means such as computer hacking, malware and viruses. Any incidents involving unauthorized access or improper use of our customers' personally identifiable information could damage our reputation and brand and result in legal or regulatory action against us.

24. Our business could suffer if we are unsuccessful in making, and maintaining investments.

We have entered into a joint venture with another company and may make other investments or enter into other joint ventures in the future. Transactions such as these create risks such as the disruption of our ongoing business, including loss of management focus on existing business, and impose certain operating covenants on us. Further, one or more parties may or may not have the same goals, strategies, priorities or resources as we do and joint ventures are intended to be operated for the benefit of all co-owners, rather than for our exclusive benefit. Additionally, joint ventures inherently involve a limited and lesser degree of control over joint venture decisions and actions, thereby potentially increasing financial, legal and compliance risks associated with each joint venture we enter into and could result in reduced profits, or in some cases, significant losses. Further, we may be unable to take action without the approval of our joint venture partners. In addition, investments in which an investee's financial performance is incorporated into our financial results, either in full or in part, require us to depend on the investee's accounting, financial reporting and similar systems, controls and processes. Furthermore, the success of our joint venture depends on the satisfactory performance by our joint venture partners of their joint venture obligations. The failure of our joint venture partners to

perform their joint venture obligations could impose on us additional financial and performance obligations that could result in reduced profits or, in some cases, significant losses for us with respect to the joint venture.

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Risks Related to Our Common Stock

1. Because Manny Mashouf beneficially owns a substantial portion of the outstanding shares, other shareholders have limited ability to influence corporate matters.

As of July 2, 2016, Manny Mashouf, our CEO and Chairman of the Board, beneficially owned approximately 58.3% of the outstanding shares of our common stock. As a result, he has the ability to control our management and affairs and substantially all matters submitted to our shareholders for approval, including the election and removal of directors and approval of any significant transaction. He also has the ability to control our management and business affairs. This concentration of ownership may have the effect of delaying, deferring or preventing a change in control, impeding a merger, consolidation, takeover or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our business, and could limit the price that certain investors might be willing to pay for shares of common stock, even if such a transaction would benefit other shareholders. In addition, he could also sell his shares at any time, in open market transactions, registered offerings or otherwise and such a sale could negatively impact our share price.

2. Our stock price could fluctuate substantially for reasons outside of our control.

Our common stock is quoted on The NASDAQ Capital Market, which has experienced, and is likely to experience in the future, significant price and volume fluctuations, which could adversely affect our stock price without regard to our financial performance. In addition, we believe that factors such as quarterly fluctuations in our financial results and comparable sales; announcements by other apparel, accessory, music and gift item retailers; the trading volume of our stock; changes in estimates of our performance by securities analysts; litigation; overall economic and political conditions, including the global economic downturn; the condition of the financial markets, including the credit crisis; and other events or factors outside of our control could cause our stock price to fluctuate substantially.

3. Our failure to meet the continued listing requirements of The NASDAQ Capital Market could result in a delisting of our common stock.

If we fail to satisfy the continued listing requirements of The NASDAQ Capital Market, such as the corporate governance requirements or the minimum closing bid price requirement, NASDAQ may take steps to de-list our common stock. Such a delisting would likely have a negative effect on the price of our common stock and would impair your ability to sell or purchase our common stock when you wish to do so. In the event of a delisting, we would expect to seek to take actions to restore our compliance with NASDAQ's listing requirements, but we can provide no assurance that any such action taken by us would allow our common stock to become listed again, stabilize the market price or improve the liquidity of our common stock, prevent our common stock from dropping below the NASDAQ minimum bid price requirement or prevent future non-compliance with NASDAQ's listing requirements.

4. If we sell shares of our common stock in the future, shareholders may experience immediate dilution and, as a result, our stock price may decline.

We may from time to time issue additional shares of common stock at a discount from the current trading price of our common stock. As a result, our shareholders would experience immediate dilution. In addition, as opportunities present themselves, we may enter into financing or similar arrangements in the future, including the issuance of debt securities, preferred stock or common stock. If we issue common stock or securities convertible into common stock, our common shareholders would experience additional dilution and, as a result, our stock price may decline.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

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

Exhibit Description

31.1 Section 302 Certification of Chief Executive Officer.

31.2 Section 302 Certification of Chief Financial Officer.

32.1 Section 906 Certification of Chief Executive Officer.

32.2 Section 906 Certification of Chief Financial Officer.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Presentation Linkbase

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SIGNATURE

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

Dated February 9, 2017

bebe stores, inc.

/s/ Walter Parks

Walter Parks, President, Chief Operating Officer, Interim Chief Financial Officer

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