

bebe stores, inc.
Form 10-Q
February 09, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2011 December 31, 2011

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)

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California (State or Jurisdiction of Incorporation or Organization)	400 Valley Drive Brisbane, California 94005 (Address of principal executive offices) Telephone: (415) 715-3900	94-2450490 (IRS Employer Identification Number)
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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 <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of January 31, 2012 was 84,227,047.

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ITEM 1. Condensed Consolidated Financial Statements

bebe stores, inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(unaudited)

	As of December 31, 2011	As of July 2, 2011	As of January 1, 2011
Assets:			
Current assets:			
Cash and equivalents	\$ 119,897	\$ 95,177	\$ 119,410
Available for sale securities	87,582	96,371	63,165
Receivables (net of allowance of \$1,259, \$1,247 and \$1,241)	6,143	5,222	4,425
Inventories, net	30,756	33,448	29,989
Deferred income taxes, net	4,930	4,930	6,595
Prepaid and other	10,374	14,207	22,242
Total current assets	259,682	249,355	245,826
Available for sale securities	64,047	64,964	77,158
Property and equipment, net	90,127	92,500	92,463
Deferred income taxes, net	29,453	29,440	26,367
Intangible asset	912	885	0
Other assets	3,985	3,978	3,904
Total assets	\$ 448,206	\$ 441,122	\$ 445,718
Liabilities and Shareholders Equity:			
Current liabilities:			
Accounts payable	\$ 15,856	\$ 17,684	\$ 19,346
Accrued liabilities	32,186	26,974	30,566
Total current liabilities	48,042	44,658	49,912
Deferred rent and other lease incentives	37,306	38,152	38,844
Uncertain tax positions	2,226	2,059	2,615
Total liabilities	87,574	84,869	91,371
Commitments and contingencies			
Shareholders equity:			
Preferred stock-authorized 1,000,000 shares at \$0.001 par value per share; no shares issued and outstanding	0	0	0
Common stock-authorized 135,000,000 shares at \$0.001 par value per share; issued and outstanding 84,226,366, 84,096,558 and 84,041,609 shares	84	84	84
Additional paid-in capital	143,332	141,829	140,836
Accumulated other comprehensive loss	(1,899)	(5)	(3,021)

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Retained earnings	219,115	214,345	216,448
Total shareholders' equity	360,632	356,253	354,347
Total liabilities and shareholders' equity	\$ 448,206	\$ 441,122	\$ 445,718

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended		Six Months Ended	
	December 31,	January	December 31,	January
	2011	1, 2011	2011	1, 2011
Net sales	\$ 151,987	\$ 136,209	\$ 278,259	\$ 251,465
Cost of sales, including production and occupancy	91,067	85,743	166,853	154,368
Gross margin	60,920	50,466	111,406	97,097
Selling, general and administrative expenses	49,927	47,958	96,969	94,303
Operating income	10,993	2,508	14,437	2,794
Interest and other income, net	107	270	410	551
Income from continuing operations before income taxes	11,100	2,778	14,847	3,345
Income tax provision	4,539	1,150	5,932	1,390
Income from continuing operations, net of tax	6,561	1,628	8,915	1,955
Loss from discontinued operations, net of tax	0	(4,355)	0	(5,835)
Net income (loss)	\$ 6,561	\$ (2,727)	\$ 8,915	\$ (3,880)
Basic per share amounts:				
Income from continuing operations, net of tax	\$ 0.08	\$ 0.02	\$ 0.11	\$ 0.02
Loss from discontinued operations, net of tax	0	(0.05)	0	(0.07)
Net income (loss)	\$ 0.08	\$ (0.03)	\$ 0.11	\$ (0.05)
Diluted per share amounts:				
Income from continuing operations, net of tax	\$ 0.08	\$ 0.02	\$ 0.11	\$ 0.02
Loss from discontinued operations, net of tax	0	(0.05)	0	(0.07)
Net income (loss)	\$ 0.08	\$ (0.03)	\$ 0.11	\$ (0.05)
Basic weighted average shares outstanding	84,190	84,035	84,156	84,385
Diluted weighted average shares outstanding	84,323	84,134	84,284	84,483

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, 2011	January 1, 2011
Cash flows from operating activities:		
Net income (loss)	\$ 8,915	\$ (3,880)
Adjustments to reconcile net loss to cash used in operating activities:		
Non-cash compensation expense	1,089	1,659
Depreciation and amortization	10,309	11,680
Non-cash charge for asset impairment	391	1,060
Net gain on disposal of property	(418)	(240)
Tax benefit from exercise of stock options and awards	166	119
Excess tax benefit from exercise of stock options and awards	(32)	(12)
Deferred rent and other lease incentives	(67)	(422)
Long term uncertain tax positions	167	(848)
Deferred income taxes	(366)	3,794
Changes in operating assets and liabilities:		
Receivables	1,108	596
Inventories	2,668	3,577
Prepaid expenses and other	3,562	(3,784)
Accounts payable	(1,565)	(2,920)
Accrued liabilities	6,137	3,576
Net cash provided by operating activities	32,064	13,955
Cash flows from investing activities:		
Purchase of property and equipment	(10,957)	(3,676)
Insurance proceeds from property and equipment	650	0
Purchase of marketable securities	(31,772)	(52,914)
Proceeds from sales of investment securities	40,817	68,088
Net cash provided (used) by investing activities	(1,262)	11,498
Cash flows from financing activities:		
Proceeds from issuance of common stock	567	157
Excess tax benefit from exercise of stock options and awards	32	12
Cash dividends paid	(4,209)	(88,242)
Purchase of common stock	0	(12,472)
Net cash used by financing activities	(3,610)	(100,545)
Net increase (decrease) in cash and equivalents	27,192	(75,092)
Effect of exchange rate changes on cash	(2,472)	(188)
Cash and equivalents:		
Beginning of period	95,177	194,690

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End of period

\$ 119,897

\$ 119,410

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, 2011, July 2, 2011 and January 1, 2011, the condensed consolidated statements of operations for the three and six months ended December 31, 2011 and January 1, 2011 and the condensed consolidated statements of cash flows for the six months ended December 31, 2011 and January 1, 2011 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, 2011.

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, 2011, 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, 2011.

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.

FISCAL YEAR

The Company's fiscal year is a 52 or 53 week period, each period ending on the first Saturday after June 30. Fiscal years 2012 and 2011 each include 52 weeks.

The three month periods ended December 31, 2011 and January 1, 2011 each include 13 weeks. The six month periods ended December 31, 2011 and January 1, 2011 each include 26 weeks.

RECENT ACCOUNTING PRONOUNCEMENTS

Fair Value

In May 2011, the FASB issued guidance to amend the accounting and disclosure requirements on fair value measurements. The new guidance limits the highest-and-best-use measure to nonfinancial assets, permits certain financial assets and liabilities with offsetting positions in market or counterparty credit risks to be measured at a net basis, and provides guidance on the applicability of premiums and discounts. Additionally, the new guidance expands the disclosures on Level 3 inputs by requiring quantitative disclosure of the unobservable inputs and assumptions, as well as description of the valuation processes and the sensitivity of the fair value to changes in unobservable inputs. The new guidance will be effective for the Company beginning July 1, 2012. The Company does not anticipate material impacts on its financial statements upon adoption.

Other Comprehensive Income

In June 2011, the FASB issued an accounting standards update to revise the manner in which entities present comprehensive income in their financial statements. This guidance requires entities to present each component of net income along with total net income, each component of other comprehensive income (OCI) along with a total for OCI, and a total amount for comprehensive income, either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This accounting standards update is effective for fiscal years beginning after December 15, 2011. The Company will adopt the provisions of this accounting standards update in the first quarter of fiscal 2013.

DISCONTINUED OPERATION OF PH8 STORES

In the fourth quarter of fiscal 2010, the Company decided to discontinue operations of the PH8 division, allowing the Company to focus its efforts on improving bebe sales and profitability, expanding internationally and continuing to develop its 2b bebe business. The Company closed 24 PH8 stores in the first fiscal quarter of 2011 and during the second fiscal quarter of 2011, closed the remaining 25 PH8 stores. The results of

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the PH8 stores closed to date, net of income tax benefit, which consists of 49 stores, have been presented as a discontinued operation in the accompanying consolidated statements of operations for all periods presented and are as follows:

	Three Months Ended		Six Months Ended	
	December 31, 2011	January 1, 2011	December 31, 2011	January 1, 2011
	(In thousands)			
Net sales	\$ 0	\$ 4,146	\$ 0	\$ 7,850
Cost of sales, including production and occupancy	0	9,591	0	13,368
Gross margin	0	(5,445)	0	(5,518)
Selling, general and administrative expenses	0	1,706	0	4,116
Loss from discontinued operation, before income tax benefit	0	(7,151)	0	(9,634)
Income tax benefit	0	(2,796)	0	(3,799)
Loss from discontinued operations, net of tax benefit	\$ 0	\$ (4,355)	\$ 0	\$ (5,835)

Costs associated with exit or disposal activities are recorded when the liability is incurred. As of December 31, 2011, the Company has reserved \$0.2 million for future costs associated with discontinued operations. This reserve has been included within the Accrued liabilities line in the Condensed Consolidated Balance Sheets.

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INVESTMENTS

The Company's investment portfolio consists of treasury bills, certificates of deposit and auction rate securities. The Company holds a variety of interest bearing auction rate securities (ARS) consisting of federally insured student loan backed securities and insured municipal authority bonds. As of December 31, 2011, the Company's ARS portfolio totaled approximately \$64.0 million classified as available for sale securities, net of a temporary impairment charge of \$10.0 million. As of that date, the Company's ARS portfolio included approximately 95% federally insured student loan backed securities and 5% municipal authority bonds and consisted of approximately 41% AAA rated investments, 7% AA rated investments, 36% A rated investments, 7% BBB rated investments and 9% CCC rated investments. As of July 2, 2011, the Company's ARS consisted of 42% AAA rated investments, 7% AA rated investments, 35% A rated investments, 7% BBB rated investments and 9% CCC rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected the Company's holdings in ARS investments and auctions for the Company's investments in these securities have failed to settle on their respective settlement dates. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While the Company continues to earn interest on its ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and the Company will not be able to access these funds until a future auction of these investments is successful, the issuer redeems the securities or at maturity. Maturity dates for these ARS investments range from 2016 to 2044 with principal distributions occurring on certain securities prior to maturity. To date, principal distributions and maturities of the securities held by the Company have all been at par value. During the three and six months ended December 31, 2011, \$1.0 million of ARS were settled at par.

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

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

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

	Cost	As of December 31, 2011		Estimated Fair Value
		Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	
(In thousands)				
Short term treasury bills	\$ 71,951	\$ 0	\$ 0	\$ 71,951
Short term certificates of deposit	15,631	0	0	15,631
	87,582	0	0	87,582
Long term auction rate securities	\$ 74,000	\$ 0	\$ (9,953)	\$ 64,047

	Cost	As of July 2, 2011		Estimated Fair Value
		Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	
(In thousands)				
Short term treasury bills	\$ 81,929	\$ 0	\$ 0	\$ 81,929
Short term certificates of deposit	14,442	0	0	14,442
	96,371	0	0	96,371
Long term auction rate securities	\$ 75,000	\$ 0	\$ (10,036)	\$ 64,964

	Cost	As of January 1, 2011		Estimated Fair Value
		Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	
(In thousands)				
Short term treasury bills	\$ 50,000	\$ 0	\$ 0	\$ 50,000
Short term certificates of deposit	13,165	0	0	13,165
	63,165	0	0	63,165
Long term auction rate securities	\$ 89,325	\$ 0	\$ (12,167)	\$ 77,158

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, 2011, the Company held financial instruments that are measured at fair value on a recurring basis. These included cash equivalents and available for sale securities. Cash equivalents consist of money market funds. Short term available for sale securities consist of government treasury bills and certificates of deposit. Long term available for sale securities consist of auction rate securities (ARS). These

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securities consist of federally insured student loan backed securities and insured municipal authority bonds.

The Company determined the estimated fair value of its investment in ARS as of December 31, 2011 using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for liquidity, interest rates, timing, credit ratings, credit wrap and amount of cash flows and expected holding periods of the ARS.

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The following items are measured at fair value on a recurring basis as of December 31, 2011:

Description	December 31, 2011	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	\$ 54,655	\$ 54,655	\$ 0	\$ 0
Current available for sale securities	87,582	87,582	0	0
Non-current available for sale securities	64,047	0	0	64,047
Total	\$ 206,284	\$ 142,237	\$ 0	\$ 64,047

The following items are measured at fair value on a recurring basis as of January 1, 2011:

Description	January 1, 2011	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	\$ 65,420	\$ 65,420	\$ 0	\$ 0
Current available for sale securities	63,165	63,165	0	0
Non-current available for sale securities	77,158	0	0	77,158
Total	\$ 205,743	\$ 128,585	\$ 0	\$ 77,158

During the quarter ended December 31, 2011, 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 has been recorded in accumulated other comprehensive income that reduces the carrying amount of the applicable non-current assets of \$74.0 million to their fair value of \$64.0 million as of December 31, 2011. The following table presents the Company's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended December 31, 2011:

	Three Months Ended December 31, 2011	Six Months Ended December 31, 2011
	(In thousands)	
Balance at beginning of period	\$ 64,942	\$ 64,964
Total gains or (losses) (realized or unrealized)		
Included in net loss	0	0
Included in accumulated other comprehensive loss	105	83
Settlements	(1,000)	(1,000)
Balance at end of period	\$ 64,047	\$ 64,047

Non-Financial Assets:

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The Company measures certain non-financial assets and liabilities, including long-lived assets, at fair value on a non-recurring basis. During the 13 weeks ended December 31, 2011 and January 1, 2011, the Company recorded impairment charges of approximately \$0.4 million and \$0.5 million, respectively, related to under-performing stores in its continuing operations. During the 26 weeks ended December 31, 2011 and January 1, 2011, the Company recorded impairment charges of approximately \$0.4 million and \$1.1 million, respectively, related to under-performing stores in its continuing operations. The fair market value of these assets was determined using the income approach and level 3 inputs, which required management to make significant estimates about future 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. This impairment charge is included in selling, general and administrative expenses (SG&A) in the accompanying condensed consolidated statements of operations. The Company was not required to measure any other significant non-financial assets and liabilities at fair value.

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The Company's inventories consisted of:

	December 31, 2011	As of July 2, 2011	January 1, 2011
	(In thousands)		
Raw materials	\$ 654	\$ 1,622	\$ 492
Merchandise available for sale	30,102	31,826	29,497
Inventories, net	\$ 30,756	\$ 33,448	\$ 29,989

CREDIT FACILITIES

The Company has an unsecured commercial line of credit agreement which provides for borrowings and issuance of letters of credit of up to a combined total of \$25.0 million and expires on May 15, 2012. The outstanding balance bears interest at either the bank's reference rate (which was 3.25% as of December 31, 2011) or the LIBOR rate (which was 0.27% as of December 31, 2011) plus 1.75 percentage points. As of December 31, 2011, there were no outstanding cash borrowings or trade letters of credit outstanding and \$3.0 million of an outstanding stand-by letter of credit. To date, no beneficiary has drawn upon the stand-by letter of credit.

This credit facility requires the Company to maintain a \$2.5 million compensating balance and to comply with certain financial covenants, including amounts for minimum tangible net worth, unencumbered liquid assets and profitability, and certain restrictions on making loans and investments. As of December 31, 2011, the Company was in compliance with all financial covenants.

UNCERTAIN TAX POSITIONS

During the first quarter of fiscal 2011, the New York State Department of Taxation and Finance completed its review of the Company's fiscal 2005 through 2007 state income tax returns. There was no material impact on the Company's effective tax rate and tax expense for the quarter. The gross unrecognized tax benefits decreased approximately \$0.7 million during the first quarter of 2011 primarily due to this event. The Company does not anticipate any significant changes to the unrecognized tax benefits over the next twelve month period.

COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended		Six Months Ended	
	December 31, 2011	January 1, 2011	December 31, 2011	January 1, 2011
	(In thousands)			
Net income (loss)	\$ 6,561	\$ (2,727)	\$ 8,915	\$ (3,880)
Gain on available for sale securities	105	619	83	894
Accumulated translation adjustments	(743)	992	(1,977)	2,561
Total comprehensive income (loss)	\$ 5,923	\$ (1,116)	\$ 7,021	\$ (425)

EARNINGS PER SHARE

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

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

	Three Months Ended		Six Months Ended	
	December 31, 2011	January 1, 2011	December 31, 2011	January 1, 2011
	(In thousands)			
Basic weighted average number of shares outstanding	84,190	84,035	84,156	84,385
Incremental shares from the assumed issuance of stock options	133	99	128	98
Diluted weighted average number of shares outstanding	84,323	84,134	84,284	84,483

Excluded from the computation of the number of diluted weighted average shares outstanding were options to purchase 4,282,954 and 4,356,782 shares of common stock for the three months ended December 31, 2011 and January 1, 2011, respectively, and 4,171,436 and 4,276,992 for the six months ended December 31, 2011 and January 1, 2011, respectively, which would have been anti-dilutive.

Table of Contents**COMMON STOCK PURCHASES**

In October 2008, the board of directors authorized a program to repurchase up to \$30 million of the Company's common stock. No shares were repurchased during the three or the six months ended December 31, 2011. No shares were repurchased during the three months ended January 1, 2011 and during the six months ended January 1, 2011, 2,137,344 shares were repurchased at an average price per share of \$5.84. The Company has repurchased the full authorization of \$30 million of shares, but may authorize the repurchase of additional shares in the future.

STOCK BASED COMPENSATION

The following table summarizes the stock based compensation expense recognized under the Company's stock plan during the three months and the six months ended December 31, 2011 and January 1, 2011:

	Three Months Ended		Six Months Ended	
	December 31, 2011	January 1, 2011	December 31, 2011	January 1, 2011
	(In thousands)			
Stock options	\$ 425	\$ 499	\$ 981	\$ 1,539
Nonvested stock awards/units	59	79	108	120
Total stock based compensation expense	\$ 484	\$ 578	\$ 1,089	\$ 1,659

Unrecognized compensation cost related to nonvested stock options and nonvested stock awards/units totaled approximately \$3.3 million and \$0.2 million, respectively, as of December 31, 2011. This cost is expected to be recognized over a weighted average period of 3.0 years. The weighted average fair value of stock options at their grant date during the three months ended December 31, 2011 and January 1, 2011 was \$2.78 and \$2.35, respectively. For the six month periods ended December 31, 2011 and January 1, 2011, the weighted average fair value of stock options at their grant date was \$2.78 and \$2.30, respectively.

LEGAL MATTERS

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

A former employee sued the Company in a complaint filed July 27, 2006 in the Superior Court of California, San Mateo County (case No. CIV 456550) alleging a failure to pay all wages, failure to pay overtime wages, failure to pay minimum wages, failure to provide meal periods, violation of Labor Code §450, violation of Labor Code §2802 and California Code of Regulations §11040(9)(A), statutory wage violations (late payment of wages), unlawful business practices under Business and Professions Code §16720 and §17200, conversion of wages and violation of Civil Code §52.1. The plaintiff purports to bring the action also on behalf of current and former California bebe employees who are similarly situated. The lawsuit seeks compensatory, statutory, punitive, restitution and injunctive relief. In September 2011, the Court certified a class of store managers who allege they were required to buy and wear our product as a condition of employment and denied certification relating to claims of missed meal periods and rest breaks. The Court has scheduled a hearing for our Motion for Summary Judgment for February 2012 and trial for March 2012.

A former employee sued the Company in a complaint filed a second amended complaint on or about September 7, 2010 in the Superior Court of California, Los Angeles County (Case No. BC429140) alleging that the Company failed to provide timely payments of commission payments, failed to provide adequate disclosure of its commission policy and wrongfully withheld commission payments. The plaintiff purports to bring the action also on behalf of current and former California bebe employees who are similarly situated. The lawsuit seeks compensatory, statutory, punitive, restitution and injunctive relief. The Court rescheduled the trial date regarding plaintiff's individual claims for June 2012. Named plaintiff has not yet made any attempt to certify a class in this matter.

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

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

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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. While we attract a broad audience, our target customer is a 21 to 34-year-old woman who seeks current fashion trends to suit her lifestyle. The "bebe look" appeals to a hip, sexy, sophisticated, body-conscious woman who takes pride in her appearance. The bebe customer expects value in the form of current fashion and high quality at a competitive price.

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

We market our products under the bebe, BEBE SPORT, bbsp and 2b bebe brand names through our 256 retail stores, of which 213 are bebe stores, including an on-line store at www.bebe.com, and 43 are 2b bebe stores, including an on-line store at www.2bstores.com, as of December 31, 2011. These stores are located in 36 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada and Japan. In addition, our licensees operate 104 international point-of-sale locations in 19 countries as of December 31, 2011. During the six months ended December 31, 2011, we opened a bebe store and three 2b bebe stores, as well as migrated our 2b product offerings from www.bebe.com to www.2bstores.com. During the remainder of fiscal 2012, we expect to open approximately 3 bebe stores and up to 4 2b bebe stores, including 1 potential conversion from bebe to 2b bebe, as well our international licensees are anticipated to grow by up to 10 point-of-sale locations.

bebe stores. We were founded by Manny Mashouf, our Chief Executive Officer and Chairman of the Board. We opened our first store in San Francisco, California in 1976, which was also the year we incorporated. 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 clients.

PH8. In the fourth quarter of fiscal 2010, we decided to discontinue operations of our PH8 division, allowing us to focus our efforts on improving bebe sales and profitability, expanding internationally and continuing to develop our 2b bebe business. We closed all of our 49 PH8 stores during fiscal 2011, converting one store to a 2b bebe store. We have recorded the net costs associated with the disposition of these stores during fiscal 2011 as the stores closed and the related assets are disposed of. Prior year results for these stores have been classified within discontinued operations on our consolidated statements of operations.

2b bebe stores. As of December 31, 2011, we operated 24 2b bebe stores and 18 stores operating in the outlet store design under the 2b bebe name. The stores operating in the 2b bebe design sell bebe logo, 2b bebe merchandise and a small percentage of bebe retail markdowns. The stores operating in the outlet design sell bebe logo, 2b bebe merchandise and a large percentage of bebe retail markdowns. 2bstores.com is our 2b bebe on-line retail store and an extension of the 2b bebe store experience that provides a complete assortment of 2b bebe merchandise and is also used as a vehicle to communicate with our clients.

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 uncertain tax positions. 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, 2011. 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 after June 30. Fiscal years 2012 and 2011 each include 52 weeks. The three months ended December 31, 2011 and January 1, 2011 each include 13 weeks. The six months ended December 31, 2011 and January 1, 2011 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, 2011	January 1, 2011	December 31, 2011	January 1, 2011
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales, including production and occupancy (1)	59.9	62.9	60.0	61.4
Gross margin	40.1	37.1	40.0	38.6
Selling, general and administrative expenses (2)	32.8	35.3	34.8	37.5
Operating income	7.2	1.8	5.2	1.1
Interest and other income, net	0.1	0.2	0.1	0.2
Income from continuing operations before income taxes	7.3	2.0	5.3	1.3
Provision for income taxes	3.0	0.8	2.1	0.5
Income from continuing operations, net of tax	4.3	1.2	3.2	0.8
Loss from discontinued operations, net of tax	0	(3.2)	0	(2.3)
Net income (loss)	4.3%	(2.0)%	3.2%	(1.5)%

(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 from continuing operations increased to \$152.0 million during the three months ended December 31, 2011 from \$136.2 million for the comparable period of the prior year, an increase of \$15.8 million, or 11.6%. The increase in net sales was primarily due to a 9.6% increase in comparable store sales driven by better customer acceptance of our bebe and 2b merchandise, as well as a \$2.9 million increase in wholesale sales to our international licensees.

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For the six months ended December 31, 2011, net sales from continuing operations increased to \$278.3 million from \$251.5 million for the comparable period of the prior year, an increase of \$26.8 million, or 10.7%. The increase in net sales was primarily due to an 8.4% increase in comparable store sales driven by better customer acceptance of our bebe and 2b merchandise, as well as a \$6.3 million increase in wholesale sales to our international licensees.

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	Three Months Ended		Six Months Ended	
	December 31, 2011	January 1, 2011	December 31, 2011	January 1, 2011
Net sales (In thousands)	\$ 151,987	\$ 136,209	\$ 278,259	\$ 251,465
Total net sales increase percentage	11.6%	3.3%	10.7%	1.0%
Comparable store increase (decrease) percentage (1)	9.6%	0.0%	8.4%	(2.3)%
Net sales per average square foot (2)	\$ 125	\$ 116	\$ 227	\$ 215
Square footage at end of period (In thousands)	1,018	1,022	1,018	1,022
Number of store locations:				
Beginning of period	251	276	253	298
New store locations	5	2	5	4
Closed store locations (3)	0	25	2	49
Number of stores open at end of period	256	253	256	253

- (1) 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. Beginning in the first quarter of fiscal 2012, we are reporting comparable store sales results inclusive of our on-line stores. We believe that given the similar nature and process of inventory planning, allocation and return policy for the on-line stores and all other retail stores, the inclusion of the on-line stores is a more meaningful way of reporting our comparable store sales results. In addition, we have been implementing cross-channel marketing initiatives, which benefit all retail sales, including our on-line stores. The inclusion of the on-line stores increased the comparable store percentage by 3.2% and 3.0% for the three and six month periods ended December 31, 2011.
- (2) We calculate net sales per average square foot using net store sales less on-line net sales and monthly average store square footage.
- (3) In fiscal 2011, closed store locations relate to the discontinuation of PH8 operations.
- Gross Margin.* Gross margin from continuing operations increased to \$60.9 million during the three months ended December 31, 2011 from \$50.5 million for the comparable period of the prior year, an increase of \$10.4 million, or 20.6%. As a percentage of net sales, gross margin increased to 40.1% for the three months ended December 31, 2011 from 37.1% in the comparable period of the prior year. The increase in gross margin as a percentage of net sales was primarily due to an increase in merchandise margin, coupled with a positive occupancy leverage, partially offset by an increase in reserves and write offs. The increase in merchandise margin was fueled by lower markdowns, partially offset by the growth of 2b and international wholesale sales which were at a lower merchandise margin.

For the six months ended December 31, 2011, gross margin from continuing operations increased to \$111.4 million from \$97.1 million for the comparable period of the prior year, an increase of \$14.3 million, or 14.7%. As a percentage of net sales, gross margin from continuing operations increased to 40.0% for the six months ended December 31, 2011 from 38.6% in the comparable period of the prior year. The increase in gross margin as a percentage of net sales was primarily due to an increase in merchandise margin, coupled with a positive occupancy leverage, partially offset by an increase in reserves and write offs. The increase in merchandise margin was fueled by lower markdowns, partially offset by the growth of 2b and international wholesale sales which were at a lower merchandise margin.

Selling, General and Administrative Expenses. Selling, general and administrative expenses from continuing operations increased to \$49.9 million during the three months ended December 31, 2011 from \$48.0 million for the comparable period of the prior year, an increase of \$1.9 million, or 4.0%. As a percentage of net sales, selling, general and administrative expenses decreased to 32.8% during the three months ended December 31, 2011 from 35.2% in the comparable period of the prior year. The decrease over the prior year was primarily due to insurance proceeds combined with lower impairment and store closure costs. The dollar increase over the prior year was primarily due to higher compensation expenses partially offset by insurance proceeds combined with lower impairment and store closure costs.

For the six months ended December 31, 2011, selling, general and administrative expenses from continuing operations increased to \$97.0 million from \$94.3 million for the comparable period of the prior year, an increase of \$2.7 million, or 2.9%. As a percentage of net sales, selling, general and administrative expenses decreased to 34.8% from 37.5% in the comparable period of the prior year. The decrease over the prior year primarily related to insurance proceeds combined with lower impairment and store closure costs. The dollar increase over the prior year was primarily due to higher compensation expenses partially offset by insurance proceeds combined with lower impairment and store closure costs.

Provision for Income Taxes. Our effective tax rate from continuing operations decreased to 40.9% for the three months ended December 31, 2011 from 41.4% for the comparable period in the prior year.

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For the six months ended December 31, 2011, our effective tax rate from continuing operations decreased to 40.0% from 41.6% for the comparable period for the prior year. The lower tax rate in the current year was primarily due to the tax benefit related to state tax credits recorded in the first quarter of fiscal 2012 as well as permanent items having a smaller overall effect as a result of higher pre-tax income.

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Discontinued Operations. In the fourth quarter of fiscal 2010 we decided to discontinue operations of the PH8 division, allowing us to focus our efforts on improving bebe sales and profitability, expanding internationally and continuing to develop our 2b bebe business. We closed 24 PH8 stores in the first fiscal quarter of 2011 and during the second fiscal quarter of 2011, closed the remaining 25 PH8 stores. The results of the PH8 stores closed to date, net of income tax benefit, which consists of 49 stores for the three and six months ended January 1, 2011, have been presented as a discontinued operation in the accompanying consolidated statements of operations for all periods presented and are as follows:

	Three Months Ended		Six Months Ended	
	December 31, 2011	January 1, 2011	December 31, 2011	January 1, 2011
	(In thousands)			
Net sales	\$ 0	\$ 4,146	\$ 0	\$ 7,850
Cost of sales, including production and occupancy	0	9,591	0	13,368
Gross margin	0	(5,445)	0	(5,518)
Selling, general and administrative expenses	0	1,706	0	4,116
Loss from discontinued operation, before income tax benefit	0	(7,151)	0	(9,634)
Income tax benefit	0	(2,796)	0	(3,799)
Loss from discontinued operations, net of tax benefit	\$ 0	\$ (4,355)	\$ 0	\$ (5,835)

Table of Contents**SEASONALITY OF BUSINESS AND QUARTERLY RESULTS**

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

LIQUIDITY AND CAPITAL RESOURCES

Our working capital requirements vary widely throughout the year and generally peak during the first and second fiscal quarters. As of December 31, 2011, we had approximately \$271.5 million of cash and equivalents and investments on hand of which \$119.9 million were cash and equivalents, approximately \$72.0 million were invested in government treasury bills, approximately \$15.6 million were invested in certificates of deposit and approximately \$64.0 million, net of temporary impairment charges of \$10.0 million, were invested in auction rate securities (ARS). We do not anticipate the lack of liquidity in the ARS to impact our ability to fund our operations in the foreseeable future and believe we have sufficient cash and equivalents to fund ongoing operations. In addition, we have a revolving line of credit, under which we may borrow or issue letters of credit up to a combined total of \$25 million. As of December 31, 2011, there were no cash borrowings outstanding under the line of credit, no trade letters of credit outstanding and \$3.0 million in a stand-by letter of credit outstanding. This credit facility requires us to maintain a \$2.5 million compensating balance and to comply with certain financial covenants, including amounts for minimum tangible net worth, unencumbered liquid assets and profitability, and certain restrictions on making loans and investments. As of December 31, 2011, we were in compliance with all covenants in this credit facility.

As of December 31, 2011, we had cash and equivalents of \$119.9 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, 2011 was \$32.1 million versus \$14.0 million for the six months ended January 1, 2011. The increase of \$18.1 million from the comparable period was due to an overall increase in net income of \$12.8 million over the prior period, an associated decrease in our prepaid income tax balance over the prior year primarily related to net income in the current period, as well as an increase in receivables related to the timing of payments from our international licensees. These increases have been partially offset by non-cash decreases to deferred income tax assets due to the change in bonus depreciation rules that occurred in the prior period.

Net cash used by investing activities for the six months ended December 31, 2011 was \$1.3 million versus \$11.5 million provided by investing activities for the six months ended January 1, 2011. The decrease of \$12.8 million versus the prior year comparable period was primarily due to increased investments in property and equipment. We expect that total capital expenditures will be approximately \$27 million in fiscal 2012, which will include capital expenditures for new stores, remodels, store expansions, information technology systems and office improvements. In addition, we are negotiating to purchase our distribution center in Benicia, CA.

Net cash used by financing activities was \$3.6 million for the six months ended December 31, 2011 versus \$100.5 million for the six months ended January 1, 2011. The decrease of \$96.9 million from the prior year comparable period was primarily due to the prior year payout of the special \$1 per share dividend declared in the fourth quarter of fiscal 2010 and the purchases of our common stock made during the prior year period.

We hold a variety of interest bearing ARS consisting of federally insured student loan backed securities and insured municipal authority bonds. As of December 31, 2011, our ARS portfolio totaled approximately \$64.0 million classified as available for sale securities. As of that date, our ARS portfolio included approximately 95% federally insured student loan backed securities and 5% municipal authority bonds and consisted of approximately 41% AAA rated investments, 7% AA rated investments, 36% A rated investments, 7% BBB rated investments and 9% CCC rated investments. As of July 2, 2011, our ARS portfolio consisted of 42% AAA rated investments, 7% AA rated investments, 35% A rated

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investments, 7% BBB rated investments and 9% CCC rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected our holdings in ARS investments and auctions for our investments in these securities have failed to settle on their respective settlement dates. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and we will not be able to access these funds until a future auction of these investments is successful, the issuer redeems the securities, or at maturity. Maturity dates for these ARS investments range from 2016 to 2044 with principal distributions occurring on certain securities prior to maturity. During the three and six months ended December 31, 2011, \$1.0 million of ARS were settled at par.

We also hold short-term available for sale securities totaling \$87.6 million at December 31, 2011 that consist of treasury bills and certificates of deposit.

In October 2008, our board of directors authorized a program to repurchase up to \$30 million of our common stock. No shares were repurchased during the six months ended December 31, 2011. During the six months ended January 1, 2011, we repurchased 2,137,344 shares at an average price per share of \$5.84. We have repurchased the full authorization of \$30 million of shares, but may repurchase additional shares in the future.

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

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.

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

All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents. Investments are considered short-term available for sale securities if the original maturity is between three months and twelve months, or long term investments if the original maturity is greater than twelve months. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. We determined the estimated fair value of our investment in ARS as of December 31, 2011 using a discounted cash flow model to estimate the fair value of our investments in ARS. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows and expected holding periods of the ARS. We have modified our investment strategy and increased our investments in more liquid money market investments.

The following table lists our cash, cash equivalents and investments as of December 31, 2011:

	Fair Value (Dollars in thousands)
Cash	\$ 65,242
Weighted average interest rate	0.00%
Cash equivalents	\$ 54,655
Weighted average interest rate	0.18%
Current available for sale securities	\$ 87,582
Weighted average interest rate	0.36%
Non-current available for sale securities	\$ 64,047
Weighted average interest rate	0.37%
Total	\$ 271,526

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

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 do not hedge against foreign currency risks and believe that foreign currency exchange risk is immaterial.

ITEM 4. CONTROLS AND PROCEDURES

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

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There has been no change in our internal control over financial reporting during the quarter ended December 31, 2011 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. Except for the addition of the security risk factor, there have been no material changes in our risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended July 2, 2011.

1. The success of our business depends in large part on our ability to identify fashion trends as well as to react to changing customer demand in a timely manner. Consequently, we depend in part upon the customer response to the creative efforts of our merchandising, design and marketing teams and their ability to anticipate trends and fashions that will appeal to our consumer base. If we miscalculate our customers product preferences or the demand for our products, we may be faced with excess inventory. Historically, this type of occurrence has resulted in excess fabric for some products and markdowns and/or write-offs, which has impaired our profitability, and may do so in the future. Similarly, any failure on our part to anticipate, identify and respond effectively to changing customer demands and fashion trends will adversely affect our sales. In addition, from time to time, we may pursue new concepts, and if the new concepts are not successful, our financial condition may be harmed.

2. We face increasing product costs from our manufacturing partners, which could result in significant margin erosion. Worldwide prices for raw materials have increased significantly year-over-year. We currently estimate that these increasing product costs could result in significant margin erosion. Additionally, a significant percentage of our apparel products are manufactured in China. Manufacturers in that country are currently experiencing increased costs due to shortages of labor and the fluctuation of the Chinese Yuan in relation to the U.S. dollar. In addition, our business and operating results may be affected by changes in the political, social or economic environment in China. If we are unable to successfully mitigate a significant portion of such product costs, our results of operations may be materially adversely affected.

3. If we are unable to obtain raw materials or unable to find manufacturing facilities or our manufacturers perform unacceptably, our sales may be negatively affected and our financial condition may be harmed. We do not own any manufacturing facilities and therefore depend on contractors and third parties to manufacture our products. We place all of our orders for production of merchandise and raw materials by purchase order and do not have any long-term contracts with any manufacturer or supplier. If we fail to maintain favorable relationships with our manufacturers and suppliers or are unable to obtain sufficient quantities of quality raw materials on commercially reasonable terms, it could harm our business and results of operations.

We cannot assure you that contractors and third-party manufacturers (1) will not supply similar products to our competitors, (2) will not stop supplying products to us completely or (3) will supply products in a timely manner. Untimely receipt of products may result in lower than anticipated sales and markdowns which would have a negative impact on earnings. Furthermore, we have received in the past, and may receive in the future, shipments of products from manufacturers that fail to conform to our quality control standards. In such event, unless we are able to obtain replacement products in a timely manner, we may lose sales. Certain of our third-party manufacturers store our raw materials. In the event our inventory was damaged or destroyed and we were unable to obtain replacement raw materials, our earnings could be negatively impacted.

4. We face significant competition in the retail and apparel industry, which could harm our sales and profitability. The retail and apparel industries are highly competitive and are characterized by low barriers to entry. We expect competition in our markets to increase. The primary competitive factors in our markets are: brand name recognition, sourcing, product styling, quality, presentation and pricing, timeliness of product development and delivery, store ambiance, customer service and convenience. We compete with traditional department stores, specialty store retailers, 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 adequately compete with them. If we fail to remain competitive in any way, it could harm our business, financial condition and results of operations.

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

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

6. We cannot assure that future store openings will be successful and new store openings may impact existing stores. We expect to open approximately 11 stores for bebe and 2b bebe in fiscal 2012 as well as up to 60 international licensee operated point-of-sale locations. In the past, we have closed stores as a result of poor performance, and we cannot assure that the stores that we plan to open in fiscal 2012, or any other stores that we might open in the future, will be successful or that our overall operating profit will increase as a result of opening these stores. During fiscal 2011, we closed 55 stores, primarily due to the PH8 discontinued operations discussed previously, and during fiscal 2012, we anticipate closing up to 11 stores. Most of our new store openings in fiscal 2012 will be in existing markets. These openings may affect the existing stores' net sales and profitability. Our failure to predict accurately the demographic or retail environment at any future store location could have a material adverse effect on our business, financial condition and results of operations.

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

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

In addition, our comparable store sales have fluctuated significantly in the past, and we expect that they will continue to fluctuate in the future. 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.

8. 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 from within our company. There is substantial competition for experienced personnel, which we expect will continue. We compete for experienced personnel with companies who have greater financial resources than we do. In the past, we have experienced significant turnover of our executive management team and retail store personnel. We are also exposed to employment practice litigation due to the large number of employees and high turnover of our sales associates. If we fail to attract, motivate and retain qualified personnel, it could harm our business and limit our ability to expand.

In addition, we depend upon the expertise and execution of our key employees, particularly: Manny Mashouf, our founder, Chief Executive Officer and Chairman of the Board of Directors; and Emilia Fabricant, President. If we lose the services of Mr. Mashouf, Ms. Fabricant, or any key officers or employees, it could harm our business and results of operations.

9. Because Manny Mashouf beneficially owns a substantial portion of the outstanding shares, other shareholders may not be able to influence the direction the company takes. As of January 31, 2012, Manny Mashouf, our Chief Executive Officer and Chairman of the Board, beneficially owned approximately 54% of the outstanding shares of our common stock. As a result, he can control the election of directors and the outcome of all issues submitted to the shareholders. This may make it more difficult for a third party to acquire shares, may discourage acquisition bids, and could limit the price that certain investors might be willing to pay for shares of common stock. This concentration of stock ownership may have the effect of delaying, deferring or preventing a change in control of our company.

10. We rely on information technology, 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 do not have adequate systems in place, or should we experience any delays or difficulties in transitioning to these or other new systems, or in integrating these systems with our current systems, or we experience any other disruptions affecting our information systems, we could experience a material adverse impact on our business. Should we experience unauthorized access, disclosure or use of any of our systems, or if our security controls, computer assets and sensitive data, including client data, are breached, this could also damage our reputation with our clients. Further, with increased technology and other patent litigation hitting the industry, and especially given our reliance on our vendor's purported ownership of third party software we license, we face the potential of receiving claims that the technology we use or license infringes on another's proprietary rights. Should this occur, and while we may secure indemnification rights in certain transactions, 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.

11. We are subject to risks associated with our on-line sales. We operate on-line stores at www.bebe.com and www.2bstores.com to sell our merchandise. Although our on-line sales encompass a relatively small percentage of our total sales, our on-line operations are subject to numerous risks, including unanticipated operating problems, reliance on third-party computer hardware and software providers and system failures. The on-line operations also involve other risks that could have an impact on our results of operations including but not limited to diversion of sales from our other stores, rapid technological change, liability for on-line content, credit card fraud and loss of sensitive data. In addition, with the migration to a third-party platform for our bebe.com store, we no longer have direct control of certain aspects of our on-line business. We cannot assure that our on-line stores will continue to achieve sales and profitability growth or even remain at their current level.

12. 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. There is an increased dependence on digital technologies by public companies and an increasing frequency and severity of 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 online activities to connect with our customers. While we have implemented measures to prevent security breaches and cyber incidents, given the ever increasing abilities of those intent on breaching

cyber-security measures and given our reliance on the security and other efforts of third-party vendors, the total security effort at any point in time may not be completely effective and any such security breaches and cyber incidents could adversely affect our business.

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

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

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

We are seeking to register our trademarks domestically and internationally. Obstacles may exist that may prevent us from obtaining a trademark for the bebe, BEBE SPORT, bbsp and 2b bebe names or related names. We may not be able to register certain trademarks, purchase the right or obtain a license to use these names or related names on commercially reasonable terms. If we fail to obtain trademark, ownership or license the requisite rights, it would limit our ability to expand. In some

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jurisdictions, despite successful registration of our trademarks, third parties may allege infringement and bring actions against us. In addition, if our licensees fail to use our intellectual property correctly, the reputation and value associated with our trademarks may be diluted. Furthermore, if we do not demonstrate use of our trademarks, our trademark rights may lapse over time.

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

17. We may be required to record losses in future quarters as a result of the decline in value of our investments in auction rates securities or as a result of a change in our ability to hold our investments in auction rate securities. We hold a variety of interest bearing ARS comprised of federally insured student loan backed securities and insured municipal authority bonds. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The recent uncertainties in the credit markets that began in February 2008 have affected our holdings in ARS investments and the majority of auctions for our investments in these securities have failed to settle on their respective settlement dates. Consequently, \$64.0 million of our ARS are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful or securities are purchased or redeemed outside of the auction process. Maturity dates for these ARS investments range from 2016 to 2044, with principal distributions occurring on certain securities prior to maturity.

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

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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. RESERVED

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.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Presentation Linkbasae

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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, 2012

bebe stores, inc.

/s/ Walter Parks

Walter Parks, Chief Operating Officer and Chief Financial Officer

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