TILLY'S, INC.
Form 10-K
April 03, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended February 2, 2013

OR

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

Commission File Number: 001-35535

TILLY S, INC.

(Exact name of registrant as specified in its charter)

Delaware	**45-2164791**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
10 Whatney, Irvine, CA	**92618**
(Address of principal executive offices)	**(Zip Code)**

(949) 609-5599

(Registrant s telephone number, including area code)

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Class A Common Stock, $0.001 par value per share	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

Large accelerated filer: ¨	Accelerated filer: ¨
Nonaccelerated filer: x (Do not check if a smaller reporting company)	Smaller reporting company: ¨

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

The aggregate market value of voting stock held by nonaffiliates of the registrant as of the last business day of the registrant s most recently completed second fiscal quarter, at July 27, 2012, was $149,771,974 based on the closing sale price of $16.19 per share.

The registrant had 10,792,859 shares of Class A common stock, par value $0.001 per share, outstanding at March 15, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the registrant s Annual Meeting of Stockholders to be held June 12, 2013 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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Forward-Looking Statements

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

- our ability to successfully open a significant number of new stores;
- effectively adapting to new challenges associated with our expansion into new geographic markets;
- our ability to maintain and enhance a strong brand image;
- generating adequate cash from our existing stores to support our growth;
- identifying and responding to new and changing customer fashion preferences and fashion-related trends;
- competing effectively in an environment of intense competition;
- containing the increase in the cost of mailing catalogs, paper and printing;
- the success of the malls, power centers, neighborhood and lifestyle centers, outlet centers and street-front locations in which our stores are located;
- our ability to attract customers in the various retail venues and geographies in which our stores are located;
- adapting to declines in consumer confidence and decreases in consumer spending;
- our ability to adapt to significant changes in sales due to the seasonality of our business;
- price reductions or inventory shortages resulting from failure to purchase the appropriate amount of inventory in advance of the season in which it will be sold;

natural disasters, unusually adverse weather conditions, boycotts and unanticipated events;

changes in the competitive environment in our industry and the markets we serve, including increased competition from other retailers;

our dependence on third-party vendors to provide us with sufficient quantities of merchandise at acceptable prices;

increases in costs of fuel or other energy, transportation or utility costs and in the costs of labor and employment;

our ability to balance proprietary branded merchandise with the third-party branded merchandise we sell;

most of our merchandise is made in foreign countries, making price and availability of our merchandise susceptible to international trade conditions;

failure of our vendors and their manufacturing sources to use acceptable labor or other practices;

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- our dependence upon key executive management or our inability to hire or retain the talent required for our business;
- our ability to effectively adapt to our rapid expansion in recent years and our planned expansion;
- failure of our information technology systems to support our current and growing business, before and after our planned upgrades;
- disruptions in our supply chain and distribution center;
- our indebtedness and lease obligations, including restrictions on our operations contained therein;
- our reliance upon independent third-party transportation providers for certain of our product shipments;
- our ability to maintain comparable store sales or sales per square foot, which may cause our operations and stock price to be volatile;
- disruptions to our information systems in the ordinary course or as a result of systems upgrades;
- our inability to protect our trademarks or other intellectual property rights;
- acts of war, terrorism or civil unrest;
- the impact of governmental laws and regulations and the outcomes of legal proceedings;
- our ability to secure the personal financial information of our customers and comply with the security standards for the credit card industry;
- our failure to maintain adequate internal controls over our financial and management systems; and
- increased costs as a result of being a public company.

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

See Risk Factors for a more complete discussion of the risks and uncertainties mentioned above and for discussion of other risks and uncertainties. All forward-looking statements attributable to us are expressly qualified in their entirety by these cautionary statements as well as others made in this annual report and hereafter in our other SEC filings and public communications. You should evaluate all forward-looking statements made by us in the context of these risks and uncertainties.

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

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PART I

Item 1. Business

Our Company

Tilly s is a fast-growing destination specialty retailer of West Coast inspired apparel, footwear and accessories. We believe we bring together an unparalleled selection of the most sought-after brands rooted in action sports, music, art and fashion. Our stores are designed to be a seamless extension of our teen and young adult consumers lifestyles with a balance of guys and juniors merchandise in a stimulating environment. We believe our success across a variety of real estate venues and geographies in the United States demonstrates Tilly s portability. Our motto If it s not here it s not happening exemplifies our goal to serve as a destination for the latest, most relevant merchandise and brands important to our customers.

The Tilly s concept began in 1982 when our co-founders, Hezy Shaked and Tilly Levine, opened their first store in Orange County, California. Since 1984 the business has been conducted through World of Jeans & Tops, Inc., a California corporation (WOJT) formed by our co-founders, which operates under the name Tilly s . In May 2011, Tilly s, Inc., a Delaware corporation, was formed solely for the purpose of reorganizing the corporate structure of WOJT in preparation for an initial public offering (IPO).

As used in this Annual Report, except where the context otherwise requires or where otherwise indicated, the terms the Company , World of Jeans & Tops , WOJT , we , our , us and Tilly s refer to WOJT before the Reorganization Transaction (as defined below), and to Tilly s, Inc subsidiary after the Reorganization Transaction.

Reorganization Transaction and IPO

On May 2, 2012, the shareholders of WOJT contributed all of their equity interests in WOJT to Tilly s, Inc. in exchange for shares of Tilly s, Inc. Class B common stock on a one-for-one basis. In addition, WOJT terminated its S Corporation status and became a C Corporation. These events are collectively referred to as the Reorganization Transaction . As a result of the Reorganization Transaction, WOJT became a wholly owned subsidiary of Tilly s, Inc.

On May 3, 2012, we completed an IPO in which we issued and sold 7,600,000 shares of Class A common stock at a price of $15.50 per share, less underwriting discounts and offering expenses payable by us, a portion of which was reimbursed by the underwriters. Certain of our stockholders also sold 1,600,000 shares of Class A common stock in the IPO at a price of $15.50 per share. We did not receive any of the proceeds from the sale of stock by our stockholders. As a result of the IPO, we raised net proceeds of approximately $107 million, after deducting the underwriting discount of $8.7 million and related fees and expenses of approximately $2.5 million. On May 9, 2012, we used $84.0 million of the net proceeds from the IPO to pay in full the principal amount of notes representing WOJT s undistributed taxable income. These notes were issued to the former shareholders of WOJT in connection with the Reorganization Transaction and all payments were made to trusts related to our founders Hezy Shaked and Tilly Levine, and their children.

Our Strengths

We believe that the following competitive strengths contribute to our success and distinguish us from our competitors:

Destination retailer with a broad, relevant assortment. We believe the combined depth and breadth of apparel, footwear and accessories offered at our stores exceeds the selection offered at many other specialty retailers. We offer an extensive selection of third-party, West Coast inspired and action sports brands complemented by our proprietary brands. Our merchandise includes a wide assortment of

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brands, styles, colors, sizes and price points to ensure we have what our customers want every time they visit our stores. We offer a balanced mix of merchandise across the guys and juniors categories, with additional merchandise in the boys, girls, footwear and accessories categories. We believe that by combining proven fashion trends and core style products with a vibrant blend of carefully selected music and visuals, we provide an in-store experience that is authentic, fun, and engaging for our core customers. We believe that our differentiated in-store environment, evolving selection of relevant brands and broader and deeper assortment positions us as a retail destination that appeals to a larger demographic than many other specialty retailers and encourages customers to visit our stores more frequently and spend more on each trip.

Dynamic merchandise model. We believe our extensive selection of third-party and proprietary merchandise allows us to identify and address trends more quickly, offer a greater range of price points and manage our inventories more dynamically. By closely monitoring trends and shipping product to our stores five times per week, we are able to adjust our merchandise mix based on store size and location. We also keep our merchandise mix relevant by introducing emerging brands not available at many other retailers. Our merchandising capabilities enable us to adjust our merchandise mix with a frequency that promotes a current look to our stores and encourages frequent visits.

Flexible real estate strategy across real estate venues and geographies. Our stores have proven to be successful in different real estate venues and geographies. As of February 2, 2013, we operated profitable stores in malls, power centers, neighborhood and lifestyle centers, outlet centers and street-front locations across 60 markets in 28 states. We believe our success operating in these different retail venues and geographies demonstrates the portability of Tilly s and provides us with greater flexibility for future expansion.

Multi-pronged marketing approach. We utilize a multi-pronged marketing strategy to connect with our customers and drive traffic to our stores and website. First, we distribute catalogs to potential and existing customers from our proprietary database to familiarize them with the Tilly s brand and our products and to drive sales to our stores and our website. Second, we partner and collaborate with our vendors on exclusive events and contests to build credibility with our target customers, actively involve them in our brands, and enhance the connection between Tilly s and the West Coast lifestyle. Third, we use social media to communicate directly with our customers while also encouraging customers to interact with one another and provide feedback on our events and products. Fourth, through our We Care Program , we support and participate in various academic, art, and athletic programs at local schools and other organizations in communities surrounding our stores. All of these programs are complemented by email marketing as well as traditional radio and print advertising to build customer awareness and loyalty, highlight key merchandise offerings, drive traffic to our stores and website and promote the Tilly s brand.

Sophisticated systems and distribution infrastructure to support growth. Over the last five years, we have invested over $25 million in our highly automated distribution center and information systems to support our future growth. We believe our distribution and allocation capabilities are unique within the industry and allow us to operate at a higher level of efficiency than many of our competitors. Our distribution center allows us to quickly sort and process merchandise and deliver it to our stores in a floor-ready format for immediate display. Our systems enable us to respond to changing fashion trends, manage inventory in real time and provide a customized selection of merchandise at each location. We believe our distribution infrastructure can support a national retail footprint in excess of 500 stores with minimal incremental capital investment.

Experienced management team. Our senior management team, led by Hezy Shaked and Daniel Griesemer, has extensive experience across a wide range of disciplines in the specialty retail and direct-to-consumer industries, including store operations, merchandising, distribution, real estate, and finance. Mr. Shaked, our Co-Founder, Chairman of the Board of Directors, and Chief Strategy Officer, plays an important role in developing our long-term growth initiatives and cultivating our unique culture.

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Mr. Griesemer, our President and Chief Executive Officer, joined Tilly s in February 2011 with 28 years of retail experience. He served in various roles with Coldwater Creek, Inc. from 2001 to 2009 including most recently as Chief Executive Officer. During his tenure, Coldwater Creek increased the store base from 13 to approximately 400 and increased revenues from approximately $340 million to approximately $1.1 billion. Mr. Griesemer also served in leadership positions at Gap, Inc. and Macy s, Inc.

Growth Strategy

We are pursuing several strategies to continue our profitable growth, including:

Expand Our Store Base. We believe there is a significant opportunity to expand our store base from 168 locations as of February 2, 2013 to more than 500 stores across the United States over the next eight years. We have a proven ability to expand the number of stores we operate, as we have more than doubled our store count over the last five years from 73 stores at the beginning of fiscal 2008 to 168 stores at February 2, 2013. We plan to add at least 25 net new stores in fiscal year 2013 and to continue opening new stores at an annual rate of approximately 15% for the next several years thereafter. Our plan includes new store openings in both existing and new markets, and in both mall and off-mall locations.

As of February 2, 2013, we operated stores in 28 states. Over the past five years we have grown our presence in existing markets and successfully expanded into 42 new markets. We have entered new markets by opening stores in high traffic malls relevant to our core customer in order to establish the Tilly s brand, as well as in off-mall locations that effectively cover trade areas where our customers want to shop. The opportunity exists to continue to significantly broaden our national footprint by entering new markets through both mall and off-mall locations.

Drive Comparable Store Sales. We seek to maximize our comparable store sales by consistently offering new, on-trend and relevant merchandise across a broad assortment of categories, increasing our brand awareness through our multi-pronged marketing approach, providing an authentic store experience for our core customers and maintaining our high level of customer service. We believe our comparable store sales will benefit as stores opened in the last few years continue to mature and we continue to build brand awareness in new markets.

Grow Our e-Commerce Platform. We believe our e-commerce platform is an extension of our brand and retail stores, providing our customers a seamless shopping experience. Our e-commerce platform allows us to provide an expanded product offering relative to our stores, reach new customers and build our brand in markets where we currently do not have stores. In fiscal year 2012, our e-commerce net sales increased 21% over fiscal 2011 and represented a little more than 11% of our net sales, up from 6% of net sales in fiscal year 2008. We believe that our target customer regularly shops online and we see continued opportunity to grow our e-commerce business to approximately 15% of total net sales over time. Key factors driving growth include continuing our successful catalog and online marketing efforts, offering a wider selection of Internet-exclusive merchandise and expanding our online selection to ensure a broad and diverse offering of brands and products relative to our competition. We also believe we will see continued growth in our e-commerce sales as we open additional stores and build brand awareness in the communities surrounding those locations. To support this growth, we plan to open a new e-commerce distribution center by the end of fiscal year 2013.

Increase Our Operating Margins. We believe we have the opportunity to drive margin expansion through scale efficiencies and continued process improvements. We believe comparable store sales increases combined with our planned store growth will permit us to take advantage of largely fixed occupancy costs, favorable buying costs from larger volume purchases, leverage of our costs for store management and corporate overhead as well as the fixed portion of shipping and handling costs over higher sales volumes. In addition, we expect to improve margins and support growth by leveraging ongoing investments in infrastructure, including the opening of a dedicated distribution center for our e-commerce store and continuing upgrades to our point-of-sale, merchandise allocation and merchandise planning systems, as well as related work processes. We also will continue to use established business processes to identify and execute initiatives focused on lowering our unit costs and improving operational efficiency throughout our organization.

Merchandising, Purchasing, and Planning and Allocation

Merchandising

We seek to be viewed by our customers as the destination for West Coast inspired and action sports related apparel, footwear and accessories. We believe we offer an unparalleled selection of relevant brands, styles, colors, sizes and price points to ensure we have what our customers want every time they visit our stores. Our extensive selection of third-party and proprietary merchandise allows us to identify and address trends more quickly, offer a greater range of price points and manage our inventories more dynamically. We offer a balanced mix of merchandise across the guys and juniors categories, with additional merchandise in the boys, girls, footwear and accessories categories. We believe this category mix contributes to our broad demographic appeal. Our apparel merchandise includes branded, fashion and core styles for tops, outerwear, bottoms, and dresses. Accessories merchandise includes backpacks, hats, sunglasses, headphones, handbags, watches, jewelry and more. We focus on our merchandise presentation and vary the visual displays in our stores and windows multiple times per month, presenting new looks and fashion combinations to our customers.

Our ability to maintain an image consistent with the West Coast inspired and action sports lifestyle is important to our branded vendors and provides us better access to a wide assortment of products and styles. Our third-party branded merchandise features established and emerging brands. We strive to keep our merchandise mix current by continuously introducing emerging brands and styles not available at many other specialty retailers in order to identify and respond to the evolving desires of our customers. Within our diversified portfolio of hundreds of third-party brands, which represented approximately 70% of our net sales in 2012, our largest brand accounted for between 4.0% and 4.5% of our net sales in each of the last two fiscal years.

Selected third-party brands include, in alphabetical order:

Billabong	Levi s	Roxy
Converse	LRG	RVCA
DC Shoes	Metal Mulisha	Spy
Famous Stars & Straps	Neff	UGG
Fox	Nike	Vans
G-Shock	Nixon	Volcom
Hurley	O Neill	Young & Reckless
KR3W		
	Quiksilver	and many more

We supplement our third-party merchandise assortment with our own proprietary brands across many of our apparel and accessory product categories. We utilize our own branded merchandise to expand our price point range, identify and respond to changing fashion trends quickly, fill merchandise gaps and provide a deeper selection of styles and colors for proven fashion items. Our own brands represented approximately 30% and 31% of our net sales for fiscal years 2012 and 2011, respectively.

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Our proprietary branded merchandise includes:

Brand	Category
	Guys , boys and juniors denim apparel and cologne
	Juniors and girls apparel, footwear and accessories
	Guys and boys apparel and accessories
	Guys , boys and juniors apparel and cologne

We believe that our extensive selection of merchandise, from both established and emerging brands as well as our proprietary brands, caters to a wide demographic of core customers and enhances our store image as a destination that carries the most sought-after apparel, footwear and accessories.

Merchandise Purchasing

Our merchandise purchasing staff is organized by category and product type and consists of a Vice President/General Merchandise Manager and Vice Presidents, divisional merchandise managers, buyers, associate buyers and assistant buyers. We believe a key element of our success is our team s ability to identify and source the latest proven fashion trends and core styles that are most relevant to our customers.

Our purchasing approach focuses on product relevance, availability, cost and speed of production in order to provide timely frequent delivery of merchandise to our stores. Our purchasing group and planning and allocation team are highly coordinated and maintain a disciplined buying strategy.

To ensure a relevant assortment, our teams:

- perform comprehensive analysis of sales trends from our stores and e-commerce site;
- gather feedback from our customers and our staff;
- maintain regular dialogue with our existing vendor network and potential new vendors;
- utilize trend and color forecasting services;
- participate in trade shows and action sport related events;
- review trade publications; and
- evaluate merchandise assortments offered by other retail and online merchants.

We have developed and maintain strong, and in many cases long-standing, relationships with our third-party vendors and we have a history of identifying and growing with emerging brands. We believe the Tilly s brand, shopping experience and core customer lifestyle is highly consistent with the image and philosophy of our key vendors. This, in addition to our customer connectivity, facilitates a partnership culture with our key vendors and provides us access to an extensive variety of products and styles, as well as certain merchandise that is exclusive to our stores and website. Our merchandise purchasing group also works closely with independent third parties who design and procure merchandise for our proprietary brands. Our proprietary brand capabilities enhance our

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ability to rapidly identify and respond to trends and consistently offer our customers proven fashion items. We work with more than 100 vendors based in the United States to supply us with our proprietary branded product. These vendors source from both domestic and international markets and either have their own factories or contract with owners of factories to source finished product. By sourcing merchandise for our proprietary brands both domestically and internationally, we have the flexibility to benefit from shorter lead times associated with domestic manufacturing and lower costs associated with international manufacturing.

Planning and Allocation

Our merchandise planning and allocation team consists of a Vice President, directors, managers, planners and analysts. We have developed an inventory planning and allocation process to support our merchandise strategy. Working closely with our merchandise purchasing team, the planning and allocation team utilizes a disciplined approach to buying, forecasting, inventory control and allocation processes. Our planning and analysis team continually analyzes information from our management information system, including inventory levels and sell-through data, to regularly adjust the assortment at each store and the inventory levels for our company as a whole. Our broad third-party vendor base allows us to shift merchandise purchases to react quickly to changing consumer preferences and market conditions. Furthermore, the vendor base for our proprietary products provides us flexibility to develop our own branded products to quickly address emerging fashion trends and provide a deeper selection of styles, colors, and price points for proven fashion items. We modify our merchandising mix based upon store size, the season, and consumer preferences in different parts of the country. We are also able to react quickly to changing customer needs due to our shipment of merchandise to our stores five times per week. Finally, we coordinate closely with our visual merchandise managers and marketing group in order to manage inventory levels in connection with our promotions and seasonality.

Stores

Store Growth

During fiscal year 2012, we continued Tilly s national expansion by opening 28 net new stores, a 20% increase in store count. We doubled the number of states where we operate stores from 14 states at the end of fiscal year 2011 to 28 states at the end of fiscal year 2012.

As of February 2, 2013, we operated 168 stores throughout the United States. Our stores are located in mall and off-mall locations and averaged approximately 7,850 square feet. They generated average net sales per store of $2.7 million and net sales per square foot of $341 in fiscal year 2012.

The table below shows historical information for our stores by type of retail center as of fiscal year end for each of the years indicated:

	2012	2011	2010	2009	2008
Regional Mall	89	71	62	55	42
Off-Mall (1)	79	69	63	56	57
	168	140	125	111	99

(1) Includes power centers, neighborhood and lifestyle centers, outlet centers and street-front locations.

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At February 2, 2013 we operated 168 stores in 28 states as shown below:

State	Number of Stores	State	Number of Stores
Arizona	18	Nevada	6
California	79	New Jersey	7
Colorado	3	New York	3
Delaware	1	North Carolina	2
Florida	16	Ohio	1
Georgia	1	Oregon	2
Illinois	2	Pennsylvania	2
Indiana	2	South Dakota	1
Iowa	1	T ennessee	1
Kentucky	1	T exas	2
Maryland	2	Utah	3
Massachusetts	2	Virginia	3
Michigan	1	Washington	2
Minnesota	1	Wisconsin	3

Distinctive Store Experience

Tilly s is a customer-driven lifestyle brand. We are energized and inspired by our customers individuality and passion for action sports, music, art, and fashion. Our stores bring these interests together in a vibrant, stimulating and authentic environment that is an extension of our customers high velocity, multitasking lifestyle. We do this by blending the most relevant brands and styles with music videos, product-related visuals and a dedicated team of store associates. Our associates share the same passion as our customers for action sports, music, art and fashion, enabling them to easily engage with our customers and make shopping at Tilly s a fun, social experience. Outside of our stores, we connect with our consumers using the same authentic approach, including social media, community outreach and sponsorship of contests, demos, and other events. We believe the Tilly s experience drives customer awareness, loyalty and repeat visits while generating a buzz and excitement for our brand.

Expansion Opportunities and Site Selection

As of February 2, 2013 approximately 60% of our stores had been opened within the previous five years. The following table shows the number of stores opened and closed in each of our last five fiscal years:

Fiscal Year	Stores Opened	Stores Closed	Total Number of Stores at End of Period
2008	26		99
2009	13	1	111
2010	16	2	125
2011	16	1	140
2012	29	1	168
	100	5	

We plan to open at least 25 net new stores in fiscal year 2013 and to continue to open stores at an annual rate of approximately 15% for the next several years thereafter. Our new store openings are planned in both existing and new markets, for both mall and off-mall locations. We focus on locations that have above average incomes and an ability to draw from a sufficient population with attractive demographics. We have entered new markets by opening stores in high traffic malls relevant to our core customer in order to establish the Tilly s brand, as well as opening stores in off-mall locations that effectively cover trade areas where our customers want to shop.

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Store Management, Culture and Training

We believe that a key to our success is our ability to attract, train, retain and motivate qualified employees at all levels of our organization. Each of our stores typically operates with a three to five member store management team. In addition, each store has 10 or more full time equivalent store associates who represent the West Coast lifestyle and promote the Tilly s brand not only inside the store, but also in their schools and communities. The number of store associates we employ generally increases during peak selling seasons, particularly the back-to-school and the winter holiday seasons, and will increase to the extent that we open new stores.

We have developed a corporate culture that we believe empowers the individual store managers to make store-level business decisions and we reward them when they exceed sales targets. We are committed to improving the skills and careers of our workforce and providing advancement opportunities for employees. We evaluate our store associates weekly on measures such as sales per hour, units per transaction and dollars per transaction to ensure productivity, to recognize top performers and to identify potential training opportunities. We endeavor to design incentive programs for store associates that promote a competitive, yet fun, culture that is consistent with our image.

We provide our managers with the knowledge and tools to succeed through comprehensive training programs, focusing on both operational expertise and supervisory skills. Our training programs and workshops are offered at the store, district and regional levels, allowing managers from multiple locations to interact with each other and exchange ideas to better operate stores. Store associates receive training from their managers to improve their product expertise and selling skills.

e-Commerce

Our e-commerce platform was established in 2004 and has grown significantly in every year of operation. In fiscal 2012, our e-commerce net sales increased 21% relative to fiscal 2011 while traffic at www.tillys.com increased 24%. We grew our e-commerce business to a little over 11% of our total net sales in fiscal 2012 from 6% of net sales in fiscal 2008. We believe that our target customer regularly shops online and we see continued opportunity to grow our e-commerce business to approximately 15% of total net sales over time. In fiscal 2012 we sold merchandise to customers in all 50 states and approximately 10% of our e-commerce net sales were to customers in states without brick-and-mortar stores. Our website serves both as a sales channel and a marketing tool to our extended customer base, including those customers in markets where we do not currently have stores. We also believe our website reinforces the Tilly s brand image and serves as an effective advertising vehicle for our retail stores. Our website provides an expanded product offering relative to our stores and includes web exclusive merchandise. Similar to the merchandising approach in our stores, we frequently change the look of our website to highlight new brands and products and to encourage frequent visits. We utilize multiple channels to drive traffic to our website, including our catalog, marketing materials in our retail stores, search engine marketing, internet ad placement, shopping site partnerships, third-party affiliations, email marketing, mobile marketing and direct mail. In addition, we utilize the website to offer current information on our upcoming events, promotions and store locations.

Our current e-commerce fulfillment is operated out of our distribution center in Irvine, California. To accommodate our growth, by the end of fiscal year 2013 we plan to transition to a new e-commerce distribution center also located in Irvine, California.

Marketing and Advertising

Our marketing approach is designed to create an authentic connection with our customers by consistently generating a buzz and excitement for our brand while staying true to our West Coast inspired, action sports

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heritage. We utilize a multi-pronged marketing strategy to connect with our customers and drive traffic to our stores and website, comprised of the following:

Catalog. We view our catalog primarily as a sales and marketing tool to drive online and store traffic from both existing and new customers. We also believe our catalog reinforces the Tilly s brand and showcases our comprehensive selection of products in settings designed to reflect our brand s lifestyle image. In fiscal 2012, we mailed approximately 8.8 million catalogs to addresses included in our growing proprietary database, which currently includes key information on over 2.7 million customers. We send these catalogs, which include coupons that can be redeemed at stores or online, to the customers in our database several times a year, primarily around key shopping periods such as spring break, back-to-school, and the winter holidays.

Brand Partnerships. We partner and collaborate with our vendors for exclusive events such as autograph signings, in-store performances, contests, demos, giveaways, shopping sprees and VIP trips. In fiscal year 2012, we organized hundreds of events, many involving musicians, celebrities and athletes in the entertainment, music and action sports industries. For example, we partnered with Universal Music Group artist All American Rejects to host an autograph signing tour at six Tilly s locations from coast to coast. We also partnered with many major action sports brands in fiscal 2012. One such partnership was the Tilly s Young & Reckless $25,000 Sweepstakes, which generated over 100,000 entries and was supported by in-store autograph signings by Young & Reckless owner and MTV Fantasy Factory star, Drama. Through these partnerships, we are able to connect with and engage our customers in an exciting, authentic experience.

Social Media. We believe our core customers rely heavily on the opinions of their peers, often expressed through social media. Therefore we use our website blog as well as Facebook and Twitter posts as a viral marketing platform to communicate directly with our customers while also allowing customers to interact with one another and provide feedback on our events and products.

Community Outreach. Through our We Care Program and in partnership with our vendors, we support and participate in various academic, art, and athletic programs at local schools and other organizations in communities surrounding our stores.

Radio, Print and Email Marketing. We utilize traditional radio and print advertising as well as email marketing to build awareness, drive traffic to our stores and website and to promote local in-store promotions and events. We periodically send emails to the customers in our proprietary database to introduce new brands and products, offer promotions on select merchandise, highlight key events and announce new store openings. We believe there is an opportunity to use national print advertising to drive new traffic among potential customers.

Distribution

We centrally distribute all of our merchandise through a 126,000 square foot distribution facility co-located with our headquarters in Irvine, California. Our lease expires in December 2017 and we have two five-year renewal option periods. We moved to our current location in January 2003 and have invested over $37 million in our highly automated distribution center and information systems. We designed this state-of-the-art facility to allow us to manage our distribution operations in an efficient, cost-effective manner and to provide support for our growth initiatives. Extensive investments have been made to the distribution-center infrastructure, focused around systems automation, material-handling equipment, RF technologies, and automated sortation in order to further enhance our processing speed and long term scalability. We believe the automation systems we utilize in our facility allow us to operate at a higher level of efficiency and accuracy than many of our competitors.

We typically ship merchandise to our stores five times per week, providing them with a steady flow of both new and replenishment products. Merchandise is shipped in a floor-ready format (carrying price tickets, sensor tags and with hangers where appropriate) which allows store employees to spend less time processing the

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merchandise and more time with our customers. We use our own fleet of trucks to ship merchandise to our local (Southern California) stores and third-party distributors to ship merchandise to stores outside our local area.

We believe our distribution infrastructure can support a national retail footprint in excess of 500 stores with minimal incremental capital investment. In addition, we anticipate spending approximately $14 million to equip our new e-commerce distribution center, which we expect to open by the end of fiscal year 2013.

Management Information Systems

Our management information systems provide a full range of business process support and information to our store, merchandising, financial, real estate and other business teams. We selected, customized and integrated our information systems to enable and support our dynamic merchandise model. We believe our systems provide us with improved operational efficiencies, scalability, management control and timely reporting that allow us to identify and quickly respond to trends in our business. We believe that our information systems are scalable, flexible and have the capacity to accommodate our current growth plans.

We have made significant investments in our management information systems over the last several years and believe we are utilizing best of breed technology. We use software licensed from JDA Software Group, Inc. for allocation, SKU classification, inventory tracking, purchase order management and sales audit functions. We utilize MicroStrategy Incorporated for business intelligence. We utilize Manhattan Associates Inc. s warehouse management systems to handle merchandise distribution. We utilize technology from Strategic Distribution, Inc. in our distribution center enabling us to automate our merchandise sortation process, allowing us greater flexibility in scaling our operations for new store expansions and peak season operations. Our financial systems are licensed from Lawson and our payroll system uses a third-party platform provided by Automatic Data Processing, Inc.

We update our sales daily in our merchandising reporting systems by collecting sales information from each store s point-of-sale, or POS, terminals utilizing software from Micros Systems, Inc. Our POS system consists of registers providing processing of retail transactions, price look-up, time and attendance and e-mail. Sales information, inventory tracking and payroll hours are uploaded to our central host system. The host system downloads price changes, performs system maintenance and provides software updates to the stores through automated nightly two-way electronic communication with each store. We evaluate information obtained through nightly polling to implement merchandising decisions, including product purchasing/reorders, markdowns and allocation of merchandise on a daily basis.

Competition

The teenage and young adult retail apparel, accessories and footwear industry is highly competitive. We compete with other retailers for customers, store locations, store associates and management personnel. We currently compete with other teenage-focused retailers such as, but not limited to, Abercrombie & Fitch Co., Aeropostale, Inc., American Eagle Outfitters, Inc., The Buckle, Inc., Forever 21, Inc., Hot Topic, Inc., Pacific Sunwear of California, Inc., Urban Outfitters, Inc., The Wet Seal, Inc. and Zumiez, Inc. In addition, we compete with independent specialty shops, department stores and direct marketers that sell similar lines of merchandise and target customers through catalogs and e-commerce. Further, we may face new competitors and increased competition from existing competitors as we expand into new markets and increase our presence in existing markets. Given the extensive number and types of retailers with which Tilly s competes for customers, we believe that our target market is highly fragmented and we do not believe we have a significant share of this market.

Competition in our sector is based, among other things, upon merchandise offerings, store location, price and the ability to identify with the customer. We believe that we compete favorably with many of our competitors based on our differentiated merchandising strategy, store environment, flexible real estate strategy and company culture. However, many of our competitors are larger, have significantly more stores, and have substantially greater financial, marketing and other resources than we do. Moreover, we recognize that we do not possess exclusive rights to many of the elements that comprise our in-store experience and product offerings. Our competitors can emulate facets of our business strategy and in-store experience, which could result in a reduction of any competitive advantage or special appeal that we might possess. See Risk Factors We face intense competition in our industry and we may not be able to compete effectively.

Trademarks

Ambitious , Blue Crown , Division 7 , Eldon , Full Tilt , If it s not here it s not happening , Infamous , RSQ , Tilly s , Vindicated some of these names, are among our trademarks registered with the U.S. Patent and Trademark Office. We regard our trademarks as valuable and intend to maintain such marks and any related registrations. We are not aware of any claims of infringement or other challenges to our right to use our marks in the U.S. We vigorously protect our trademarks.

Employees

As of February 2, 2013, we employed approximately 1,200 full-time and approximately 2,800 part-time employees, of which approximately 500 were employed at our corporate office and distribution facility and approximately 3,500 were employed at our store locations. However, the number of employees, especially part-time employees, fluctuates depending upon our seasonal needs and, in fiscal year 2012, varied between approximately 3,600 and 6,200 employees. None of our employees are represented by a labor union and we consider our relationship with our employees to be good.

Government Regulation

We are subject to labor and employment laws, laws governing advertising and promotions, privacy laws, safety regulations, consumer protection regulations and other laws that regulate retailers and govern the promotion and sale of merchandise and the operation of stores and warehouse facilities. We monitor changes in these laws and believe that we are in material compliance with applicable laws.

Insurance

We use a combination of insurance and self-insurance for a number of risk management activities, including workers compensation, general liability, automobile liability and employee-related health care benefits, a portion of which is paid by the employees. We evaluate our insurance requirements on an ongoing basis to maintain adequate levels of coverage.

Seasonality

Due to the seasonal nature of the retail industry, we have historically experienced and expect to continue to experience some fluctuations in our revenues and net income reflecting increased demand during the year-end holiday season, other holidays, such as Easter, the beginning of spring break and peak shopping periods, such as the back-to-school season. Revenues generated during the holiday selling season generally contribute to our relatively higher fourth quarter net income. Revenues generated around the back-to-school season generally contribute to our relatively higher third quarter net income. If for any reason our revenues were below seasonal norms or expectations during these quarters, our annual results of operations could be adversely affected. The level of our working capital reflects the seasonality of our business. We expect inventory levels, along with an increase in accounts payable and accrued expenses, generally to reach their highest levels in anticipation of the increased revenues during these periods.

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Additional Information

We make available free of charge on our internet website, www.tillys.com, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after filing such material electronically with, or otherwise furnishing it to, the Securities and Exchange Commission (SEC). The public may also read and copy any materials that we have filed with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. In addition, these materials may be obtained at the web site maintained by the SEC at www.sec.gov.

The reference to our website address does not constitute incorporation by reference of the information contained on the website, and the information contained on the website is not part of this document.

Item 1A. Risk Factors

Investing in our securities involves a high degree of risk and you should carefully consider all of the information in this report. In particular, the following risks and uncertainties could materially affect our business, financial condition and results of operations in future periods, and should be kept in mind when you read forward-looking statements contained in this report. Forward-looking statements generally express expectations, beliefs, plans, objectives, assumptions and future events, and may be identified by the use of words or phrases such as anticipate , believe , estimate , expect , intend , plan and project , and similar words or phrases. The risks and uncertainties described below are not the only ones that we face. Additional risks not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and results of operations in future periods.

Risks Related to Our Business

Our business depends upon identifying and responding to changing customer fashion preferences and fashion-related trends. If we cannot identify trends in advance or we select the wrong fashion trends, our sales could be adversely affected.

Fashion trends in the West Coast inspired and action sports related apparel, footwear and accessories market can change rapidly. We need to anticipate, identify and respond quickly to changing trends and consumer demands in order to provide the merchandise our customers seek and maintain our brand image. If we cannot identify changing trends in advance, fail to react to changing trends or misjudge the market for a trend, our sales could be adversely affected and we may be faced with a substantial amount of unsold inventory or missed opportunities. As a result, we may be forced to mark down our merchandise in order to dispose of slow moving inventory, which may result in lower profit margins, negatively impacting our financial condition and results of operations.

We face intense competition in our industry and we may not be able to compete effectively.

The retail industry is highly competitive. We currently compete with other retailers such as, but not limited to, Abercrombie & Fitch Co., Aeropostale, Inc., American Eagle Outfitters, Inc., The Buckle, Inc., Forever 21, Inc., Hot Topic, Inc., Pacific Sunwear of California, Inc., Urban Outfitters, Inc., The Wet Seal, Inc. and Zumiez, Inc. In addition, we compete with independent specialty shops, department stores and direct marketers that sell similar lines of merchandise and target customers through catalogs and e-commerce. Moreover, the internet and other new technologies facilitate competitive entry and comparison shopping in our retail segment. While we offer a multichannel shopping experience and use social media as a way to interact with our customers and enhance their shopping experiences, multichannel retailing is rapidly evolving and we must keep pace with changing customer expectations and new developments by our competitors. Competition with some or all of these retailers noted above could require us to lower our prices or risk losing customers. In addition, significant or unusual promotional activities by our competitors may cause us to respond in-kind and adversely impact our operating cash flow. Because of these factors, current and future competition could have a material adverse effect on our financial condition and results of operations.

Furthermore, many of our competitors have greater financial, marketing and other resources than we currently do, and therefore may be able to devote greater resources to the marketing and sale of their products, generate national brand recognition or adopt more aggressive pricing policies than we can, which would put us at a competitive disadvantage. Moreover, we do not possess exclusive rights to many of the elements that comprise our in-store experience and product offerings. Our competitors may seek to emulate facets of our business strategy and in-store experience, which could result in a reduction of any competitive advantage or special appeal that we might possess. In addition, most of our products are sold to us on a non-exclusive basis. As a result, our current and future competitors may be able to duplicate or improve on some or all of our in-store experience or product offerings that we believe are important in differentiating our stores and our customers shopping experience. If our competitors were to duplicate or improve on some or all of our in-store experience or product offerings, our competitive position and our business could suffer.

Our sales could be severely impacted by declines in consumer confidence and decreases in consumer spending.

We depend upon consumers feeling confident to spend discretionary income on our product offering to drive our sales. Consumer spending may be adversely impacted by economic conditions such as consumer confidence in future economic conditions, interest and tax rates, employment levels, salary and wage levels, general business conditions, the availability of consumer credit and the level of housing, energy and food costs. These risks may be exacerbated for retailers like us who focus on specialty apparel and accessories. Our financial performance is particularly susceptible to economic and other conditions in regions or states where we have a significant number of stores, such as the southwestern U.S. and Florida. If periods of decreased consumer spending persist, our sales could decrease and our financial condition and results of operations could be adversely affected.

We have expanded rapidly in recent years and have limited operating experience at our current size.

We have significantly expanded our operations in the last eight and a half years, increasing from 32 stores in June 2004 in the state of California to operating 168 stores in 28 states as of February 2, 2013. If our operations continue to grow, we will be required to expand our sales and distribution functions, marketing, support services, management information systems and administrative personnel. This expansion could increase the strain on our existing resources, causing operational difficulties such as difficulties in hiring, obtaining adequate levels of merchandise, delayed shipments and decreased customer service levels. These difficulties could cause our brand image to deteriorate and lead to a decrease in revenues, income and the price of our common stock.

Our continued growth depends upon our ability to successfully open a significant number of new stores.

We have grown our store count rapidly in recent years and that has contributed to our growth in profits. However, we must continue to open and operate new stores to help maintain this revenue and profit growth. We opened 29 stores in 2012 and 16 stores in 2011. We plan to open at least 25 net new stores in 2013. However, there can be no assurance that we will open the planned number of new stores in fiscal year 2013 or thereafter. Our ability to successfully open and operate new stores is subject to a variety of risks and uncertainties, such as:

- identifying suitable store locations, the availability of which is beyond our control;
- obtaining acceptable lease terms;
- sourcing sufficient levels of inventory;
- selecting the appropriate merchandise that appeals to our customers;

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- hiring and retaining store employees;
- assimilating new store employees into our corporate culture;
- effectively marketing the new stores locations;
- avoiding construction delays and cost overruns in connection with the build-out of new stores;
- managing and expanding our infrastructure to accommodate growth; and
- integrating the new stores with our existing buying, distribution and other support operations.

Our failure to successfully address these challenges could have a material adverse effect on our financial condition and results of operations, causing the market price of our Class A common stock to decline.

Expanding into new geographic markets may present challenges that are different from those we currently encounter. Failure to effectively adapt to these new challenges could adversely affect our ability to profitably operate those stores and maintain our brand image.

We operate stores in a variety of different geographic markets in the U.S. and do not significantly differentiate between our stores by visual display or by the product offering. We also currently do not significantly differentiate our general store business plan from store to store. As we expand store locations, we may face challenges that are different from those we currently encounter. Our expansion into new geographic markets could result in competitive, merchandising, distribution and other challenges. In addition, as the number of our stores increases, we may face risks associated with market saturation of our product offerings and locations. Our vendors may also restrict their sales to us in new markets to the extent they are already saturating that market with their products through other retailers or their own stores. There can be no assurance that any newly opened stores will be received as well as, or achieve net sales or profitability levels comparable to those of, our existing stores in the time periods estimated by us, or at all. If our stores fail to achieve, or are unable to sustain, acceptable net sales and profitability levels, our business may be materially harmed and we may incur significant costs associated with closing those stores and our brand image may be negatively impacted.

Our business largely depends on a strong brand image, and if we are not able to maintain and enhance our brand, particularly in new markets where we have limited brand recognition, we may be unable to increase or maintain our level of sales.

We believe that our brand image and brand awareness has contributed significantly to the success of our business. We also believe that maintaining and enhancing our brand image, particularly in new markets where we have limited brand recognition, is important to maintaining and expanding our customer base. As we execute our growth strategy, our ability to successfully integrate new stores into their surrounding communities, to expand into new markets or to maintain the strength and distinctiveness of our brand image in our existing markets will be adversely impacted if we fail to connect with our target customer. Maintaining and enhancing our brand image may require us to make substantial investments in areas such as merchandising, marketing, store operations, community relations, store graphics, catalog distribution and employee training, which could adversely affect our cash flow and which may not ultimately be successful. Failure to successfully market our brand in new and existing markets could harm our business, results of operations and financial condition.

Our sales can significantly fluctuate based upon shopping seasons, which may cause our operating results to fluctuate disproportionately on a quarterly basis.

Because of a traditionally higher level of sales during the back-to-school and winter holiday shopping seasons, our sales are typically higher in the third and fourth fiscal quarters than they are in the first and second fiscal quarters. Accordingly, the results of a single fiscal quarter, particularly the third and fourth fiscal quarters, should not be relied on as an indication of our annual results or future performance. In addition, any factors that harm our third and fourth fiscal quarter operating results could have a disproportionate effect on our results of operations for the entire fiscal year.

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We depend on cash generated from our existing store operations to support our growth, which could strain our cash flow.

We primarily rely on cash flow generated from existing stores to fund our current operations and our growth plans. It takes several months and a significant amount of cash to open a new store. If we continue to open a large number of stores relatively close in time, the cost of these store openings and the cost of continuing operations could reduce our cash position. An increase in our net cash outflow for new stores could adversely affect our operations by reducing the amount of cash available to address other aspects of our business.

In addition, as we expand our business, we will need significant amounts of cash from operations to pay our existing and future lease obligations, build out new store space, purchase inventory, pay personnel, pay for the increased costs associated with operating as a public company, and, if necessary, further invest in our infrastructure and facilities. If our business does not generate sufficient cash flow from operations to fund these activities and sufficient funds are not otherwise available from our existing revolving credit facility or future credit facilities, we may need additional equity or debt financing. If such financing is not available to us on satisfactory terms, our ability to operate and expand our business or to respond to competitive pressures would be limited and we could be required to delay, curtail or eliminate planned store openings. Moreover, if we raise additional capital by issuing equity securities or securities convertible into equity securities, your ownership may be diluted. Any debt financing we may incur may impose on us covenants that restrict our operations, and will require interest payments that would create additional cash demands and financial risk for us.

Our ability to attract customers to our stores depends significantly on the success of the retail centers where the stores are located.

We depend on the location of our stores to generate a large amount of our customer traffic. We try to select well-known and popular malls, power centers, neighborhood and lifestyle centers, outlet centers and street-front locations, usually near prominent retailers, to generate customer traffic for our stores. Customer traffic at these retail centers, and consequently our stores, could be adversely affected by economic downturns nationally or regionally, competition from Internet retailers, changes in consumer demographics, the closing or decrease in popularity of other retailers in the retail centers in which our stores are located, our inability to obtain or maintain prominent store locations within retail centers or the selection by prominent retailers and businesses of other locations. A reduction in customer traffic would likely lead to a decrease in our sales, and, if similar reductions in traffic occur at a number of our stores, this could have a material adverse effect on our financial condition and results of operations.

Some of our new stores may open in locations close enough to our existing stores that sales at those existing stores may be negatively impacted.

As we continue to open additional locations within existing markets, some of our new stores may open in locations close enough to our existing stores that a segment of customers will stop shopping at our existing locations and prefer to shop at the new locations, and therefore sales and profitability at those existing stores may decline. If this were to occur with a number of our stores, this could have a material adverse effect on our results of operations.

We purchase merchandise in advance of the season in which it will be sold and if we purchase too much inventory we may need to reduce prices in order to sell it, which may adversely affect our overall profitability.

We must actively manage our purchase of inventory. Generally, we order merchandise months in advance of it being received and offered for sale. If there is a significant decrease in demand for our products or if we fail to accurately predict fashion trends or consumer demands, we may be forced to rely on markdowns or promotional sales to dispose of excess inventory. In addition, seasonal fluctuations also affect our inventory levels, as we usually order and carry a significant amount of inventory before the back-to-school and winter holiday shopping seasons. If we are not successful in selling our inventory during these periods, we may be forced to rely on markdowns or promotional sales to dispose of the inventory, or we may not be able to sell the inventory at all, which could have an adverse effect on our margins and operating income.

We buy and stock merchandise based upon seasonal weather patterns and therefore unseasonable weather could negatively impact our sales.

We buy select merchandise for sale based upon expected weather patterns during the seasons of winter, spring, summer and fall. If we encounter untimely aberrations in weather conditions, such as warmer winters or cooler summers than would be considered typical, these weather variations could cause some of our merchandise to be inconsistent with what consumers wish to purchase, causing our sales to decline. Furthermore, extended unseasonable weather conditions in regions such as in the southwestern U.S., particularly in California and Arizona, or Florida, will likely have a greater impact on our sales because of our store concentration in those regions.

If we fail to maintain good relationships with our suppliers or if our suppliers are unable or unwilling to provide us with sufficient quantities of merchandise at acceptable prices, our business and operations may be adversely affected.

Our business is largely dependent on continued good relations with our suppliers, including vendors for our third-party branded products and manufacturers for our proprietary branded products. We operate on a purchase order basis for our proprietary branded and third-party branded merchandise and do not have long-term contractual relationships with our suppliers. Accordingly, our suppliers can refuse to sell us merchandise, limit the type or quantity of merchandise they sell us or raise prices at any time, which can have an adverse impact on our business. Deterioration in our relationships with our suppliers could have a material adverse impact on our business, and there can be no assurance that we will be able to acquire desired merchandise in sufficient quantities on terms acceptable to us in the future. Also, some of our vendors are vertically integrated, selling products directly from their own retail stores, and therefore are in direct competition with us. These vendors may decide at some point in the future to discontinue supplying their merchandise to us, supply us less desirable merchandise or raise prices on the products they do sell us. If we lose key vendors or are unable to find alternative vendors to supply us with substitute merchandise for lost products, our business may be adversely affected.

A rise in the cost of raw materials, labor and transportation could increase our cost of sales and cause our results of operations and margins to decline.

Fluctuations in the price, availability and quality of fabrics or other raw materials used to manufacture our products, as well as the price for labor and transportation, could have adverse impacts on our cost of sales and our ability to meet our customers demands. In particular, because a key component of our clothing is cotton, increases in the cost of cotton may significantly affect the cost of our products and could have an adverse impact on our cost of sales. We may not be able to pass all or a portion of these higher costs on to our customers, which could have a material adverse effect on our profitability.

Any inability to balance merchandise bearing our proprietary brands with the third-party branded merchandise we sell may have an adverse effect on our sales and gross margin.

Our proprietary branded merchandise represented approximately 30% of our net sales for the fiscal year ended February 2, 2013. Our proprietary branded merchandise generally has a higher gross margin than the third-party branded merchandise we offer. As a result, we may determine that it is best for us to continue to hold or increase the penetration of our proprietary brands in the future. However, carrying our proprietary brands limits the amount of third-party branded merchandise we can carry and, therefore, there is a risk that the customers perception that we offer many major brands will decline. By maintaining or increasing the amount of our proprietary branded merchandise, we are also exposed to greater fashion risk, as we may fail to anticipate fashion trends correctly. These risks, if they occur, could have a material adverse effect on sales and profitability.

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Most of our merchandise is produced in foreign countries, making the price and availability of our merchandise susceptible to international trade and other international conditions.

Although we purchase our merchandise from domestic suppliers, these suppliers have a majority of their merchandise made in foreign countries. Some foreign countries can be, and have been, affected by political and economic instability and natural disasters, negatively impacting trade. The countries in which our merchandise currently is manufactured or may be manufactured in the future could become subject to new trade restrictions imposed by the U.S. or other foreign governments. Trade restrictions, including increased tariffs or quotas, embargoes and customs restrictions, against apparel items, as well as U.S. or foreign labor strikes, work stoppages or boycotts, could increase the cost or reduce the supply of apparel available to us and have a material adverse effect on our business, financial condition and results of operations. In addition, our merchandise supply could be impacted if our suppliers imports become subject to existing or future duties and quotas, or if our suppliers face increased competition from other companies for production facilities, import quota capacity and shipping capacity. Any increase in the cost of our merchandise or limitation on the amount of merchandise we are able to purchase could have a material adverse effect on our financial condition and results of operations.

If our vendors and manufacturing sources fail to use acceptable labor or other practices our reputation may be harmed, which could negatively impact our business.

We purchase merchandise from independent third-party vendors and manufacturers. If any of these suppliers have practices that are not legal or accepted in the U.S., consumers may develop a negative view of us, our brand image could be damaged and we could become the subject of boycotts by our customers and/or interest groups. Further, if the suppliers violate labor or other laws of their own country, these violations could cause disruptions or delays in their shipments of merchandise. For example, much of our merchandise is manufactured in China and Mexico, which have different labor practices than the U.S. We do not independently investigate whether our suppliers are operating in compliance with all applicable laws and therefore we rely upon the suppliers representations set forth in our purchase orders and vendor agreements concerning the suppliers compliance with such laws. If our goods are manufactured using illegal or unacceptable labor practices in these countries, or other countries from which our suppliers source the product we purchase, our ability to supply merchandise for our stores without interruption, our brand image and, consequently, our sales may be adversely affected.

If we lose key management personnel our operations could be negatively impacted.

Our business and growth depends upon the leadership and experience of our key executive management team, including our co-founder, Hezy Shaked, who currently serves as our Chief Strategy Officer and Chairman of our board of directors, and Daniel Griesemer, our President and Chief Executive Officer, and we may be unable to retain their services. We also may be unable to retain other existing management personnel that are critical to our success, which could result in harm to our vendor and employee relationships, loss of key information, expertise or know-how and unanticipated recruitment and training costs. The loss of services of any of our key personnel could have a material adverse effect on our business and prospects, and could be viewed in a negative light by investors and analysts, which could cause our Class A common stock price to decline. None of our employees, except for Mr. Griesemer, have employment agreements and we do not intend to purchase key person life insurance covering any employee. If we lose the services of any of our key personnel or we are not able to attract additional qualified personnel, we may not be able to successfully manage our business.

If we cannot retain or find qualified employees to meet our staffing needs in our stores, our distribution center, or our corporate offices, our business could be adversely affected.

Our success depends upon the quality of the employees we hire. We seek employees who are motivated, represent our corporate culture and brand image and, for many positions, have knowledge of our merchandise and the skill necessary to excel in a customer service environment. The turnover rate in the retail industry is high and finding qualified candidates to fill positions may be difficult. If we cannot attract and retain corporate

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employees, district managers, store managers and store associates with the qualifications we deem necessary, our ability to effectively operate and expand may be adversely affected. In addition, we rely on temporary personnel to staff our distribution center, as well as seasonal part-time employees to provide incremental staffing to our stores in busy selling seasons such as the back-to-school and winter holiday seasons. We cannot guarantee that we will be able to find adequate temporary or seasonal personnel to staff our operations when needed, which may strain our existing personnel and negatively impact our operations.

Our corporate headquarters, distribution center and management information systems are in a single location in southern California, and if their operations are disrupted, we may not be able to operate our store support functions or ship merchandise to our stores, which would adversely affect our business.

Our corporate headquarters, distribution center and management information systems are in a single location in Irvine, California. If we encounter any disruptions to our operations at this building or if it were to shut down for any reason, including by fire or other natural disaster, then we may be prevented from effectively operating our stores, shipping and processing our merchandise and operating our e-commerce business. Furthermore, the risk of disruption or shut down at this building is greater than it might be if it were located in another region, as southern California is prone to natural disasters such as earthquakes and wildfires. Any disruption or shut down at this location could significantly impact our operations and have a material adverse effect on our financial condition and results of operations.

Our stores are mostly located in the southwestern U.S. and Florida, with a significant number of stores located in California, putting us at risk to region-specific disruptions.

Out of a total of 168 stores as of February 2, 2013, we operated 79 stores in California, 18 stores in Arizona, six stores in Nevada and 16 stores in Florida. Sales in these states could be more susceptible than the country generally to disruptions, such as from economic and weather conditions, demographic and population changes and changes in fashion tastes, and consequently, we may be more susceptible to these factors than more geographically diversified competitors. For example, because of the negative economic impact caused by the downturn in the housing market that began several years ago, sales in these states may have slowed more than sales would have in other regions or the country as a whole. Compared to the country as a whole, stores in California are exposed to a relatively high risk of damage from a major earthquake or wildfires, while stores in Florida are also exposed to a relatively high risk from hurricane damage. Any negative impact upon or disruption to the operations of stores in these states could have a material adverse effect on our financial condition and results of operations.

We are required to make significant lease payments for our store leases and corporate offices and warehouses and distribution center, which may strain our cash flow.

We lease all of our retail store locations as well as our corporate headquarters and warehouses and distribution center. We do not own any real estate. Leases for our stores are typically for terms of ten years and many can be extended in five-year increments. Many of our leases have early cancelation clauses which permit us to terminate the lease if certain sales thresholds are not met in certain periods of time. Our costs under these leases are a significant amount of our expenses and are growing rapidly as we expand the number of locations and existing locations experience expense increases. In fiscal year 2012, our total operating lease rent expense was $37.3 million and our common area maintenance expense was $14.3 million. This increased from $30.7 million and $11.3 million, respectively, in fiscal year 2011 and can be expected to continue to increase as we open more stores. We are required to pay additional rent under many of our lease agreements based upon achieving certain sales plateaus for each store location. In addition, we must make significant payments for common area maintenance and real estate taxes. Many of our lease agreements also contain provisions which increase the rent payments on a set time schedule, causing the cash rent paid for a location to escalate over the term of the lease. In addition, rent costs could escalate when multi-year leases are renewed at the expiration of their lease term. These costs are significant, recurring and increasing, which places a consistent strain on our cash flow.

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We depend on cash flows from operations to pay our lease expenses and to fulfill our other cash needs. If our business does not generate sufficient cash flows from operating activities, and sufficient funds are not otherwise available to us from borrowings under our available revolving credit facility or from other sources, we may not be able to service our operating lease expenses, grow our business, respond to competitive challenges or to fund our other liquidity and capital needs, which would harm our business.

Additional sites that we lease are likely to be subject to similar long-term leases. If an existing or future store is not profitable, and we decide to close it, we may nonetheless be committed to perform our obligations under the applicable lease including, among other things, paying the base rent for the balance of the lease term. In addition, as our leases expire, we may fail to negotiate renewals, either on commercially acceptable terms or at all, which could cause us to close stores in desirable locations. If we are unable to enter into new leases or renew existing leases on terms acceptable to us or be released from our obligations under leases for stores that we close, our business, profitability and results of operations may be harmed.

We rely on Integrity Retail Distribution and Federal Express to deliver merchandise to our stores located outside of southern California and therefore our business could be negatively impacted by disruptions in the operations of these third-party providers.

We rely on Integrity Retail Distribution to ship our merchandise from our distribution center in Irvine, California to our stores located in northern and central California, Arizona and Nevada, and we rely on Federal Express to ship our merchandise to stores in all other states. We also rely on Federal Express and the U.S. Postal Service to ship all e-commerce sales packages to our customers. Relying on these third-party delivery services puts us at risk from disruptions in their operations, such as employee strikes, inclement weather and their ability to meet our shipping demands. If we are forced to use other delivery services, our costs could increase and we may not be able to meet shipment deadlines. Moreover, we may not be able to obtain terms as favorable as those received from the transportation providers we currently use, which would further increase our costs. These circumstances may negatively impact our financial condition and results of operations.

We may not be able to maintain comparable store sales or sales per square foot, which may cause our results of operations to decline and the price of our Class A common stock to be volatile.

The investing public may use comparable store sales or net store sales per square foot projections or results, over a certain period of time, such as on a quarterly or yearly basis, as an indicator of our profitability growth. Our comparable store sales can vary significantly from period to period for a variety of reasons, such as the age of stores, changing economic factors, unseasonable weather, changing fashion trends, pricing, the timing of the release of new merchandise and promotional events and increased competition. These factors could cause comparable store sales or net store sales per square foot to decline period to period or fail to grow at expected rates, which could adversely affect our results of operations and cause the price of our Class A common stock to be volatile during such periods.

If our management information systems fail to operate or are unable to support our growth, our operations could be disrupted.

We rely upon our management information systems in almost every aspect of our daily business operations. For example, our management information systems serve an integral part in enabling us to order merchandise, process merchandise at our distribution center and retail stores, perform and track sales transactions, manage personnel, pay vendors and employees, operate our e-commerce business and report financial and accounting information to management. In addition, we rely on our management information systems to enable us to leverage our costs as we grow. If our management information systems fail to operate or are unable to support our growth, our store operations and e-commerce business could be severely disrupted, and we could be required to make significant additional expenditures to remediate any such failure.

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Our internal operations or management information systems could be disrupted by system security failures. These disruptions could negatively impact our sales, increase our expenses, and harm our reputation and the price of our Class A common stock.

Hackers, computer programmers and internal users may be able to penetrate our network security and create system disruptions, cause shutdowns and misappropriate our confidential information or that of third parties, including our customers. Therefore, we could incur significant expenses addressing problems created by security breaches to our network. This risk is heightened because we collect and store customer information for marketing purposes, as well as credit card information. We must, and do, take precautions to secure customer information and prevent unauthorized access to our database of confidential information. However, if unauthorized parties, including external hackers or computer programmers, gain access to our database, they may be able to steal this confidential information. Our failure to secure this information could result in costly litigation, adverse publicity or regulatory action that could have a material adverse effect on our financial condition and results of operations. In addition, sophisticated hardware and operating system software and applications that we procure from third parties may contain defects in design or manufacture that could unexpectedly interfere with our operations. The cost to alleviate security risks, defects in software and hardware and address any problems that occur could negatively impact our sales, distribution and other critical functions, as well as our financial results.

If we are unable to protect our intellectual property rights, our financial results may be negatively impacted.

Our success depends in large part on our brand image. Our company s name, logo, domain name and our proprietary brands and our registered and unregistered trademarks and copyrights are valuable assets that serve to differentiate us from our competitors. We currently rely on a combination of copyright, trademark, trade dress and unfair competition laws to establish and protect our intellectual property rights. We cannot assure you that the steps taken by us to protect our proprietary rights will be adequate to prevent infringement of our trademarks and proprietary rights by others, including imitation and misappropriation of our brand. We cannot assure you that obstacles will not arise as we expand our product lines and geographic scope. The unauthorized use or misappropriation of our intellectual property could damage our brand identity and the goodwill we created for our company, which could cause our sales to decline. Moreover, litigation may be necessary to protect or enforce these intellectual property rights, which could result in substantial costs and diversion of our resources, causing a material adverse effect on our business, financial condition, results of operations or cash flows. If we cannot protect our intellectual property rights, our brand identity and the goodwill we created for our company may diminish, causing our sales to decline.

Most of our intellectual property has not been registered outside of the U.S. and we cannot prohibit other companies from using our unregistered trademarks in foreign countries. Use of our trademarks in foreign countries could negatively impact our identity in the U.S. and cause our sales to decline.

We may be subject to liability if we, or our vendors, infringe upon the intellectual property rights of third parties.

We may be subject to liability if we infringe upon the intellectual property rights of third parties. If we were to be found liable for any such infringement, we could be required to pay substantial damages and could be subject to injunctions preventing further infringement. Such infringement claims could harm our brand image. In addition, any payments we are required to make and any injunction we are required to comply with as a result of such infringement actions could adversely affect our financial results.

We purchase merchandise from vendors that may be subject to design copyrights, design patents, or otherwise may incorporate protected intellectual property. We are not involved in the manufacture of any of the merchandise we purchase from our vendors for sale to our customers, and we do not independently investigate whether these vendors legally hold intellectual property rights to merchandise that they are manufacturing or distributing. As a result, we rely upon vendors representations set forth in our purchase orders and vendor

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agreements concerning their right to sell us the products that we purchase from them. If a third party claims to have licensing rights with respect to merchandise we purchased from a vendor, or we acquire unlicensed merchandise, we could be obligated to remove such merchandise from our stores, incur costs associated with destruction of such merchandise if the distributor or vendor is unwilling or unable to reimburse us and be subject to liability under various civil and criminal causes of action, including actions to recover unpaid royalties and other damages and injunctions. Although our purchase orders and vendor agreement with each vendor require the vendor to indemnify us against such claims, a vendor may not have the financial resources to defend itself or us against such claims, in which case we may have to pay the costs and expenses associated with defending such claim. Any of these results could harm our brand image and have a material adverse effect on our business and growth.

Our founders control a majority of the voting power of our common stock, which may prevent other stockholders from influencing corporate decisions and may result in conflicts of interest that cause the price of our Class A common stock to decline.

Our common stock consists of two classes: Class A and Class B. Holders of Class A common stock are entitled to one vote per share, and holders of Class B common stock are entitled to 10 votes per share, on all matters to be voted on by our common stockholders. All of the shares of Class B common stock are beneficially owned by Hezy Shaked, Tilly Levine and their children through related trusts, which we refer to as the Shaked and Levine family entities. As of February 2, 2013, the Shaked and Levine family entities controlled approximately 94% of the total voting power of our outstanding common stock. In addition, Mr. Shaked serves as Chairman of the Board of Directors, and is the voting trustee, pursuant to a voting trust agreement, covering the shares owned by Ms. Levine. As a result, Mr. Shaked is in a position to dictate the outcome of any corporate actions requiring stockholder approval, including the election of directors and mergers, acquisitions and other significant corporate transactions. Mr. Shaked may delay or prevent a change of control from occurring, even if the change of control could appear to benefit the stockholders. Mr. Shaked may also have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interests. This ownership concentration may adversely impact the trading of our Class A common stock because of a perceived conflict of interest that may exist, thereby depressing the value of our Class A common stock.

We have entered into tax indemnification agreements with our existing shareholders and could become obligated to make payments to them for any additional federal, state or local income taxes assessed against them for fiscal periods prior to the completion of our initial public offering in May 2012.

World of Jeans & Tops historically was treated as an S Corporation for U.S. federal income tax purposes. Effective upon completion of the Reorganization Transaction, World of Jeans & Tops S Corporation status terminated and it thereafter became subject to federal income taxes and increased state income taxes. In the event of an adjustment to World of Jeans & Tops reported taxable income for a period or periods prior to termination of its S Corporation status, its shareholders during those periods could be liable for additional income taxes for those prior periods. Therefore, we entered into tax indemnification agreements with the former shareholders of World of Jeans & Tops prior to the Reorganization Transaction. Pursuant to the tax indemnification agreements, we agreed to indemnify, defend and hold harmless each such shareholder on an after-tax basis against additional income taxes, plus interest and penalties resulting from adjustments made, as a result of a final determination made by a competent tax authority, to the taxable income World of Jeans & Tops reported as an S Corporation. Such indemnification also includes any losses, costs or expenses, including reasonable attorneys fees, arising out of a claim for such tax liability.

War, terrorism or civil unrest could negatively affect our business.

All of our stores are located in public areas where large numbers of people typically gather. Terrorist attacks, threats of terrorist attacks or civil unrest involving public areas could cause people not to visit areas where our stores are located. Further, armed conflicts or acts of war throughout the world may create uncertainty, causing consumers to spend less on discretionary purchases, including on apparel and accessories, and disrupting our ability to obtain merchandise for our stores. Such decreases in consumer spending or disruptions in our ability to obtain merchandise would likely decrease our sales and materially adversely affect our financial condition and results of operations.

Litigation costs and the outcome of litigation could have a material adverse effect on our business.

From time to time we may be subject to litigation claims through the ordinary course of our business operations regarding, but not limited to, employment matters, compliance with the Americans with Disabilities Act of 1990, apparel, footwear and accessory safety standards, security of customer and employee personal information, contractual relations with vendors, marketing and infringement of trademarks and other intellectual property rights. Litigation to defend ourselves against claims by third parties, or to enforce any rights that we may have against third parties, may be necessary, which could result in substantial costs and diversion of our resources, causing a material adverse effect on our business, financial condition, results of operations or cash flows.

Management does not believe the nature of any pending legal proceeding will have a material adverse effect on our financial condition and results of operations. However, management s assessment may change at any time based upon the discovery of facts or circumstances that are presently not known to us. Therefore, there can be no assurance that any pending or future litigation will not have a material adverse effect on our financial condition and results of operations.

We may be subject to unionization, work stoppages, slowdowns or increased labor costs.

Currently, none of our employees are represented by a union. However, our employees have the right under the National Labor Relations Act to form or affiliate with a union. If some or all of our workforce were to become unionized and the terms of the collective bargaining agreement were significantly different from our current compensation arrangements, it could increase our costs and adversely impact our profitability. Moreover, participation in labor unions could put us at increased risk of labor strikes and disruption of our operations.

Violations of and/or changes in laws, including employment laws and laws related to our merchandise, could make conducting our business more expensive or change the way we do business.

We are subject to numerous regulations, including labor and employment, customs, truth-in-advertising, consumer protection and zoning and occupancy laws and ordinances that regulate retailers generally and/or govern the importation, promotion and sale of merchandise and the operation of stores and warehouse facilities. If these regulations were violated by our management, employees or vendors, the costs of certain goods could increase, or we could experience delays in shipments of our goods, be subject to fines or penalties or suffer reputational harm, which could reduce demand for our merchandise and hurt our business and results of operations.

Similarly, changes in laws could make operating our business more expensive or require us to change the way we do business. For example, changes in laws related to employee healthcare, hours, wages, job classification and benefits could significantly increase operating costs. In March 2010, the Patient Protection and Affordable Care Act, or the Act, and the Health Care Education Reconciliation Act of 2010, or the Reconciliation Act, were signed into law. The Act and the Reconciliation Act include a number of health care provisions taking effect over several years, including expanded dependent coverage, incentives for business to provide health care benefits, a prohibition on denial of coverage and denial of claims on pre-existing conditions, a prohibition on limiting essential benefits, and other expansion of health care benefits and coverage. Some of the associated taxes and fees, as well as certain health care changes required by these acts, are expected to result in increased health care costs for us. The costs of such legislation may adversely impact our results of operations.

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In addition, changes in product safety or other consumer protection laws could lead to increased costs for certain merchandise, or additional labor costs associated with readying merchandise for sale. It may be difficult for us to foresee regulatory changes impacting our business and our actions needed to respond to changes in the law could be costly and may negatively impact our operations.

As a result of our recent initial public offering, our costs have increased and our management is required to devote substantial time to complying with public company regulations.

We have historically operated our business as a private company. In May 2012, we completed an initial public offering. As a result, we are required to incur additional legal, accounting, compliance and other expenses that we did not incur as a private company. We are obligated to file periodic reports with the SEC under the Securities Exchange Act of 1934, as amended. We are also subject to other reporting and corporate governance requirements, including certain requirements of the New York Stock Exchange, or NYSE, and certain provisions of the Sarbanes-Oxley Act of 2002, or SOX, and the regulations promulgated thereunder, which impose significant compliance obligations on us.

SOX, as well as rules subsequently implemented by the SEC and NYSE, have imposed increased regulation and disclosure and have required enhanced corporate governance practices of public companies. Our efforts to comply with evolving laws, regulations and standards are likely to result in increased administrative expenses and a diversion of management s time and attention from revenue-generating activities. We may not be successful in implementing or maintaining these requirements. In addition, if we were to fail to implement or maintain the requirements with respect to our internal accounting and audit functions, our ability to continue to report our operating results on a timely and accurate basis could be impaired and we could be subject to sanctions or investigation by regulatory authorities, such as the SEC or NYSE. Any such action could harm our reputation and the confidence of investors and customers in our company and could materially adversely affect our business and cause the price of our Class A common stock to decline.

Our failure to maintain adequate internal controls over our financial and management systems may cause errors in our financial reporting. These errors may cause a loss of investor confidence and result in a decline in the price of our Class A common stock.

Our public company reporting obligations and our anticipated growth will likely strain our financial and management systems, internal controls and our employees. In addition, pursuant to Section 404 of SOX, and the Jumpstart Our Business Startups Act, or JOBS Act, we are required to provide annually an assessment of the effectiveness of our internal controls over financial reporting and, starting with the year after we are no longer an emerging growth company as defined in the JOBS Act, our independent registered public accounting firm will be required to provide an attestation on our assessment of our internal controls over financial reporting.

We are currently taking the necessary steps to comply with Section 404 of SOX. However, this process is time consuming and costly. If during this process we identify one or more material weaknesses in our internal controls, it is possible that our management may not be able to certify that our internal controls are effective by the certification deadline. We cannot be certain we will be able to successfully complete the implementation, certification and attestation requirements of Section 404 within the time period allowed.

Moreover, if we identify any material weaknesses or significant deficiencies in our internal controls we will have to implement appropriate changes to these controls, which may require specific compliance training for our directors, officers and employees, require the hiring of additional finance, accounting, legal and other personnel, entail substantial costs to modify our existing accounting systems and take a significant period of time to complete. Such changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. Effective internal controls are necessary for us to produce reliable financial reports and are important to prevent

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fraud. As a result, our failure to satisfy the requirements of Section 404 on a timely basis could result in us being subject to regulatory action and a loss of investor confidence in the reliability of our financial statements, both of which in turn could cause the market value of our Class A common stock to decline.

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

Concurrent with and as a result of the Reorganization Transaction, our S Corporation status terminated and we are now treated as a C Corporation for federal and applicable state income tax purposes. As a C Corporation, we are subject to increased federal and state income taxes. In addition, if the unaudited, open tax years in which we were an S Corporation are audited by the Internal Revenue Service, and we are determined not to have qualified for, or to have violated, our S Corporation status, we will be obligated to pay back taxes, interest and penalties, and the company will not have the right to reclaim tax distributions it made to its shareholders during those periods. These amounts could include taxes on all of our taxable income while we were an S Corporation. Any such claims could result in additional costs to us and could have a material adverse effect on our results of operations and financial condition.

The terms of our credit facility impose operating and financial restrictions on us that may impair our ability to respond to changing business and economic conditions.

On May 3, 2012, we amended and restated our credit agreement with Wells Fargo Bank, National Association (the Amended Credit Agreement). The Amended Credit Agreement amended and restated our prior credit agreement, and among other things, increased the line of credit and letter of credit subfacility. The Amended Credit Agreement contains customary affirmative and negative covenants, including limitations on indebtedness; limitations on consolidations, mergers and sales of assets; and limitations on transactions with affiliates. The Amended Credit Agreement also contains financial covenants setting forth requirements for certain levels of liquidity and profitability. These limitations and covenants may restrict our ability to respond to changing business and economic conditions, and may therefore have a material adverse effect on our business. If we are unable to meet these limitations and covenants, we may be in default under the Amended Credit Agreement, which could also have a material adverse effect on our business.

We may engage in strategic transactions that could negatively impact our liquidity, increase our expenses and present significant distractions to our management.

We may consider strategic transactions and business arrangements, including, but not limited to, acquisitions, asset purchases, partnerships, joint ventures, restructurings, divestitures and investments. Any such transaction may require us to incur non-recurring or other charges, may increase our near and long-term expenditures and may pose significant integration challenges or disrupt our management or business, which could harm our operations and financial results.

Our e-commerce business subjects us to numerous risks that could have an adverse effect on our results of operations.

For fiscal year 2012, sales from our e-commerce business increased 21% over the previous year and represented a little more than 11% of our total net sales. Our e-commerce business and its continued growth subject us to certain risks that could have an adverse effect on our results of operations, including:

- diversion of traffic from our stores;
- liability for online content;
- government regulation of the Internet; and

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- risks related to the computer systems that operate our website and related support systems, including computer viruses, electronic break-ins and similar disruptions.

We may incur substantial expenses related to our issuance of stock-based compensation, which may have a negative impact on our operating results for future periods.

We follow the provisions of the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, 718, *Compensation-Stock Compensation*, for stock-based compensation. Our stock-based compensation expenses may be significant in future periods, which could have an adverse impact on our operating and net income. FASB ASC 718 requires the use of subjective assumptions, including the options expected lives and the price volatility of our Class A common stock. Changes in the subjective input assumptions can materially affect the amount of our stock-based compensation expense. In addition, an increase in the competitiveness of the market for qualified employees could result in an increased use of stock-based compensation awards, which in turn would result in increased stock-based compensation expense in future periods.

Risks Related to Ownership of Our Class A Common Stock

We are a controlled company within the meaning of the NYSE rules, and, as a result, we may rely on exemptions from certain corporate governance requirements that provide protection to stockholders of other companies.

Mr. Shaked controls more than 50% of the total voting power of our common stock and we are considered a controlled company under the NYSE corporate governance listing standards. As a controlled company, certain exemptions under the NYSE listing standards will exempt us from the obligation to comply with certain NYSE corporate governance requirements, including the requirements:

- that a majority of our board of directors consist of independent directors, as defined under the rules of the NYSE;
- that we have a corporate governance and nominating committee that is composed entirely of independent directors with a written charter addressing the committee s purpose and responsibilities; and
- that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee s purpose and responsibilities.

Although we intend to comply with these listing requirements even though we are a controlled company, there is no guarantee that we will not take advantage of these exemptions in the future. Accordingly, so long as we are a controlled company, holders of our Class A common stock may not have the same protections afforded to stockholders of companies that are subject to all of the NYSE corporate governance requirements.

If securities or industry analysts publish inaccurate or unfavorable research about our business, the price and trading volume of our Class A common stock could decline.

The trading market for our Class A common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who covers us downgrades our Class A common stock or publishes inaccurate or unfavorable research about our business, the price of our Class A common stock would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our Class A common stock could decrease, which could cause the price of our Class A common stock and trading volume to decline.

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Financial forecasting by us and financial analysts who may publish estimates of our performance may differ materially from actual results.

Given the dynamic nature of our business, the current uncertain economic climate and the inherent limitations in predicting the future, forecasts of our revenues, comparable sales, margins, net income and other financial and operating forecasts may differ materially from actual results. Such discrepancies could cause a decline in the trading price of our Class A common stock.

We have a small public float and this may result in price swings in our Class A common stock or make it difficult to acquire or dispose of our Class A common stock.

As of February 2, 2013, we had 10,772,215 publicly traded shares of Class A common stock outstanding. This small public float can result in large swings in our stock price with relatively low trading volume. In addition, a purchaser that seeks to acquire a significant number of shares may be unable to do so without increasing our common stock price, and conversely, a seller that seeks to dispose of a significant number of shares may experience a decreasing stock price.

The price of our Class A common stock may be volatile and decline in value.

The market for retail apparel stocks can be highly volatile. As a result, the market price of our Class A common stock is likely to be volatile and investors may experience a decrease in the value of the Class A common stock, unrelated to our operations. The price of our Class A common stock could fluctuate significantly in response to a number of factors, as discussed in this Risk Factors section and such as those listed below:

- variations in our operating performance and the performance of our competitors;
- publication of research reports or recommendation by securities analysts about us, our competitors or our industry, or a lack of such securities analyst coverage;
- our failure or our competitors failure to meet analysts projections or guidance;
- our levels of comparable store sales;
- changes to our management team;
- regulatory developments negatively affecting our industry;
- changes in stock market valuations of our competitors;
- the development and sustainability of an active trading market for our Class A common stock;
- the public s response to press releases or other public announcements by us or third parties, including our filings with the SEC;
- the performance and successful integration of any new stores that we open;

- actions by competitors or other mall and off-mall tenants;
- announcements by us or our competitors of new product offerings or significant acquisitions;
- ratings downgrades by any securities analysts who follow our common stock;
- fluctuations in the stock markets generally;
- changes in general market and economic conditions; and
- changes in fashion trends that we did not anticipate.

Further, securities class action litigation has often been initiated against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management s attention and resources, and could also require us to make substantial payments to satisfy judgments or to settle litigation. The threat or filing of class action litigation lawsuits could cause the price of our Class A common stock to decline.

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Future sales of our common stock by us or by existing stockholders could cause the price of our Class A common stock to decline.

Any sales of a substantial number of shares of our common stock in the public market, or the perception that such sales might occur, may cause the market price for our Class A common stock to decline. As of February 2, 2013, we had 10,772,215 publicly traded shares of Class A common stock and 16,919,910 shares of Class B common stock outstanding, excluding 2,133,625 shares of Class A common stock issuable upon the exercise of outstanding stock options. All of these shares, other than the 16,919,910 shares of Class B common stock held by the Shaked and Levine family entities, are freely tradable without restriction under the Securities Act of 1933, as amended, or Securities Act. The shares held by the Shaked and Levine family entities and our directors, officers and other affiliates are restricted securities under the Securities Act, and may not be sold in the public market unless the sale is registered under the Securities Act or an exemption from registration is available.

Our corporate organizational documents and Delaware law have anti-takeover provisions that may inhibit or prohibit a takeover of us and the replacement or removal of our management.

In addition to the concentration of ownership and voting power in the Shaked and Levine family entities, the anti-takeover provisions under Delaware law, as well as the provisions contained in our corporate organizational documents, may make an acquisition of us more difficult.

For example:

- our certificate of incorporation includes a provision authorizing our board of directors to issue blank check preferred stock without stockholder approval, which, if issued, would increase the number of outstanding shares of our capital stock and make it more difficult for a stockholder to acquire us;

- our certificate of incorporation provides that if all shares of our Class B common stock are converted into Class A common stock or otherwise cease to be outstanding, our board of directors will be divided into three classes in the manner provided by our certificate of incorporation. After the directors in each class serve for the initial terms provided in our certificate of incorporation, each class will serve for a staggered three-year term;

- our certificate of incorporation permits removal of a director only for cause by the affirmative vote of the holders of a majority of the voting power of the company once the board of directors is divided into three classes and provides that director vacancies can only be filled by an affirmative vote of a majority of directors then in office;

- our bylaws require advance notice of stockholder proposals and director nominations; and

- Section 203 of the Delaware General Corporation Law may prevent large stockholders from completing a merger or acquisition of us.

These provisions may prevent a merger or acquisition of us which could limit the price investors would pay for our common stock in the future.

We do not intend to pay cash dividends on our common stock, which may make our Class A common stock less desirable to investors and decrease its value.

We intend to retain all of our earnings to finance our operations and growth and do not anticipate paying any cash dividends on our common stock for the foreseeable future. Therefore, you may only receive a return on your investment in our Class A common stock if the market price increases above the price at which you purchased it, which may never occur.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

We lease approximately 172,000 square feet for our corporate headquarters and retail support and distribution center located at 10 Whatney and 12 Whatney, Irvine, California. Our lease began on January 1, 2003. We have exercised the first of three five-year renewal options on this lease. Upon exercising the first renewal option, the lease now terminates on December 31, 2017.

We lease approximately 24,000 square feet of office and warehouse space located at 15 Chrysler, Irvine, California. Our lease began on November 1, 2010 and terminates on October 31, 2014. Approximately 17,000 square feet of this building is subleased to a third party and we use the remaining space.

We lease approximately 26,000 square feet of office and warehouse space located at 11 Whatney, Irvine, California. The lease began on September 2, 2011 and terminates on June 30, 2022.

We lease approximately 81,000 square feet of office and warehouse space located at 17 Pasteur, Irvine, California. The lease began on November 1, 2011 and terminates on October 31, 2021. Pursuant to the lease agreement, we requested that the landlord expand the building. Upon commencement of the building expansion, we returned the building to the landlord for the duration of the construction. As of February 2, 2013, the landlord returned the expanded building to us. We expect to use this property as our e-commerce distribution center.

All of our stores, encompassing approximately 1.3 million total square feet as of February 2, 2013, are occupied under operating leases. The store leases generally have a base lease term of 10 years and many have renewal option periods, and we are generally responsible for payment of property taxes and utilities, common area maintenance and mall marketing fees.

Item 3. Legal Proceedings

From time to time, we may become involved in lawsuits and other claims arising from our ordinary course of business. Management is currently unable to predict the ultimate outcome of any litigation or claim, determine whether a liability has been incurred or make an estimate of the reasonably possible liability that could result from an unfavorable outcome because of the uncertainties related to the incurrence, amount and range of loss on any pending litigation or claim. Because of the unpredictable nature of these matters, we cannot provide any assurances regarding the outcome of any litigation or claim to which we are a party or that the ultimate outcome of any of the matters threatened or pending against us, including those disclosed below, will not have a material adverse effect on our financial condition or results of operations. See Item 1A Risk Factors Litigation costs and the outcome of litigation could have a material adverse effect on our business included in this report.

Kristin Christiansen and Shellie Smith, on behalf of themselves and all others similarly situated vs. World of Jeans & Tops, Superior Court of California, County of Sacramento, Case No. 34-2013-00139010. On January 29, 2013, the plaintiffs in this matter filed a lawsuit against us alleging violations of California Civil Code Section 1747.08 which prohibits requesting or requiring personal identification information from a customer paying for goods with a credit card and recording such information. The complaint seeks certification of a class, unspecified damages, injunctive relief and attorneys fees. We intend to defend this case vigorously.

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

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Deborah Lyddy v. World of Jeans & Tops and Tilly s, Inc., Superior Court of California, County of San Diego (37-2011-00098812-CU-BT-CTL). In October 2011, plaintiff filed a putative class action against us alleging various causes of action based on our California gift card redemption policies. The plaintiff seeks unspecified damages, declaratory and injunctive relief and attorneys fees. The lawsuit is ongoing and we intend to defend this case vigorously.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our Class A common stock has been listed on the New York Stock Exchange under the symbol TLYS since May 4, 2012, the day after our initial public offering. The following table sets forth the high and low sales prices of our Class A common stock, as reported by the NYSE, during each fiscal quarter since our initial public offering:

	High	Low
Fiscal quarter ended:		
July 28, 2012 (commencing May 4, 2012)	$ 19.29	$ 13.70
October 28, 2012	19.57	15.41
February 2, 2013	17.15	12.36

As of March 22, 2013, we had approximately 14 stockholders of record, ten of whom were holders of our Class A common stock and four of whom were holders of our Class B common stock. The number of stockholders of record is based upon the actual number of stockholders registered at such date and does not include holders of shares in street names or persons, partnerships, associates, corporations or other entities identified in security position listings maintained by depositories.

Dividends

Our Class A common stock began trading on May 4, 2012, following our initial public offering. Since that time, we have not declared any cash dividends, and we do not anticipate declaring any cash dividends in the foreseeable future.

Prior to our initial public offering, as an S Corporation, we distributed annually to our shareholders amounts sufficient to cover their tax liabilities, due to the income that flowed through the shareholders tax returns. Additional amounts were distributed from time to time to our shareholders at the discretion of the board of directors. During fiscal year 2012, we paid distributions of $84.3 million to our shareholders, which included a final distribution (resulting from the termination of our S Corporation status) of 100% of our undistributed taxable income from the date of our formation through May 2, 2012.

Securities Authorized for Issuance Under Equity Compensation Plans

The information required by this Item is incorporated herein by reference to the Company s Proxy Statement for the 2013 Annual Meeting of Stockholders, which will be filed with the SEC no later than 120 days after the close of the fiscal year ended February 2, 2013.

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Stock Performance Graph

The graph set forth below compares the cumulative stockholder return on our Class A common stock between May 4, 2012 (the date of our initial public offering) and February 2, 2013 to the cumulative return of (i) the S&P Midcap 400 Index and (ii) the S&P 400 Apparel Retail Index over the same period. This graph assumes an initial investment of $100 on May 4, 2012 in our Class A common stock, the S&P Midcap 400 Index and the S&P 400 Apparel Retail Index and assumes the reinvestment of dividends, if any. The graph also assumes that the initial prices of our Class A common stock, the S&P Midcap 400 Index and the S&P 400 Apparel Retail Index on May 4, 2012 were the closing prices on that trading day.

Recent Sales of Unregistered Securities

Other than the sales of unregistered securities that have been previously reported, we did not sell any unregistered equity securities or purchase any of our securities during the fiscal year ended February 2, 2013.

Use of Proceeds from Registered Securities

On May 3, 2012, our Registration Statement on Form S-1, as amended (File No. 333-175299), was declared effective, pursuant to which we registered the offering and sale of 7,600,000 shares of Class A common stock by Tilly s, Inc., the associated sale of 400,000 shares of Class A common stock by selling stockholders, and the sale pursuant to the underwriters over-allotment option of an additional 1,200,000 shares of Class A common stock by selling stockholders, at a price of $15.50 per share. On May 9, 2012, Tilly s, Inc. sold all 7,600,000 shares of Class A common stock for an aggregate offering price of $117.8 million, the selling stockholders sold 1,600,000 shares of common stock, including 1,200,000 shares pursuant to the underwriters over-allotment option, for an aggregate offering price of $24.8 million, and the offering terminated. The underwriters were Goldman, Sachs & Co., Merrill Lynch, Pierce, Fenner & Smith, Incorporated, Piper Jaffray, William Blair & Company, L.L.C., and Stifel Nicolaus & Company, Incorporated.

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As a result of the offering, Tilly s, Inc. received net proceeds of approximately $107 million, after deducting the underwriting discount of $8.7 million and related fees and expenses of approximately $2.5 million. On May 9, 2012, we used $84.0 million of the net proceeds from the offering to pay in full the principal amount of notes representing World of Jeans & Tops undistributed taxable income. These notes were to the former shareholders of World of Jeans & Tops in connection with the Reorganization Transaction and all payments were made to trusts related to Hezy Shaked, Tilly Levine and their children.

With respect to the remaining $23 million in net proceeds from the offering, there has been no material change in the planned use of such proceeds from our initial public offering as described in the final prospectus filed with the SEC pursuant to Rule 424(b) and dated May 3, 2012.

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Item 6. Selected Financial Data

The following tables present selected consolidated financial and other data as of and for the periods indicated, and certain unaudited pro forma information to reflect our conversion from an S Corporation to a C Corporation for income tax purposes. The selected consolidated statement of income data for the fiscal years ended February 2, 2013, January 28, 2012 and January 29, 2011 and selected consolidated balance sheet data as of February 2, 2013 and January 28, 2012 are derived from our consolidated financial statements audited by Deloitte & Touche LLP, our independent registered public accounting firm, included in Item 8 of this report. The selected consolidated statement of income data for the fiscal years ended January 30, 2010 and January 31, 2009 and the selected consolidated balance sheet data as of January 29, 2011, January 30, 2010 and January 31, 2009 are derived from our audited consolidated financial statements that have not been included elsewhere in this report. The historical results presented below are not necessarily indicative of the results to be expected for any future period. You should read this selected consolidated financial data in conjunction with the consolidated financial statements and accompanying notes and the information under Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this report.

	Fiscal Year Ended (1)				
	February 2, 2013	January 28, 2012	January 29, 2011	January 30, 2010	January 31, 2009
	(in thousands, except per share data)				
Consolidated Statements of Income Data:					
Net sales	$ 467,291	$ 400,624	$ 332,604	$ 282,764	$ 254,983
Cost of goods sold (2)	317,096	271,482	229,989	195,430	172,107
Gross profit	150,195	129,142	102,615	87,334	82,876
Selling, general and administrative expenses	118,805	94,217	77,668	65,912	59,043
Operating income	31,390	34,925	24,947	21,422	23,833
Interest income (expense), net	(91)	(196)	(249)	(284)	35
Income before income taxes	31,299	34,729	24,698	21,138	23,868
Income tax expense	7,406	389	282	275	262
Net income	$ 23,893	$ 34,340	$ 24,416	$ 20,863	$ 23,606
Basic earnings per share	$ 0.93	$ 1.72	$ 1.22	$ 1.04	$ 1.18
Diluted earnings per share	$ 0.92	$ 1.68	$ 1.21	$ 1.04	$ 1.18
Weighted average basic shares outstanding	25,656	20,000	20,000	20,000	20,000
Weighted average diluted shares outstanding	26,076	20,500	20,098	20,014	20,000
Pro Forma Income Information (3):					
Pro forma income tax expense	$ 12,520	$ 13,892	$ 9,879	$ 8,455	$ 9,547
Pro forma net income	18,779	20,837	14,819	12,683	14,321
Pro forma basic earnings per share	$ 0.73	$ 1.04	$ 0.74	$ 0.63	$ 0.72
Pro forma diluted earnings per share	$ 0.72	$ 1.02	$ 0.74	$ 0.63	$ 0.72

	Fiscal Year Ended				
	February 2, 2013	January 28, 2012	January 29, 2011	January 30, 2010	January 31, 2009
Operating Data (unaudited):					
Stores operating at beginning of period	140	125	111	99	73
Stores opened during the period	29	16	16	13	26
Stores closed during the period	1	1	2	1	-
Stores operating at end of period	168	140	125	111	99
Comparable store sales change (4)	2.2%	10.7%	6.7%	-3.1%	-12.5%
Total square feet at end of period	1,318,803	1,094,419	967,011	862,971	775,832
Average square footage per store at end of period	7,850	7,817	7,736	7,775	7,837
Average net sales per store (in thousands) (5)	$ 2,676	$ 2,718	$ 2,528	$ 2,479	$ 2,750

Average net store sales per square foot (5)	$ 341	$ 350	$ 326	$ 318	$ 349
Capital expenditures (in thousands)	$ 33,298	$ 20,223	$ 15,674	$ 17,514	$ 23,406

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	As of				
	February 2, 2013	January 28, 2012	January 29, 2011 (in thousands)	January 30, 2010	January 31, 2009
Consolidated Balance Sheet Data:					
Cash, cash equivalents and marketable securities	$ 57,182	$ 25,091	$ 29,338	$ 25,705	$ 24,535
Working capital	73,891	27,673	33,907	29,639	22,779
Total assets	205,381	140,819	130,974	115,454	110,142
Total long-term debt (6)	3,970	4,638	5,266	5,857	6,412
Stockholders equity	117,296	60,424	62,092	59,896	55,053

(1) The fiscal year ended February 2, 2013 includes 53 weeks. The fiscal years ended January 28, 2012, January 29, 2011, January 30, 2010 and January 31, 2009 each included 52 weeks.
(2) Includes buying, distribution and occupancy costs.
(3) The unaudited pro forma income statement for all years presented gives effect to an adjustment for income tax expense as if we had been a C Corporation for all years presented at an assumed combined federal, state and local effective income tax rate, which approximates our statutory income tax rate, of 40%.
(4) Comparable store sales are net sales from stores that have been open at least 12 full fiscal months as of the end of the current reporting period. A remodeled or relocated store is included in comparable store sales, both during and after construction, if the square footage of the store was not changed by more than 20% and the store was not closed for more than five days in any fiscal month. Comparable store sales include sales through our e-commerce store but exclude gift card breakage income and e-commerce shipping and handling fee revenue. E-commerce sales contributed 2.1%, 2.3%, 3.3%, 2.9% and 1.9% to the comparable store sales change for fiscal years 2012, 2011, 2010, 2009 and 2008, respectively. The comparable store sales change for the period ended February 2, 2013 excludes the 53rd week in fiscal year 2012.
(5) The number of stores and the amount of square footage reflect the number of days during the period that new stores were open. E-commerce sales, e-commerce shipping revenue, and gift card breakage income are excluded from our sales in deriving net sales per store.
(6) Comprised solely of a capital lease for our corporate headquarters and distribution center.

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

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

We operate on a fiscal calendar widely used by the retail industry that results in a given fiscal year consisting of a 52- or 53-week period ending on the Saturday closest to January 31 of the following year. References to fiscal year 2012 or fiscal 2012 refer to the fiscal year ended February 2, 2013, references to fiscal year 2011 or fiscal 2011 refer to the fiscal year ended January 28, 2012 and references to fiscal year 2010 or fiscal 2010 refer to the fiscal year ended January 29, 2011. Fiscal year 2012 consisted of a 53-week period, and fiscal years 2011 and 2010 each consisted of a 52-week period.

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Overview

Tilly s is a fast-growing destination specialty retailer of West Coast inspired apparel, footwear and accessories. We believe we bring together an unparalleled selection of the most sought-after brands rooted in action sports, music, art and fashion. Our West Coast heritage dates back to 1982 when Hezy Shaked and Tilly Levine opened our first store in Orange County, California. As of February 2, 2013, we operated 168 stores in 28 states, averaging approximately 7,850 square feet. We also sell our products through our e-commerce website, www.tillys.com.

Our strong growth and operating results reflect initiatives taken by our management team as well as our customers increasing awareness of our brand and merchandise assortment as we have expanded our presence in both existing and new markets. We increased net sales 17%, to $467.3 million in fiscal year 2012 from $400.6 million in fiscal year 2011. Operating income decreased 10%, to $31.4 million in fiscal year 2012 from $34.9 million in fiscal year 2011, primarily due to the recognition of $9.6 million of stock-based compensation expense for stock options during fiscal year 2012. Our comparable store sales increased 2.2% in fiscal year 2012 after a 10.7% increase in fiscal year 2011. Since the beginning of fiscal 2008, we have more than doubled our store count from 73 stores to 168 stores at the end of fiscal year 2012.

We expect to continue our strong growth in the future. We believe there is a significant opportunity to expand our store base to more than 500 stores over the next 8 years. We plan to add a total of at least 25 net new stores in fiscal year 2013 and to continue opening new stores at an annual rate of approximately 15% for the next several years thereafter. We expect to fund this store expansion through our cash on hand. We believe our success operating in different retail venues and geographies demonstrates the portability of Tilly s and provides us with flexibility for future expansion. We also expect to continue to support our comparable store sales by consistently offering new, on-trend and relevant merchandise, increasing our brand awareness, providing an engaging store experience for our core customers and maintaining our high level of customer service.

Over the last five years, we have invested over $25 million in infrastructure and systems to support our recent and long-term growth. We believe our distribution and allocation capabilities are unique within the industry and allow us to quickly sort and process merchandise and deliver it to our stores in a floor-ready format for immediate display. We believe our distribution infrastructure can support a national retail footprint in excess of 500 stores with minimal incremental capital investment. In addition, we anticipate spending approximately $14 million to equip our new e-commerce distribution center, which we expect to open near the end of fiscal year 2013. We plan to fund the tenant improvements for this leased facility from cash on hand and cash flows from operations.

We believe our business strategy will continue to offer significant opportunity, but it also presents risks and challenges. These risks and challenges include, but are not limited to, that we may not be able to effectively identify and respond to changing fashion trends and customer preferences, that we may not be able to find desirable locations for new stores and that we may not be able to effectively manage our future growth. In addition, our financial results can be expected to be directly impacted by trends in the general economy. A decline in consumer spending or a substantial increase in product costs due to commodity cost increases or general inflation could lead to a reduction in our sales as well as greater margin pressure as costs may not be able to be passed on to consumers and the competitive environment could become more highly promotional. See Risk Factors for other important factors that could adversely impact us and our results of operations. We strive to ensure that addressing these risks does not divert our attention from continuing to build on the strengths that we believe have driven the growth of our business.

How We Assess the Performance of Our Business

In assessing the performance of our business, we consider a variety of performance and financial measures. The key indicators of the financial condition and operating performance of our business are net sales, comparable store sales, gross profit, selling, general and administrative expenses and operating income.

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Net Sales

Net sales reflect revenue from the sale of our merchandise at store locations as well as sales of merchandise through our e-commerce store, which is reflected in sales when the merchandise is received by the customer. Net sales also include shipping and handling fees for e-commerce shipments that have been delivered to the customer. Net sales are net of returns on sales during the period as well as an estimate of returns expected in the future stemming from current period sales. Revenue from the sale of gift cards is deferred and not included in net sales until the gift cards are used to purchase merchandise. However, over time, the redemption of some gift cards becomes remote (referred to as gift card breakage). Revenue from estimated gift card breakage is also included in net sales.

Our business is seasonal and as a result our revenues fluctuate from quarter to quarter. In addition, our revenues in any given quarter can be affected by a number of factors including the timing of holidays and weather patterns. The third and fourth quarters of the fiscal year, which include the back-to-school and holiday sales seasons, have historically produced stronger sales and disproportionately stronger operating results than have the first two quarters of the fiscal year.

Comparable Store Sales

Comparable store sales are net sales from stores that have been open at least 12 full fiscal months as of the end of the current reporting period. A remodeled or relocated store is included in comparable store sales, both during and after construction, if the square footage of the store was not changed by more than 20% and the store was not closed for more than five days in any fiscal month. Comparable store sales include sales through our e-commerce store, but exclude gift card breakage income and e-commerce shipping and handling fee revenue. Some of our competitors and other retailers may calculate comparable or same store sales differently than we do. As a result, data in this report regarding our comparable store sales may not be comparable to similar data made available by other retailers.

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

- overall economic trends;
- our ability to identify and respond effectively to consumer preferences and fashion trends;
- competition;
- the timing of our releases of new and seasonal styles;
- changes in our product mix;
- pricing;
- the level of customer service that we provide in stores;
- our ability to source and distribute products efficiently;
- calendar shifts of holiday or seasonal periods;

- the number and timing of store openings and the relative proportion of new stores to mature stores; and

- the timing and success of promotional and advertising efforts.

Opening new stores is an important part of our growth strategy and we expect a significant percentage of our net sales during this growth period to come from non-comparable store sales. Accordingly, comparable store sales are only one element we use to assess the success of our business.

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Gross Profit

Gross profit is equal to our net sales less our cost of goods sold. Cost of goods sold reflects the direct cost of purchased merchandise as well as buying, distribution and occupancy costs. Buying costs include compensation expense for our internal buying organization. Distribution costs include costs for receiving, processing, warehousing and shipping of merchandise to or from our distribution center, to our e-commerce customers and between store locations. Occupancy costs include the rent, common area maintenance, utilities, property taxes, security, and depreciation costs of all store locations. These costs are significant and can be expected to continue to increase as our company grows. The components of our reported cost of goods sold may not be comparable to those of other retail companies.

We regularly analyze the components of gross profit as well as gross profit as a percentage of net sales. Specifically we look at the initial markup on purchases, markdowns and reserves, shrinkage, buying costs, distribution costs and occupancy costs. Any inability to obtain acceptable levels of initial markups, a significant increase in our use of markdowns or a significant increase in inventory shrinkage or inability to generate sufficient sales leverage on the buying, distribution and occupancy components of cost of goods sold could have an adverse impact on our gross profit and results of operations.

Gross profit is also impacted by shifts in the proportion of sales of proprietary branded products compared to third-party branded products, as well as by sales mix shifts within and between brands and between major product categories such as guys and juniors apparel, footwear or accessories. A substantial shift in the mix of products could have a material impact on our results of operations. In addition, gross profit and gross profit as a percent of sales have historically been higher in the third and fourth quarters of the fiscal year, as these periods include the back-to-school and winter holiday selling seasons. This reflects that various costs, including occupancy costs, generally do not increase in proportion to the seasonal sales increase.

Selling, General and Administrative Expenses

Our selling, general and administrative, or SG&A, expenses are composed of store selling expenses and corporate-level general and administrative expenses. Store selling expenses include store and regional support costs, including personnel, advertising and debit and credit card processing costs, e-commerce processing costs and store supplies costs. General and administrative expenses include the payroll and support costs of corporate functions such as executive management, legal, accounting, information systems, human resources and other centralized services. Store selling expenses generally vary proportionately with net sales and store growth. In contrast, general and administrative expenses are generally not directly proportional to net sales and store growth, but will be expected to increase over time to support the needs of our growing company. SG&A expenses as a percentage of net sales are usually higher in lower volume periods and lower in higher volume periods.

The components of our SG&A expenses may not be comparable to those of other retailers. We expect that our SG&A expenses will increase in future periods due to our continuing store growth and in part due to additional legal, accounting, insurance and other expenses we incur as a result of being a public company. Among other things, we expect that compliance with the Sarbanes-Oxley Act of 2002 and related rules and regulations could result in significant incremental legal, accounting and other overhead costs.

Operating Income

Operating income equals gross profit less SG&A expenses. Operating income excludes interest income, interest expense and income taxes. Operating income percentage measures operating income as a percentage of our net sales.

Income Taxes

Prior to May 2, 2012, we were taxed as an S Corporation for federal income tax purposes under Section 1362 of the Internal Revenue Code, and therefore were not subject to federal and state income taxes

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(subject to an exception in a limited number of state and local jurisdictions that do not recognize the S Corporation status). On May 2, 2012, our S Corporation status terminated and we became subject to corporate-level federal and state income taxes at prevailing corporate rates.

Results of Operations

The following tables summarize key components of our results of operations for the periods indicated, both in dollars and as a percentage of our net sales.

	Fiscal Year Ended		
	February 2, 2013	January 28, 2012 (in thousands)	January 29, 2011
Statements of Income Data:			
Net sales	$ 467,291	$ 400,624	$ 332,604
Cost of goods sold	317,096	271,482	229,989
Gross profit	150,195	129,142	102,615
Selling, general and administrative expenses	118,805	94,217	77,668
Operating income	31,390	34,925	24,947
Interest expense, net	91	196	249
Income before income taxes	31,299	34,729	24,698
Income tax expense	7,406	389	282
Net income	$ 23,893	$ 34,340	$ 24,416
Percentage of Net Sales:			
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	67.9%	67.8%	69.1%
Gross profit	32.1%	32.2%	30.9%
Selling, general and administrative expenses	25.4%	23.5%	23.4%
Operating income	6.7%	8.7%	7.5%
Interest expense, net	0.0%	0.0%	0.1%
Income before income taxes	6.7%	8.7%	7.4%
Income tax expense	1.6%	0.1%	0.1%
Net income	5.1%	8.6%	7.3%
Pro Forma Data (unaudited) (1):			
Income before income taxes	$ 31,299	$ 34,729	$ 24,698
Pro forma income tax expense	12,520	13,892	9,879
Pro forma net income	$ 18,779	$ 20,837	$ 14,819

(1) The unaudited pro forma income statement for all periods presented gives effect to an adjustment for income tax expense as if we had been a C Corporation at an assumed combined federal, state and local effective income tax rate, which approximates our statutory income tax rate, of 40%.

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

	Fiscal Year Ended		
	February 2, 2013	January 28, 2012	January 29, 2011
Store Operating Data:			
Stores operating at end of period	168	140	125
Comparable store sales change (1)	2.2%	10.7%	6.7%
Total square feet at end of period	1,318,803	1,094,419	967,011
Average net sales per store (in thousands) (2)	$ 2,676	$ 2,718	$ 2,528
Average net sales per square foot (2)	$ 341	$ 350	$ 326
E-commerce revenues (in thousands) (3)	$ 52,953	$ 43,587	$ 32,804

(1) Comparable store sales are net sales from stores that have been open at least 12 full fiscal months as of the end of the current reporting period. A remodeled or relocated store is included in comparable store sales, both during and after construction, if the square footage of the store was not changed by more than 20% and the store was not closed for more than five days in any fiscal month. Comparable store sales include sales through our e-commerce store but exclude gift card breakage income and e-commerce shipping and handling fee revenue. E-commerce sales contributed 2.1%, 2.3% and 3.3% to the comparable store sales change for fiscal years 2012, 2011 and 2010, respectively. The comparable store sales change for the period ended February 2, 2013 excludes the 53rd week in fiscal year 2012.

(2) E-commerce sales, e-commerce shipping fee revenue and gift card breakage are excluded from net sales in deriving average net sales per store and average net sales per square foot.

(3) E-commerce revenues include e-commerce sales and e-commerce shipping fee revenue.

Fiscal Year 2012 Compared to Fiscal Year 2011

Net Sales

Net sales increased $66.7 million, or 17%, to $467.3 million in fiscal year 2012 from $400.6 million in fiscal year 2011. New stores opened in fiscal year 2012 accounted for $30.8 million of the increase in net sales. Also, $27.2 million of the increase in net sales resulted from the additional portion of the year that stores opened during fiscal year 2011 were operating in fiscal year 2012, as well as fees charged to customers for shipping merchandise sold through our e-commerce store. Net sales also increased due to a comparable store net sales increase of 2.2%, or $8.7 million. The comparable store net sales increase stemmed from higher net sales of guys and juniors apparel, as well as footwear and accessories, which was partially offset by lower net sales of boys and girls apparel. There were 139 comparable stores and 29 non-comparable stores open at February 2, 2013.

Net sales, including shipping and handling fees, from our e-commerce store increased $9.4 million, or 21%, to $53.0 million in fiscal year 2012 from $43.6 million in fiscal year 2011. This increase reflects higher sales in all major product categories which was attributable at least partially to the greater marketing efforts that directly supported the e-commerce business. E-commerce sales, excluding shipping and handling fees, are included in our calculation of comparable store sales, as comparable store sales is intended to reflect revenue from the sale of merchandise only.

Gross Profit

Gross profit increased $21.1 million, or 16%, to $150.2 million in fiscal year 2012 from $129.1 million in fiscal year 2011. As a percentage of net sales, gross profit was 32.1% and 32.2% during fiscal years 2012 and 2011, respectively. Of the 0.1% decrease, 0.4% related to higher occupancy costs as a percentage of net sales reflecting the large number of new stores opened during the year. This was mostly offset by a 0.3% decrease in product, buying and distribution costs as a percentage of net sales as these costs increased at a slower rate than the increase in net sales.

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Selling, General and Administrative Expenses

SG&A expenses increased $24.6 million, or 26%, to $118.8 million in fiscal year 2012 from $94.2 million in fiscal year 2011. As a percentage of net sales, SG&A expenses were 25.4% and 23.5% during fiscal years 2012 and 2011, respectively.

Store selling expenses increased $11.3 million, or 18%, to $75.1 million in fiscal year 2012 from $63.8 million in fiscal year 2011. As a percentage of net sales, store selling expenses were 16.1% and 15.9% during fiscal years 2012 and 2011, respectively.

The following contributed to the increase in store selling expenses as a percentage of net sales:

- marketing costs increased $2.7 million, or 0.2% as a percentage of net sales, reflecting growth in the size and number of marketing campaigns, entry into many new markets, increased distribution of catalog mailings and marketing costs incurred to support and drive the growth of our e-commerce business;

- store and regional payroll, payroll benefits and related personnel costs increased $8.1 million, or 0.2% as a percentage of net sales, as these costs increased more quickly than net sales, partially due to many new store openings; and

- supplies and other support costs increased $0.5 million, but decreased 0.2% as a percentage of net sales.

General and administrative expenses increased $13.3 million, or 44%, to $43.7 million in fiscal year 2012 from $30.4 million in fiscal year 2011. As a percentage of net sales, general and administrative expenses were 9.4% and 7.6% during fiscal years 2012 and 2011, respectively.

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

- a one-time charge of $7.6 million, or 1.6% of net sales, to recognize life-to-date stock-based compensation expense for stock options, recognition that was triggered by the consummation of our IPO during the second quarter of 2012;

- ongoing stock-based compensation expense of $2.0 million, or 0.4% of net sales, which commenced upon the completion of our IPO during the second quarter of 2012;

- payroll, payroll benefits and related costs for corporate office personnel increased $1.4 million, which represents a decrease of 0.5% as a percentage of net sales, as these costs increased more slowly than sales; and

- depreciation, legal, audit and tax services and other expenses, including incremental costs in the current year as a result of becoming a public company, increased $2.3 million, or 0.3% as a percentage of net sales.

Operating Income

Operating income decreased $3.5 million, or 10%, to $31.4 million in fiscal year 2012 from $34.9 million in fiscal year 2011. As a percentage of net sales, operating income was 6.7% and 8.7% during fiscal years 2012 and 2011, respectively. The decrease in operating income as a percentage of net sales was due to the recognition of $9.6 million of stock-based compensation expense for stock options during fiscal year 2012, as discussed above.

Interest Income (Expense), Net

Net interest expense was $0.1 million and $0.2 million in fiscal years 2012 and 2011, respectively. Net interest expense reflects interest paid on a capitalized lease of our corporate office and distribution center as well

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as costs related to maintaining our unused line of credit bank facility, net of interest income earned on cash balances.

Income Tax Expense

Income tax expense in fiscal year 2012 was $7.4 million. Income tax expense was comprised of (1) a one-time deferred tax benefit of $3.0 million recognized upon the conversion to a C Corporation, (2) income tax expense of $0.1 million related to the period during fiscal year 2012 in which the company was an S Corporation (January 29, 2012 through May 1, 2012) computed at the S Corporation effective tax rate and (3) income tax expense of $10.3 million related to the period in which the company was a C Corporation (May 2, 2012 through February 2, 2013) at the C Corporation effective tax rate. For fiscal year 2011, our income tax expense of $0.4 million (calculated at the effective tax rate of 1.1%) was mainly comprised of a 1.5% California franchise tax. The increase in our effective tax rate resulted from our change in tax status.

Net Income

Net income decreased $10.4 million, or 30%, to $23.9 million in fiscal year 2012 from $34.3 million in fiscal year 2011, due to the factors discussed above. Applying a pro forma 40% C Corporation effective tax rate to both years, rather than the S Corporation tax rate that actually applied to us prior to the Reorganization, pro forma net income decreased $2.1 million, or 10%, to $18.8 million in fiscal year 2012 from $20.8 million in fiscal year 2011.

Fiscal Year 2011 Compared to Fiscal Year 2010

Net Sales

Net sales increased $68.0 million, or 20%, to $400.6 million in fiscal year 2011 from $332.6 million in fiscal year 2010. New stores opened in fiscal year 2011 accounted for $18.8 million of the increase in net sales. Also, $15.2 million of the increase in net sales resulted from the additional portion of the year that stores opened during fiscal year 2010 were operating in fiscal year 2011, as well as fees charged to customers for shipping merchandise sold through our e-commerce store. Net sales also increased due to a comparable store net sales increase of 10.7%, or $34.0 million. The comparable store net sales increase stemmed from higher net sales of guys , juniors and girls apparel, footwear and accessories, which was partially offset by slightly lower net sales of boys apparel. There were 121 comparable stores and 19 non-comparable stores open at January 28, 2012.

Net sales, including shipping and handling fees, from our e-commerce store increased $10.8 million, or 33%, to $43.6 million in fiscal year 2011 from $32.8 million in fiscal year 2010. This increase reflects higher sales in all major product categories (guys and juniors apparel, footwear and accessories), which was attributable at least partially to the greater marketing efforts that directly supported the e-commerce business. E-commerce sales, excluding shipping and handling fees, are included in our calculation of comparable store sales, as comparable store sales is intended to reflect revenue from the sale of merchandise only.

Gross Profit

Gross profit increased $26.5 million, or 26%, to $129.1 million in fiscal year 2011 from $102.6 million in fiscal year 2010. As a percentage of net sales, gross profit was 32.2% and 30.9% during fiscal years 2011 and 2010, respectively. Of the 1.3% increase, 0.7% related to buying, distribution and occupancy costs increasing at a slower rate than the increase in net sales. The remaining 0.6% of the increase in gross profit as a percentage of net sales was mostly due to lower promotional markdowns.

Selling, General and Administrative Expenses

SG&A expenses increased $16.5 million, or 21%, to $94.2 million in fiscal year 2011 from $77.7 million in fiscal year 2010. As a percentage of net sales, SG&A expenses were 23.5% and 23.4% during fiscal years 2011 and 2010, respectively.

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Store selling expenses increased $10.1 million, or 19%, to $63.8 million in fiscal year 2011 from $53.7 million in fiscal year 2010. As a percentage of net sales, store selling expenses were 15.9% and 16.1% during fiscal years 2011 and 2010, respectively.

The following contributed to the decrease in store selling expenses as a percentage of net sales:

- marketing costs increased $3.0 million, or 0.3% as a percentage of net sales, reflecting growth in the size and number of marketing campaigns, including the frequency and distribution of catalog mailings as well as marketing costs incurred to support and drive the growth of our e-commerce business;
- store and regional payroll, payroll benefits and related personnel costs increased $6.2 million, but decreased 0.4% as a percentage of net sales, reflecting cost leverage as these costs increased more slowly than net sales; and
- supplies and other support costs increased $0.9 million, but decreased 0.1% as a percentage of net sales.

General and administrative expenses increased $6.4 million, or 27%, to $30.4 million in fiscal year 2011 from $24.0 million in fiscal year 2010. As a percentage of net sales, general and administrative expenses were 7.6% and 7.2% during fiscal years 2011 and 2010, respectively.

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

- payroll, payroll benefits and related costs for corporate office personnel increased $6.6 million, or 0.8% as a percentage of net sales. This increase reflects the addition of staff to support company growth and pay increases, and an increase in incentive pay reflecting individual and company-wide performance;
- depreciation, legal and other office expenses did not change significantly in absolute terms between fiscal years 2010 and 2011, but decreased 0.3% as a percentage of net sales; and
- a charge for the impairment of the fixed assets at one store location of $0.6 million in fiscal year 2011 and one location of $0.8 million in fiscal year 2010, which represented 0.1% and 0.2% as a percentage of net sales in each year, respectively.

Operating Income

Operating income increased $10.0 million, or 40%, to $34.9 million in fiscal year 2011 from $24.9 million in fiscal year 2010. As a percentage of net sales, operating income was 8.7% and 7.5% during fiscal years 2011 and 2010, respectively. Of the 1.2% increase in operating income as a percentage of net sales, 0.6% was due to lower product costs as a percentage of net sales resulting from lower promotional markdowns, and the remaining 0.6% was due to other costs and expenses increasing at a slower rate than net sales.

Interest Income (Expense), Net

Net interest expense was $0.2 million in both fiscal years 2011 and 2010. Net interest expense reflects interest paid on a capitalized lease of our corporate office and distribution center as well as costs related to maintaining our unused line of credit bank facility, net of interest income earned on cash balances and on tenant construction allowances due from landlords.

Provision for Income Taxes

Income taxes were $0.4 million and $0.3 million in fiscal years 2011 and 2010, respectively. This reflected a slight drop in the effective tax rate, from 1.14% of income before provision for income taxes in fiscal year 2010 to 1.12% of income before provision for income taxes in fiscal year 2011.

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Prior to the Reorganization Transaction, World of Jeans & Tops recognized income taxes as an S Corporation for federal and state income tax purposes and therefore, with the exception of a limited number of state and local jurisdictions, was not subject to income taxes. The shareholders of World of Jeans & Tops, and not World of Jeans & Tops itself, were subject to income tax on their distributive share of its earnings. In connection with the Reorganization Transaction, World of Jeans & Tops converted to a C Corporation. On a pro forma basis, if World of Jeans & Tops had been taxed as a C Corporation at an estimated 40% effective tax rate, income taxes would have increased to $13.9 million in fiscal year 2011 from $9.9 million in fiscal year 2010, an increase proportional to the increase in income before provision for income taxes.

Net Income

Net income increased $9.9 million, or 41%, to $34.3 million in fiscal year 2011 from $24.4 million in fiscal year 2010, due to the factors discussed above. Applying a pro forma 40% C Corporation effective tax rate to both years, rather than the S Corporation tax rate that actually applied to us, pro forma net income increased $6.0 million, or 41%, to $20.8 million in fiscal year 2011 from $14.8 million in fiscal year 2010.

Liquidity and Capital Resources

General

Our business relies on cash flows from operating activities as well as cash on hand as our primary sources of liquidity. In addition, we have had access to additional liquidity through a $25.0 million revolving credit facility with Wells Fargo Bank, NA. We have never drawn funds from or issued letters of credit financing from the revolving credit facility and we do not expect to draw from the revolving credit facility over the next 12 months. We expect to finance company operations and store growth with existing cash on hand, marketable securities and cash flows from operations.

Historically our primary cash needs have been for merchandise inventories, payroll, store rent, capital expenditures associated with opening new stores, improvements to our distribution facilities, marketing and information technology expenditures and shareholder distributions. As a result of our conversion to a C Corporation for income tax purposes, we no longer make S Corporation distributions to shareholders. In addition to cash and cash equivalents and marketable securities, the most significant components of our working capital are merchandise inventories, accounts payable and accrued expenses. We believe that cash flows from operating activities, the availability of cash under our revolving credit facility and our cash and marketable securities on hand will be sufficient to cover working capital requirements and anticipated capital expenditures for the next 12 months. If cash flows from operations and borrowings under our existing revolving credit facility are not sufficient or available to meet our capital requirements, then we will be required to obtain additional equity or debt financing in the future. There can be no assurance that equity or debt financing will be available to us when we need it or, if available, that the terms will be satisfactory to us and not dilutive to our stockholders.

Cash Flow Analysis

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

	Fiscal Year Ended		
	February 2, 2013	**January 28, 2012**	**January 29, 2011**
		(in thousands)	
Net cash provided by operating activities	$ 41,730	$ 52,584	$ 41,702
Net cash used in investing activities	(72,326)	(20,195)	(15,258)
Net cash provided by (used in) financing activities	22,819	(36,636)	(22,811)

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Net Cash Provided by Operating Activities

Operating activities consist primarily of net income adjusted for non-cash items that include depreciation, asset impairment write-downs, deferred income taxes and stock-based compensation expense, plus the effect on cash of changes during the year in our assets and liabilities.

We generated $41.7 million of net cash from operating activities in fiscal year 2012. The significant components of cash flows from operating activities were net income of $23.9 million, the add-back of non-cash depreciation and amortization expense of $16.7 million, the change in deferred income taxes of $6.7 million and non-cash stock-based compensation expense of $9.6 million. Deferred rent increased by $8.6 million due to the opening of new stores. The above was offset by an increase in merchandise inventories of $9.9 million due to the opening of 29 new stores and the growth in sales, an increase in prepaid expenses and other assets of $12.9 million mainly due to increases in prepaid rent resulting from the opening of new stores and the recognition of deferred tax assets resulting from our conversion from an S Corporation to a C Corporation, and a decrease in accrued compensation and benefits of $1.4 million due to lower incentive pay accruals offset partially by the timing of payroll payments.

We generated $52.6 million of net cash from operating activities in fiscal year 2011. The significant components of cash flows from operating activities were net income of $34.3 million and the add-back of non-cash depreciation and amortization expense of $15.1 million. In addition, accounts payable and accrued expenses increased by $2.3 million due to the timing of payments and growth in inventory. Accrued compensation and benefits increased by $3.4 million due to the addition of staff to support company growth and pay increases, and an increase in incentive pay reflecting individual and company-wide performance. Deferred rent increased by $4.2 million due to the opening of new stores. The above was offset by an increase in merchandise inventories of $3.0 million due to the opening of new stores and the growth in sales, an increase in receivables of $2.3 million due to the growth of the business and an increase in prepaid expenses and other assets of $2.9 million due to the growth in the number of stores and the timing of payments.

We generated $41.7 million of net cash from operating activities in fiscal year 2010. The significant components for cash flows from operating activities were net income of $24.4 million and the add-back of non-cash depreciation and amortization expense of $14.3 million and non-cash impairment of assets of $2.0 million. In addition, accounts payable and accrued expenses increased by $9.4 million due to the timing of payments and growth in inventory and deferred rent increased by $3.1 million due to the opening of new stores. The above was offset by an increase in merchandise inventories of $9.6 million due to the opening of new stores and growth in sales, an increase in receivables of $2.2 million due to the growth of the business and a receivable on a casualty insurance claim and an increase in prepaid expenses and other current assets of $1.4 million due to the growth in the number of stores and the timing of payments.

Net Cash Used in Investing Activities

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

Net cash used in investing activities was $72.3 million in fiscal year 2012. Of this total, $33.3 million was for capital expenditures. Spending on new stores and the remodeling or other improvements of existing stores was $24.9 million of this total. The remaining capital expenditures were for our investment in information technology systems and distribution and corporate facility enhancements. In addition, we received $0.8 million of insurance proceeds related to fixed assets that were destroyed by smoke damage as a result of a fire in 2010 at a mall where one of our stores is located. We purchased $75.4 million of marketable securities and received proceeds of $35.5 million from the sale of marketable securities during the period.

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Net cash used in investing activities was $20.2 million and $15.3 million in fiscal years 2011 and 2010, respectively. Of these totals, $16.1 million and $13.3 million was for capital expenditures for new stores or the remodeling and other improvements of existing stores in fiscal years 2011 and 2010, respectively. The remaining capital expenditures in each period were primarily for our investment in information technology systems and distribution and corporate facility enhancements.

Capital expenditures during fiscal year 2013 are expected to be between $45 million and $50 million. We expect to spend approximately $25 million for new stores and remodels of existing stores, approximately $14 million for a new e-commerce distribution facility, $4 million for other enhancements to our distribution centers and corporate offices and the remainder for information technology systems and other store projects. These expenditures are expected to be funded from cash provided by operations.

Net Cash Provided by (Used in) Financing Activities

Financing activities consist of payments on our capital lease obligation, proceeds from the exercise of stock options, excess tax benefits from stock-based compensation and, prior to the Reorganization, distributions to our shareholders. In fiscal year 2012 net proceeds from our initial public offering were included in financing activities.

Net cash provided by financing activities was $22.8 million in fiscal year 2012. This included $106.8 million in net proceeds from our initial public offering, which was consummated during the second quarter of 2012. Offsetting this was $84.3 million for final distributions to the former shareholders of World of Jeans & Tops. We received $0.9 million in proceeds from the exercise of stock options, net of tax withholdings, and paid $0.7 million for our capital lease obligation during the period.

Net cash used in financing activities was $36.6 million and $22.8 million in fiscal years 2012 and 2011, respectively. This included $36.0 million and $22.2 million, respectively, in distributions to our shareholders primarily for them to pay their S Corporation taxes, and $0.6 million in both fiscal years 2011 and 2010 for payments on our capital lease obligation.

Line of Credit

On May 3, 2012, we entered into an amended and restated credit agreement with Wells Fargo Bank, N.A. The revolving credit facility provides for a $25.0 million revolving credit facility with a maturity date of May 3, 2014. The interest charged is either at the London Interbank Offered Rate, or LIBOR, plus $1.75%, or at the bank s prime rate. We have the ability to select between the prime rate or LIBOR-based rate at the time of a cash advance. The revolving credit facility is secured by substantially all of the Company s assets. As a sub-feature under the revolving credit facility the bank may issue stand-by and commercial letters of credit up to $15.0 million.

We are required to maintain certain financial and nonfinancial covenants in accordance with the revolving credit facility. The financial covenants contain requirements for certain levels of tangible net worth, liquidity and profitability, including: (i) a minimum current asset to current liability ratio of 1.25 to 1.00, (ii) a net profit before tax of at least $1, excluding a non-cash charge of up to a maximum of $2 million for the write-off of impaired fixed assets for the cumulative rolling four-quarter period measured, determined as of the end of each fiscal quarter on a cumulative rolling four-quarter basis and (iii) a maximum ratio of 4.00 to 1.00 for funded debt to EBITDAR , where funded debt includes credit facility borrowings, capital lease debt and eight times annual operating lease rent expense, and EBITDAR includes net income before interest, income taxes, depreciation, amortization and rent expense.

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Contractual Obligations

We enter into long-term contractual obligations and commitments in the normal course of business, primarily noncancellable capital and operating leases.

We lease approximately 172,000 square feet for our corporate headquarters and distribution center from a company that is owned by the co-founders of Tilly s. These buildings are located at 10 and 12 Whatney, Irvine, California. On June 29, 2012, we exercised the first of our three five-year renewal options on this lease, with the renewal commencing on January 1, 2013. The lease now expires on December 31, 2017, with two remaining five-year renewal option periods. The land component of this lease is accounted for as an operating lease and the building component is accounted for as a capital lease. The initial obligation at inception under the capital lease was $9.2 million, with an outstanding balance of $4.0 million as of February 2, 2013. The value of the capital lease assets was $7.8 million as of February 2, 2013. The accumulated depreciation of the building under the capital lease was $5.3 million as of February 2, 2013. Prior to signing the lease we received an independent market analysis regarding this property and therefore believe that the terms of this lease are reasonable and are not materially different than terms we would have obtained from an unaffiliated third party.

We lease approximately 24,000 square feet of office and warehouse space from a company that is owned by one of the co-founders of Tilly s. This building is located at 15 Chrysler, Irvine California. The lease is accounted for as an operating lease and expires on October 31, 2014. We sublease approximately 17,000 square feet of the building to an unrelated third party. The sublease began December 1, 2010 and terminates on May 31, 2014. The rental income paid to us with respect to the sublease, per square foot, is slightly above the rental expense paid by us with respect to the master lease. Prior to signing the lease we received an independent market analysis regarding this property and therefore believe that the terms of this lease are reasonable and are not materially different than terms we would have obtained from an unaffiliated third party.

We lease approximately 26,000 square feet of office and warehouse space with a company that is owned by one of the co-founders of Tilly s. This building is located at 11 Whatney, Irvine, California. The lease is accounted for as an operating lease and expires on June 30, 2022. Prior to signing the lease we received an independent market analysis regarding this property and therefore believe that the terms of this lease are reasonable and are not materially different than terms we would have obtained from an unaffiliated third party.

We lease approximately 81,000 square feet of office and warehouse space with a company that is owned by one of the co-founders of Tilly s. This building is located at 17 Pasteur, Irvine, California. The lease is accounted for as an operating lease and expires on October 31, 2021. Pursuant to the lease agreement, the Company requested that the landlord expand the building. Upon commencement of the building expansion, the Company returned the building to the landlord for the duration of the construction. As of February 2, 2013, the landlord returned the expanded building to us. We intend to use this property as our e-commerce distribution center beginning late in fiscal year 2013. Prior to signing the lease we received an independent market analysis regarding this property and therefore believe that the terms of this lease are reasonable and are not materially different than terms we would have obtained from an unaffiliated third party.

With the exception of the corporate headquarters and distribution center and warehouse leases discussed above, our leases are generally noncancellable operating leases expiring at various dates through 2024. Certain leases provide for additional rent based on a percentage of sales and annual rent increases based upon the Consumer Price Index. In addition, many of our store leases contain certain co-tenancy provisions that permit us to pay rent based on a pre-determined percentage of sales when the occupancy of the retail center falls below minimums established in such lease.

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As of February 2, 2013, our contractual cash obligations over the next several periods are set forth below (in thousands).

		Payments Due by Period			
	Total	Less Than 1 Year	1-2 Years (in thousands)	3-5 Years	More Than 5 Years
Capital Lease Obligations (1)(3)	$ 4,540	$ 940	$ 1,800	$ 1,800	$
Operating Lease Obligations (2)(3)	304,824	42,812	79,571	73,005	109,436
Purchase Obligations (4)	105,790	105,790			
Total	$ 415,154	$ 149,542	$ 81,371	$ 74,805	$ 109,436

(1) The capital lease is for the building portion of our corporate headquarters and distribution center, including interest.

(2) Our store leases generally have initial lease terms of 10 years and many also include renewal options on substantially the same terms and conditions as the original lease. Also included in operating leases is the land portion of the corporate headquarters and distribution center lease, as well as the warehouse leases described above.

(3)