

TILLY'S, INC.  
Form 10-Q  
June 11, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**

**FORM 10-Q**

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

**For the quarterly period ended May 2, 2015**

**OR**

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

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

**Commission file number: 001-35535**

**TILLY S, INC.**

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

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**45-2164791**  
**(I.R.S. Employer**  
**Identification No.)**

**10 Whatney**  
**Irvine, CA 92618**

**(Address of principal executive offices)**

**(949) 609-5599**

**(Registrant's telephone number, including area code)**

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

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

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

Large accelerated filer  Accelerated filer

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

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

As of June 5, 2015, the registrant had the following shares of common stock outstanding:

Class A common stock \$0.001 par value	12,176,994
Class B common stock \$0.001 par value	16,179,097



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**TILLY'S, INC.**

**FORM 10-Q**

**For the Quarter Ended May 2, 2015**

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**Table of Contents****Part I. Financial Information****Item 1. Financial Statements (Unaudited)****TILLY S, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share data)

(Unaudited)

	May 2, 2015	January 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 44,181	\$ 49,789
Marketable securities	34,971	34,957
Receivables	5,475	4,682
Merchandise inventories	61,696	51,507
Prepaid expenses and other current assets	12,145	12,349
Total current assets	158,468	153,284
Property and equipment, net	101,341	101,335
Other assets	2,798	2,932
Total assets	\$ 262,607	\$ 257,551
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 24,864	\$ 23,109
Accrued expenses	14,227	12,325
Deferred revenue	5,822	7,075
Accrued compensation and benefits	4,180	5,911
Current portion of deferred rent	6,060	6,070
Current portion of capital lease obligation	819	806
Total current liabilities	55,972	55,296
Long-term portion of deferred rent	41,323	41,875
Long-term portion of capital lease obligation	1,484	1,694
Total long-term liabilities	42,807	43,569
Total liabilities	98,779	98,865

## Commitments and contingencies (Note 5)

## Stockholders' equity:

Common stock (Class A), \$0.001 par value; May 2, 2015 - 100,000 shares authorized, 12,167 shares issued and outstanding; January 31, 2015 - 100,000 shares authorized, 11,546 shares issued and outstanding	12	11
Common stock (Class B), \$0.001 par value; May 2, 2015 - 35,000 shares authorized, 16,189 shares issued and outstanding; January 31, 2015 - 35,000 shares authorized, 16,544 shares issued and outstanding	16	17
Preferred stock, \$0.001 par value; May 2, 2015 and January 31, 2015 - 10,000 shares authorized, no shares issued or outstanding		
Additional paid-in capital	130,426	126,565
Retained earnings	33,354	32,072
Accumulated other comprehensive income	20	21
<b>Total stockholders' equity</b>	<b>163,828</b>	<b>158,686</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 262,607</b>	<b>\$ 257,551</b>

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

Table of Contents**TILLY S, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share data)

(Unaudited)

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
Net sales	\$ 120,190	\$ 111,134
Cost of goods sold (includes buying, distribution, and occupancy costs)	84,138	79,807
Gross profit	36,052	31,327
Selling, general and administrative expenses	33,923	30,250
Operating income	2,129	1,077
Other income, net	(8)	
Income before income taxes	2,137	1,077
Income tax expense	855	486
Net income	\$ 1,282	\$ 591
Basic earnings per share of Class A and Class B common stock	\$ 0.05	\$ 0.02
Diluted earnings per share of Class A and Class B common stock	\$ 0.05	\$ 0.02
Weighted average basic shares outstanding	28,173	27,983
Weighted average diluted shares outstanding	28,321	28,151

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

Table of Contents**TILLY'S, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)

(Unaudited)

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
Net income	\$ 1,282	\$ 591
Other comprehensive income:		
Net change in unrealized gain on available-for-sale securities, net of tax	(1)	
Other comprehensive income	(1)	
<b>Comprehensive income</b>	<b>\$ 1,281</b>	<b>\$ 591</b>

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



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

(In thousands)

(Unaudited)

	Number of Shares			Additional	Accumulated		Total
	Common	Common		Paid-in	Retained	Other	Stockholders'
	Stock	Stock	Common	Capital	Earnings	Comprehensive	Equity
	(Class	(Class	Stock			Income	
	A)	B)					
Balance at January 31, 2015	11,546	16,544	\$ 28	\$ 126,565	\$ 32,072	\$ 21	\$ 158,686
Net income					1,282		1,282
Shares converted by founders	355	(355)					
Stock-based compensation expense				1,269			1,269
Exercise of stock options	266			2,592			2,592
Change in unrealized gain on available-for-sale securities						(1)	(1)
Balance at May 2, 2015	12,167	16,189	\$ 28	\$ 130,426	\$ 33,354	\$ 20	\$ 163,828

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

Table of Contents**TILLY'S, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 1,282	\$ 591
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	5,611	4,776
Stock-based compensation expense	1,269	838
Loss on disposal of assets	49	29
Gain on sales and maturities of marketable securities	(31)	(37)
Deferred income taxes	(138)	34
Excess tax benefit from stock-based compensation	(92)	
Changes in operating assets and liabilities:		
Receivables	(793)	(751)
Merchandise inventories	(10,189)	(6,584)
Prepaid expenses and other assets	477	(517)
Accounts payable	1,469	2,176
Accrued expenses	1,606	1,279
Accrued compensation and benefits	(1,731)	(1,517)
Deferred rent	(562)	798
Deferred revenue	(1,253)	(1,012)
Net cash (used in) provided by operating activities	(3,026)	103
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(5,084)	(7,943)
Purchases of marketable securities	(14,985)	(4,991)
Maturities of marketable securities	15,000	15,000
Net cash (used in) provided by investing activities	(5,069)	2,066
<b>Cash flows from financing activities</b>		
Proceeds from exercise of stock options	2,592	
Payment of capital lease obligation	(197)	(185)
Excess tax benefit from stock-based compensation	92	

Net cash provided by (used in) financing activities	2,487	(185)
Change in cash and cash equivalents	(5,608)	1,984
Cash and cash equivalents, beginning of period	49,789	25,412
Cash and cash equivalents, end of period	\$ 44,181	\$ 27,396
<b>Supplemental disclosures of cash flow information</b>		
Interest paid	\$ 38	\$ 50
Income taxes paid (refunded)	\$ 1,754	\$ (22)
<b>Supplemental disclosure of non-cash activities</b>		
Unpaid purchases of property and equipment	\$ 2,095	\$ 3,422

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

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**TILLY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**Note 1: Description of the Company and Basis of Presentation**

Tilly's, Inc., is a leading chain of specialty retail stores featuring casual clothing, footwear and accessories for teens and young adults. We operated 213 stores in 33 states as of May 2, 2015. The stores are located in malls, lifestyle centers, power centers, community centers, outlet centers and street-front locations. Customers may also shop online, where we feature a similar assortment of products as is carried in our brick-and-mortar stores.

Tilly's, Inc. was formed as a Delaware corporation on May 4, 2011 for the purpose of reorganizing the corporate structure of World of Jeans & Tops, a California corporation (WOJT). On May 2, 2012, the shareholders of WOJT contributed all of their shares of common stock to Tilly's, Inc. in return for shares of Tilly's, Inc. Class B common stock on a one-for-one basis. In addition, effective May 2, 2012, WOJT converted from an S Corporation to a C Corporation for income tax purposes. These events are collectively referred to as the Reorganization. As a result of the Reorganization, WOJT became a wholly owned subsidiary of Tilly's, Inc. Except where context requires or where otherwise indicated, the terms the Company, Tilly's, we, or us, refers to WOJT before the Reorganization and to Tilly's, Inc. and its subsidiary, WOJT, after the Reorganization.

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, or GAAP, for interim financial reporting. These consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted from this report as is permitted by SEC rules and regulations.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all normal and recurring adjustments necessary to present fairly the financial condition, results of operations and cash flows for the interim periods presented. The results of operations for the thirteen weeks ended May 2, 2015 and May 3, 2014 are not necessarily indicative of results to be expected for the full fiscal year. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

***Fiscal Periods***

Our fiscal year ends on the Saturday closest to January 31. References to the fiscal quarters ended May 2, 2015 and May 3, 2014 refer to the thirteen-week periods ended as of those dates.

***Correction of an Error***

We identified a prior period error related to the accrual of contingent rent. Accordingly, we have corrected the accompanying consolidated balance sheet as of May 2, 2015. We identified \$0.4 million included in contingent rent liabilities, which was calculated incorrectly in prior periods. We corrected this error in the current period resulting in a decrease of \$0.4 million to the deferred rent liability in the Consolidated Balance Sheet and a decrease of \$0.4 million to cost of goods sold in the Consolidated Statement of Income for the fiscal quarter ended May 2, 2015. We have

evaluated the materiality of the error quantitatively and qualitatively and concluded it was not material to any of the prior periods and the correction of this error, as an out-of-period adjustment, is not expected to be material to the annual consolidated statements of income and the consolidated financial statements for the year ending January 30, 2016.

**Table of Contents****Note 2: Summary of Significant Accounting Policies**

Information regarding significant accounting policies is contained in Note 2, Summary of Significant Accounting Policies, of the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

**Note 3: Marketable Securities**

Marketable securities are classified as available-for-sale and, as of May 2, 2015 and January 31, 2015, consisted entirely of commercial paper, all of which was less than one year from maturity.

The following table summarizes our investments in marketable securities at May 2, 2015 and January 31, 2015 (in thousands):

	<b>May 2, 2015</b>			
	<b>Cost</b>	<b>Gross Unrealized Holding Gains</b>	<b>Gross Unrealized Holding Losses</b>	<b>Fair Value</b>
Commercial paper	\$ 34,938	\$ 34	\$ (1)	\$ 34,971

  

	<b>January 31, 2015</b>			
	<b>Cost</b>	<b>Gross Unrealized Holding Gains</b>	<b>Gross Unrealized Holding Losses</b>	<b>Fair Value</b>
Commercial paper	\$ 34,922	\$ 35	\$	\$ 34,957

For the thirteen weeks ended May 2, 2015 and May 3, 2014, we recognized gains on investments of \$31 thousand and \$37 thousand, respectively, for commercial paper which matured during the period. Upon recognition of the gains, we reclassified these amounts out of accumulated other comprehensive income and into Other income, net on the Consolidated Statements of Income.

**Note 4: Line of Credit**

On May 3, 2012, we entered into an amended and restated credit agreement with Wells Fargo Bank, N.A. (Bank), which we amended on March 17, 2014 to extend the maturity date, reduce the borrowing rate, eliminate a fee of 0.10% on the average daily unused amount on the line of credit, eliminate certain financial covenants related to current liabilities, funded debt and net profits, and add certain new covenants relating to total net losses and maximum balance sheet leverage. The amended credit facility, which was effective as of February 3, 2014, continues to provide for a \$25.0 million revolving line of credit, with a maturity date of May 31, 2017. The interest charged on borrowings is either at the London Interbank Offered Rate, or LIBOR, plus 1.00%, 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 our 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 require certain levels of leverage and profitability, such as (i) an aggregate maximum net loss after taxes not to exceed \$5 million (measured at the end of each fiscal quarter), with no more than one annual net loss after taxes for any fiscal year (in either case, excluding all charges for impairment of goodwill, other intangibles and store assets impairment on the balance sheet of WOJT, in an aggregate amount of up to \$2.0 million for the relevant period), and (ii) a maximum ratio of 2.00 to 1.00 for balance sheet leverage, defined as total liabilities divided by total tangible net worth.

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As of May 2, 2015, we were in compliance with all of our covenants and had no outstanding borrowings under the revolving credit facility.

On June 10, 2015, we received a consent to guarantee payments under a settlement agreement with one of our vendors and provide a payment advance on their behalf in exchange for a promissory note. Refer to Note 5 below for further discussion.

**Note 5: Commitments and Contingencies**

From time to time, we may become involved in lawsuits and other claims arising from our ordinary course of business. We are 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, results of operations or cash flows. See Risk Factors in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015 for important factors that could adversely impact us and our results of operations.

*Kristin Christiansen, Shellie Smith and Paul Haug, on behalf of themselves and all others similarly situated vs. World of Jeans & Tops, Superior Court of California, County of Sacramento, Case No. 34-2013-00139010.* On January 29, 2013, the plaintiffs in this matter filed a putative class action lawsuit against 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, subject to exceptions. In June 2013, the Court granted our motion to strike portions of the plaintiffs' complaint and granted plaintiffs leave to amend. Plaintiffs have amended the complaint and the parties are proceeding with discovery on class certification issues. Class certification briefing is currently expected to conclude in July 2015 with a hearing in August 2015. 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 putative class action 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 22, 2013, to add a claim for penalties under the California Private Attorneys General Act. In March 2013, we filed a motion to compel arbitration, which was denied in June 2013 and later affirmed on appeal. In October 2014, we filed an answer to the amended complaint. We intend to defend this case vigorously.

*Karina Whitten, on behalf of herself and all others similarly situated, v. Tilly's Inc., Superior Court of California, County of Los Angeles, Case No. BC 548252.* On June 10, 2014, plaintiff filed a putative class action and representative Private Attorney General Act 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. The complaint seeks class certification, penalties, restitution, injunctive relief and attorneys' fees and costs. Plaintiff filed a first amended complaint on December 3, 2014, removing the expense reimbursement claim. We answered the complaint on January 8, 2015. We intend to defend this case vigorously.



*Herbert Ortiz and Audra Haynes, individually, and on behalf of the generally public, v. Tilly's Inc., United States District Court for the Eastern District of California, Case No, 1:15-CV-00108-MJS.* On November 6, 2014, plaintiff filed a putative class action and representative Private Attorney General Act lawsuit against the Company in the Superior Court of California, County of Fresno, alleging violations of California's wage and hour, meal break and rest break rules and regulations, and unfair competition law, among other things. The complaint seeks class certification, penalties, restitution, injunctive relief and attorneys' fees and costs. On January 21, 2015, we answered

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the complaint and removed the action to the United States District Court for the Eastern District of California. On March 2, 2015, the parties stipulated to stay the action while they discuss settlement. The parties also stipulated that if settlement negotiations are unsuccessful, the plaintiffs' claims will be arbitrated on an individual, and not a class or representative, basis, as required under the terms of the arbitration agreements they signed. If the matter does not settle, the Company intends to defend the case vigorously.

On June 10, 2015, we and one of our vendors entered into a settlement arrangement with a plaintiff who filed a copyright infringement lawsuit against us and the vendor related to certain vendor products we sell. The settlement requires that the vendor pay \$2.0 million to the plaintiff over three years and we have agreed to guarantee such payments. In connection with the settlement: (i) we have agreed to advance an initial payment of \$0.2 million to the plaintiff in exchange for a promissory note from the vendor in the amount of \$0.2 million, (ii) we entered into an agreement to purchase a minimum of \$1.0 million in merchandise from our vendor, some of which may be offset against our obligation under the settlement arrangement in the event of the vendor's default, and (iii) we have received a security interest in certain of our vendor's intellectual property. In the event of the vendor's default, it is reasonably possible that we could incur a loss as the guarantor and we would attempt to enforce our security interest in certain of the vendor's intellectual property. The current estimated range of a reasonably possible loss is zero to \$2.0 million representing our best estimate with respect to this matter and is based on currently available information.

**Note 6: Fair Value Measurements**

We determine fair value based on the three level valuation hierarchy established under GAAP, which provides a framework for measuring fair value and expands disclosures about fair value measurements. Fair value is defined under GAAP as the exit price associated with the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date. The three level hierarchy of inputs is as follows:

*Level 1* Quoted prices in active markets for identical assets and liabilities.

*Level 2* Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3* Unobservable inputs (i.e. projections, estimates, interpretations, etc.) that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

We measure certain financial assets at fair value on a recurring basis, including our marketable securities, which are classified as available-for-sale securities, and certain cash equivalents, specifically money market accounts. The money market accounts are valued based on quoted market prices in active markets. The marketable securities are valued based on other observable inputs for those securities (including market corroborated pricing or other models that utilize observable inputs such as interest rates and yield curves) based on information provided by independent third party entities.

During the thirteen weeks ended May 2, 2015 and May 3, 2014, we did not make any transfers between Level 1 and Level 2 financial assets. Furthermore, as of May 2, 2015 and January 31, 2015, we did not have any Level 3 financial assets. We conduct reviews on a quarterly basis to verify pricing, assess liquidity, and determine if significant inputs have changed that would impact the fair value hierarchy disclosure.

From time to time, we measure certain assets at fair value on a non-recurring basis, specifically long-lived assets evaluated for impairment. We estimate the fair value of our long-lived assets using company-specific assumptions which would fall within Level 3 of the fair value hierarchy.

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In accordance with GAAP, we categorized our financial assets based on the priority of the inputs to the valuation technique for the instruments as follows (in thousands):

	May 2, 2015			January 31, 2015		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
<b>Cash equivalents:</b>						
Money market securities	\$ 29,454	\$	\$	\$ 34,433	\$	\$
<b>Marketable securities:</b>						
Commercial paper		34,971			34,957	

**Note 7: Stock-Based Compensation**

In April 2012, the Compensation Committee adopted the Tilly's 2012 Equity and Incentive Award Plan, which authorized the issuance of options, shares or rights to acquire up to 2,913,900 shares of our Class A common stock. In June 2014, our stockholders approved the Amended and Restated Tilly's 2012 Equity and Incentive Award Plan (the 2012 Plan), which increased the aggregate number of shares reserved for issuance thereunder by 1,500,000 shares, from 2,913,900 shares to a total of 4,413,900 shares; and added operating income and comparable store sales growth as additional performance goals that may be used in connection with performance-based awards granted under the 2012 Plan. As of May 2, 2015, there were 2,147,409 shares still available for future issuance under the 2012 Plan.

*Options*

The Compensation Committee has granted stock options to certain existing and new employees to acquire our Class A common stock under the 2012 Plan. The exercise price of options granted is equal to the closing price per share of our stock at the date of grant. The nonqualified options vest ratably at a rate of 25% on each of the first four anniversaries of the grant date provided that the award recipient continues to be employed by us through each of those vesting dates, and expire ten years from the date of grant.

The following table summarizes the stock option activity for the thirteen weeks ended May 2, 2015 (aggregate intrinsic value in thousands):

	Stock Options	Grant Date Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value(1)
Outstanding at January 31, 2015	2,880,040	\$ 13.03		
Granted	37,500	\$ 16.03		
Exercised	(266,140)	\$ 9.74		
Forfeited	(13,125)	\$ 13.20		
Outstanding at May 2, 2015	2,638,275	\$ 13.40	7.2	\$ 3,348

Vested and expected to vest at May 2, 2015	2,553,131	\$	13.42	7.1	\$	3,247
Exercisable at May 2, 2015	1,457,900	\$	13.44	6.2	\$	2,188

- (1) Intrinsic value for stock options is defined as the difference between the market price of our Class A common stock on the last business day of the fiscal quarter and the weighted average exercise price of in-the-money stock options outstanding at the end of each fiscal period. The market value per share was \$13.76 at May 2, 2015. The stock option awards were measured at fair value on the grant date using the Black-Scholes option valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, expected volatility of our stock over the option's expected term, the risk-free interest rate over the option's expected term and our expected annual dividend yield, if any. Our estimate of pre-vesting forfeitures, or forfeiture rate, was based on our internal analysis, which included the award recipients' positions and the vesting period of the awards. We will issue shares of Class A common stock when the options are exercised.

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The fair value of stock options granted during the thirteen weeks ended May 2, 2015 and May 3, 2014 was estimated on the grant date using the following assumptions:

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
Expected option term(1)	5.0 years	5.0 years
Expected volatility factor(2)	47.8%	46.9%
Risk-free interest rate(3)	1.4%	1.8%
Expected annual dividend yield	0%	0%

- (1) We have limited historical information regarding the expected option term. Accordingly, we determined the expected option term of the awards using historical data available from comparable public companies and management's expectation of exercise behavior.
- (2) Stock volatility for each grant is measured using the weighted average of historical daily price changes of our competitors' common stock over the most recent period equal to the expected option term of the awards.
- (3) The risk-free interest rate is determined using the rate on treasury securities with the same term as the expected life of the stock option as of the grant date.

*Restricted stock*

We grant restricted stock awards (RSAs) and restricted stock units (collectively with the RSAs "restricted stock") under the 2012 Plan to the independent directors on our Board of Directors and certain of our employees. The RSAs granted to the independent directors on our Board of Directors vest ratably at a rate of 50% on each of the first two anniversaries of the grant date provided that the respective award recipient continues to serve on the our Board of Directors through each of those vesting dates. The restricted stock units granted to certain employees vest ratably at a rate of 25% on each of the first four anniversaries of the grant date provided that the respective recipient continues to be employed by us through each of those vesting dates. Restricted stock units represent shares issuable in the future upon vesting whereas RSAs represent restricted shares issued upon the date of grant in which the recipient's rights in the stock are restricted until the shares are vested. We determine the fair value of restricted stock based upon the closing price of our Class A common stock on the date of grant.

A summary of the status of non-vested restricted stock as of May 2, 2015 and changes during the first quarter of fiscal 2015 are presented below:

	<b>Restricted Stock</b>	<b>Weighted Average Grant-Date Fair Value</b>
<b>Nonvested at January 31, 2015</b>	48,584	\$ 9.88
Granted	280,000	\$ 16.07
<b>Nonvested at May 2, 2015</b>	328,584	\$ 15.15



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Stock-based compensation expense associated with stock options and restricted stock is recognized on a straight-line basis over the vesting period. The following table summarizes stock-based compensation recorded in the Consolidated Statements of Income:

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
Cost of goods sold	\$ 239	\$ 172
Selling, general and administrative expenses	1,030	666
Stock-based compensation	\$ 1,269	\$ 838

At May 2, 2015, there was \$10.9 million of total unrecognized stock-based compensation expense related to unvested stock options and restricted stock. This cost has a weighted average remaining recognition of 3.0 years.

**Note 8: Income Taxes**

We account for income taxes and the related accounts under the liability method in accordance with ASC Topic 740, *Income Taxes*. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates expected to be in effect during the year in which the basis differences reverse. Because we believe that it is more likely than not that we will realize the full amount of the net deferred tax assets, we have not recorded any valuation allowance for the deferred tax assets.

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

Our effective income tax rate for the thirteen weeks ended May 2, 2015 and May 3, 2014 was 40.0% and 45.1%, respectively. The effective income tax rate for the thirteen weeks ended May 3, 2014 reflects a discrete item related to vested stock option forfeitures.

Our fiscal 2012 C-Corporation income tax return is currently under examination by the Internal Revenue Service. We were notified during the first quarter of fiscal 2015 that the S-Corporation tax period ending May 1, 2012 was also selected for examination by the Internal Revenue Service. There are not any known liabilities and we do not expect that the results of the examinations will have a material impact on our financial condition or statement of operations in fiscal 2015.



**Table of Contents****Note 9: Earnings Per Share**

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

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
Net income	\$ 1,282	\$ 591
Weighted average basic shares outstanding	28,173	27,983
Dilutive effect of stock options and restricted stock	148	168
Weighted average shares for diluted earnings per share	28,321	28,151
Basic earnings per share	\$ 0.05	\$ 0.02
Diluted earnings per share	\$ 0.05	\$ 0.02

Total stock options and restricted stock of 2,013,000 and 2,114,000 as of May 2, 2015 and May 3, 2014, respectively, have been excluded from the calculation of diluted earnings per share as the effect of including these stock options would have been anti-dilutive.

**Note 10: Related Party Transactions**

The following persons and entities that participated in related party transactions include Hezy Shaked, Tilly Levine, Shaked Holdings, LLC and Amnet Holdings, LLC. Mr. Shaked is our Co-Founder, Executive Chairman of our Board of Directors, one of our executive officers and a holder of more than 5% of our common stock. Ms. Levine is our Co-Founder, an employee of our company and a holder of more than 5% of our common stock. Mr. Shaked, through the Hezy Shaked Living Trust established May 18, 1999, or the Hezy Shaked Trust, owns 63% of Shaked Holdings, LLC. Ms. Levine, through the Tilly Levine Separate Property Trust established March 31, 2004, or the Tilly Levine Trust, owns 37% of Shaked Holdings. Mr. Shaked, through the Hezy Shaked Trust, is the sole member and owner of Amnet Holdings, LLC, or Amnet Holdings.

*Certain Leases*

We lease office and warehouse space (11 Whatney, Irvine, California) from Amnet Holdings. The lease expires on June 30, 2022 and provides for base monthly payments of \$28,683 which adjust annually based upon the Los Angeles/Anaheim/Riverside Urban Consumer Price Index, not to exceed 7%, but a minimum of 3%, in any one annual increase. We incurred rent expense of \$0.1 million in the first quarter of both fiscal 2015 and fiscal 2014

related to the lease.

We lease a building (17 Pasteur, Irvine, California) from Amnet Holdings. The lease expires on October 31, 2021 and provides for base monthly rent payments of \$76,024. We use this property as our e-commerce fulfillment center. The lease payments adjust annually based upon the Los Angeles/Anaheim/Riverside Urban Consumer Price Index, not to exceed 7%, but a minimum of 3%, in any one annual increase. We incurred rent expense of \$0.2 million in the first quarter of both fiscal 2015 and fiscal 2014 related to this lease.

We lease our corporate headquarters and distribution center (10 and 12 Whatney, Irvine, California) from Shaked Holdings. 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 and expiring on December 31, 2017. The land component of this lease is accounted for as an operating lease and the building component is accounted for as a capital lease. The capital lease obligation was \$2.3 million and \$2.5 million as of May 2, 2015 and January 31, 2015, respectively. Payments under the capital lease obligation including principal and interest totaled \$0.4 million in the first quarter of fiscal 2015. The gross amount of the building under capital lease was \$7.8 million as of May 2, 2015 and January 31, 2015. The accumulated depreciation of the building under capital lease was \$6.4 million and \$6.3 million as of May 2, 2015 and January 31, 2015, respectively. We incurred rent expense of \$0.2 million in the first quarter of fiscal 2015 related to the operating (land component) of this lease.

Prior to signing the related party leases, we received an independent market analysis regarding the property and therefore believe that the terms of each lease are reasonable and are not materially different than terms we would have obtained from an unaffiliated third party.

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*Tax Indemnification Agreements*

In connection with the Reorganization, we entered into certain tax indemnification agreements with each of the Hezy Shaked Living Trust and the Tilly Levine Separate Property Trust. Pursuant to such tax indemnification agreements, we agreed to indemnify, defend and hold harmless each such stockholder 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 our subsidiary, World of Jeans & Tops, Inc., reported as an S Corporation. Such agreement provides that we defend and hold harmless such stockholders against any losses, costs or expenses, including reasonable attorneys' fees, arising out of a claim for such tax liability.

*Tilly's Life Center*

Tilly's Life Center (TLC) is a charitable organization that was founded and is run by Ms. Levine. In June 2014, our Board of Directors approved support for TLC of up to \$20,000. We incurred costs of approximately \$3,000 related to printing of TLC's program's materials during the first quarter of fiscal 2015. We also provide support for marketing and website services for TLC.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis of the financial condition and results of our operations should be read together with the financial statements and related notes of Tilly's, Inc. included in Item 1 of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015. As used in this Quarterly Report on Form 10-Q, except where the context otherwise requires or where otherwise indicated, the terms "company", "World of Jeans & Tops", "we", "our", "us" and "Tilly's" refer to Tilly's, Inc. and its subsidiary.*

**Cautionary Statement Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate", "believe", "can", "continue", "could", "estimate", "expect", "intend", "may", "plan", "project", "seek", "should", "target", "will", "expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. These forward-looking statements are subject to numerous risks and uncertainties, including the risks and uncertainties described under the section titled "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015, those identified in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Quarterly Report on Form 10-Q, and in other filings we may make with the Securities and Exchange Commission from time to time. Moreover, we operate in an evolving environment. New risk factors and uncertainties emerge from time to time and it is not possible for our management to predict all risk factors and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors may cause actual results to differ materially from those contained in any forward-looking statement. We qualify all of our forward-looking statements by these cautionary statements.

**Overview**

Tilly's is a fast-growing destination specialty retailer of West Coast inspired apparel, footwear and accessories. We believe we bring together an unparalleled selection of the most sought-after brands rooted in action sports, music, art and fashion. Our West Coast heritage dates back to 1982 when Hezy Shaked and Tilly Levine opened our first store in Orange County, California. As of May 2, 2015, we operated 213 stores, averaging 7,653 square feet, in 33 states. We also sell our products through our e-commerce website, [www.tillys.com](http://www.tillys.com) (the information available at our website is not incorporated by reference into this report).

Net sales increased \$9.1 million, or 8.1%, to \$120.2 million for the thirteen weeks ended May 2, 2015 from \$111.1 million for the thirteen weeks ended May 3, 2014. Operating income nearly doubled to \$2.1 million for the thirteen weeks ended May 2, 2015 from \$1.1 million for the thirteen weeks ended May 3, 2014, primarily due to an increase in the number of stores and an increase in our comparable store sales, including our e-commerce sales, and a favorable adjustment related to the correction of the accrual for contingent rent. Our comparable store sales increased 2.0% in the first quarter of fiscal 2015, as compared to a 6.8% decrease in the first quarter of fiscal 2014.

We continued to focus on product differentiation and innovation, which drove increases in conversion and average transaction value. We invested in dominant, on-trend products and categories, introducing more products and brands that are new, unique or exclusive to Tilly's.

We continued to use our new digital platform and our Tilly's Hookup loyalty program to further build the Tilly's brand through customer awareness and loyalty. We are making further investments in the digital team with key talent and have begun to implement various enhancements to key components of our digital strategy in our marketing and execution, all of which are contributing to further improvements in our e-commerce business.

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Over the last five fiscal years, we have more than doubled our store count to 213 stores at May 2, 2015 and believe there is a significant opportunity to grow our national footprint up to 500 stores over time. We have added two new stores in the first quarter of fiscal 2015 and plan to add at least 13 additional new stores by the end of the year in mall, off-mall and outlet locations. We expect to fund this store expansion through our cash on hand and cash flows from operations.

We also believe that investing in our existing stores is strategically important to enhance customer loyalty, elevate the customer experience and in turn, drive comparable store sales and increase profitability. We made progress on our plans to refresh at least 25 existing high-volume stores in locations within our original heritage markets during the first quarter of fiscal 2015.

We believe our business strategy will continue to offer significant opportunity, but it also presents risks and challenges. These risks and challenges include, but are not limited to, that we may not be able to effectively identify and respond to changing fashion trends and customer preferences, that we may not be able to find desirable locations for new stores and that we may not be able to effectively manage our future growth. In addition, our financial results can be expected to be directly impacted by trends in the general economy. A decline in consumer spending or a substantial increase in product costs due to commodity cost increases or general inflation could lead to a reduction in our sales as well as greater margin pressure as costs may not be able to be passed on to consumers and the competitive environment could become more highly promotional. See **Risk Factors** in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015 for other important factors that could adversely impact us and our results of operations.

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

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

#### ***Net Sales***

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

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

#### ***Comparable Store Sales***

Comparable store sales is a measure that indicates the change in year-over-year comparable store sales which 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;

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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.

Comparable store sales are sales from our e-commerce platform and stores open at least 12 full fiscal months as of the end of the current reporting period. A remodeled, relocated or refreshed 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. We include sales from our e-commerce platform as part of comparable store sales as we manage and analyze our business on a single omni-channel and have substantially integrated our investments and operations for our stores and e-commerce platform to give our customers seamless access and increased ease of shopping. Comparable store sales 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.

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

***Gross Profit***

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 and benefit expense for our internal buying organization. Distribution costs include costs for receiving, processing and warehousing our store merchandise, and shipping of merchandise to or from our distribution and e-commerce fulfillment centers, 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 receiving and 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

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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 ongoing 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.

**Results of Operations**

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

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
	<b>(in thousands)</b>	
<b>Statements of Income Data:</b>		
Net sales	\$ 120,190	\$ 111,134
Cost of goods sold	84,138	79,807
Gross profit	36,052	31,327
Selling, general and administrative expenses	33,923	30,250
Operating income	2,129	1,077
Other income, net	(8)	
Income before income taxes	2,137	1,077
Income tax expense	855	486
Net income	\$ 1,282	\$ 591
<b>Percentage of Net Sales:</b>		
Net sales	100.0%	100.0%
Cost of goods sold	70.0%	71.8%
Gross profit	30.0%	28.2%
Selling, general and administrative expenses	28.2%	27.2%

Operating income	1.8%	1.0%
Interest expense, net	0.0%	0.0%
Income before income taxes	1.8%	1.0%
Income tax expense	0.7%	0.4%
Net income	1.1%	0.5%

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

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
<b>Store Operating Data:</b>		
Stores operating at end of period	213	198
Comparable store sales change (1)	2.0%	-6.8%
Total square feet at end of period	1,630,195	1,535,437
Average net sales per brick-and-mortar store (in thousands) (2)	\$ 502	\$ 499
Average net sales per square foot (2)	\$ 66	\$ 64

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- (1) Comparable store sales include sales through our e-commerce store, but excludes gift card breakage income and e-commerce shipping and handling fee revenue.
- (2) E-commerce sales, e-commerce shipping fee revenue and gift card breakage are excluded from net sales in deriving average net sales per brick-and-mortar store and average net sales per square foot.

**Thirteen Weeks Ended May 2, 2015 Compared to Thirteen Weeks Ended May 3, 2014**

	<b>Thirteen Weeks Ended</b>		<b>Change</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>	<b>\$</b>	<b>%</b>
	<b>(in thousands)</b>			
<b>Statements of Income Data:</b>				
Net sales	\$ 120,190	\$ 111,134	\$ 9,056	8.1%
Cost of goods sold	84,138	79,807	4,331	5.4%
Gross profit	36,052	31,327	4,725	15.1%
Selling, general and administrative expenses	33,923	30,250	3,673	12.1%
Operating income	2,129	1,077	1,052	97.7%
Other income, net	(8)		(8)	
Income before income taxes	2,137	1,077	1,060	98.4%
Income tax expense	855	486	369	75.9%
Net income	\$ 1,282	\$ 591	\$ 691	116.9%

*Net Sales*

Net sales increased primarily due to an increase in the average number of stores coupled with an increase of comparable store sales of \$2.1 million, or 2.0%, in the first quarter of fiscal 2015 as compared to the first quarter of fiscal 2014. The comparable store sales increase was due to increases in conversion and average transaction value. There were 193 comparable brick-and-mortar stores and 20 non-comparable brick-and-mortar stores open as of May 2, 2015.

*Gross Profit*

Gross profit increased \$4.7 million in the first quarter of fiscal 2015 as compared to the first quarter of fiscal 2014 primarily due to higher net sales. As a percentage of net sales, gross profit was 30.0% and 28.2% during the first quarter of fiscal 2015 and fiscal 2014, respectively. The 180 basis point increase in gross profit was due to a 90 basis point increase in product margin as a result of an improvement in regular price sales and a decrease in markdown rates, as well as a 90 basis point decrease in buying, distribution and occupancy costs primarily due to the leverage on positive comparable store sales and the favorable adjustment related to the correction of the accrual for contingent rent for prior periods as compared to the first quarter of fiscal 2014.

*Selling, General and Administrative Expenses*

SG&A expenses increased 12.1% in the first quarter of fiscal 2015 as compared to first quarter of fiscal 2014. As a percentage of net sales, SG&A expenses were 28.2% and 27.2% during the first quarter of fiscal 2015 and fiscal 2014, respectively.

Store selling expenses increased \$1.9 million, or 9.0%, to \$23.1 million in the first quarter of fiscal 2015 as compared to \$21.2 million in the first quarter of fiscal 2014. As a percentage of net sales, store selling expenses were 19.2% and 19.1% during the first quarter of fiscal 2015 and fiscal 2014, respectively.

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

payroll, benefits and related costs for stores increased \$1.7 million, or 40 basis points as a percentage of net sales, primarily due to minimum wage increases and increased headcount; and

marketing costs increased \$0.7 million, or 30 basis points, primarily due to higher spend on catalogs and other marketing activities.

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However, the increase in store selling expenses was partially offset by a decrease of \$0.5 million, or 60 basis points as a percentage of net sales, due to a decrease in e-commerce fulfillment services.

General and administrative expenses increased \$1.8 million to \$10.8 million, or 18.7%, in the first quarter of fiscal 2015 from \$9.1 million in the first quarter of fiscal 2014. As a percentage of net sales, general and administrative expenses were 9.0% and 8.1% during the first quarter of fiscal 2015 and fiscal 2014, respectively.

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

payroll, benefits and related costs for corporate office personnel increased \$1.1 million, or 50 basis points as a percentage of net sales;

ongoing stock-based compensation expense increased \$0.4 million, or 30 basis point as a percentage of net sales, due to additional equity awards granted during the quarter;

depreciation related to capital investments increased \$0.2 million, or 10 basis points as a percentage of net sales; and

other general and administrative expenses increased \$0.1 million, but as a percentage of sales remained consistent.

### *Operating Income*

Operating income increased \$1.1 million, or 97.7%, to \$2.1 million for the first quarter of fiscal 2015 as compared to \$1.1 million for the first quarter of fiscal 2014. As a percentage of net sales, operating income was 1.8% and 1.0% for the first quarter of fiscal 2015, and fiscal 2014, respectively. The increase in operating income as a percentage of net sales was primarily due to an increase in our comparable store sales, including e-commerce sales, an increase in the number of stores, the favorable adjustment related to the correction of the accrual for contingent rent and the increased gross profit noted above. Our comparable store sales increased 2.0% in the first quarter of fiscal 2015, as compared to a 6.8% decrease in the first quarter of fiscal 2014.

### *Other Income, Net*

Net other income was \$8 thousand and less than \$1 thousand for the first quarter of fiscal 2015 and fiscal 2014, respectively. Net interest expense reflects interest paid on a capitalized lease of our corporate and distribution center. Interest income reflects earned income on cash balances, gains on commercial paper investments and tenant construction allowances due from landlords.

### *Income Tax Expense*

Income taxes were \$0.9 million and \$0.5 million for the first quarter of fiscal 2015 and fiscal 2014, respectively. This reflects effective tax rates of 40.0% and 45.1% for the first quarter of fiscal 2015 and fiscal 2014, respectively. The effective tax rate of 45.1% for the first quarter of fiscal 2014 reflects a discrete item related to vested stock option

forfeitures.

*Net Income*

Net income increased \$0.7 million, or 116.9%, to \$1.3 million for the first quarter of fiscal 2015 from \$0.6 million for the first quarter of fiscal 2014, due to the factors discussed above.

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Basic and diluted earnings per share of Class A and Class B common stock increased 150.0% to \$0.05 for the first quarter of fiscal 2015 from \$0.02 for the first quarter of fiscal 2014.

**Liquidity and Capital Resources*****General***

Our business relies on cash flows from operating activities as well as cash on hand as our primary sources of liquidity. In addition, we have access to additional liquidity through a \$25.0 million revolving credit facility with Wells Fargo Bank, NA. We have not 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 and the expansion of our distribution and fulfillment 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, if necessary, 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:

	<b>Thirteen Weeks Ended</b>	
	<b>May 2, 2015</b>	<b>May 3, 2014</b>
	<b>(in thousands)</b>	
Net cash (used in) provided by operating activities	\$ (3,026)	\$ 103
Net cash (used in) provided by investing activities	(5,069)	2,066
Net cash provided by (used in) financing activities	2,487	(185)

***Net Cash (Used in) Provided by Operating Activities***

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

Net cash flows used in operating activities decreased to \$3.0 million during the first quarter of fiscal 2015 as compared to net cash flows provided by operating activities of \$0.1 million in the first quarter of fiscal 2014. The \$3.1



million decrease is due to an increase in merchandise purchases, net of merchandise payables due to new stores and initiatives for the upcoming summer and back-to-school seasons and to support the planned growth in our e-commerce business, as well as the timing of receivables and payables and the adjustment to deferred rent. These decreases were partially offset by an increase in net income and non-cash adjustments of \$1.7 million.

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### *Net Cash (Used in) Provided by Investing Activities*

Investing activities consist primarily of capital expenditures for growth related to new store openings as well as for refreshes, 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, less net proceeds from sales, maturities, and purchases of marketable securities.

Net cash used in investing activities was \$5.1 million during the first quarter of fiscal 2015 consisting of capital expenditures of \$5.1 million, the majority of which related to new stores and store refreshes and remodels. We received proceeds of \$15.0 million from the maturities of marketable securities and purchased \$15.0 million of marketable securities during the period.

Net cash provided by investing activities was \$2.1 million during the first quarter of fiscal 2014. We received proceeds of \$15.0 million from the maturities of marketable securities and purchased \$5.0 million of marketable securities during the period. Capital expenditures totaled \$7.9 million, the majority of which related to new stores and our new e-commerce fulfillment center.

### *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 and excess tax benefits from stock-based compensation.

Net cash provided by financing activities was \$2.5 million for the first quarter of fiscal 2015 which consisted of \$2.7 million of proceeds from the exercise of stock options and excess tax benefits from stock-based compensation, partially offset by payments on our capital lease obligation of \$0.2 million.

Net cash used in financing activities was \$0.2 million for the first quarter of fiscal 2014 which consisted of \$0.2 million for payments on our capital lease obligation.

## **Line of Credit**

We maintain a credit facility with Wells Fargo Bank, NA that provides for a \$25.0 million revolving line of credit with a maturity date of May 31, 2017. The interest charged on borrowings is either at LIBOR plus 1.00%, 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 credit facility is secured by substantially all of our 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 require certain levels of leverage and profitability, such as (i) an aggregate maximum net loss after taxes not to exceed \$5 million (measured at the end of each fiscal quarter), with no more than one annual net loss after taxes for any fiscal year (in either case, excluding all charges for impairment of goodwill, other intangibles and store assets impairment on the balance sheet of WOJT, in an aggregate amount of up to \$2.0 million for the relevant period), and (ii) a maximum ratio of 2.00 to 1.00 for balance sheet leverage, defined as total liabilities divided by total tangible net worth.

As of May 2, 2015, we were in compliance with all of our covenants and had no outstanding borrowings under the revolving credit facility.

On June 10, 2015, we received a consent to guarantee payments under a settlement agreement with one of our vendors and provide a payment advance on their behalf in exchange for a promissory note. See Note 5: Commitments and Contingencies in the notes to our consolidated financial statements for further discussion.

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**Contractual Obligations**

As of May 2, 2015, there were no material changes to our contractual obligations are described in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

**Off-Balance Sheet Arrangements**

We are not a party to any off-balance sheet arrangements, except for operating leases, purchase obligations and our revolving credit facility.

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**Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. requires the appropriate application of certain accounting policies, some of which require us to make estimates and assumptions about future events and their impact on amounts reported in our consolidated financial statements. Since future events and their impact cannot be determined with absolute certainty, the actual results will inevitably differ from our estimates. A summary of our significant accounting policies is included in Note 2 to the consolidated financial statements of Tilly's, Inc. in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

Certain of our accounting policies and estimates are considered critical, as these policies and estimates are the most important to the depiction of our consolidated financial statements and require significant, difficult or complex judgments, often about the effect of matters that are inherently uncertain. Such policies are summarized in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

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

As of May 2, 2015, there were no material changes in the market risks described in the Quantitative and Qualitative Disclosure of Market Risks section of our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Disclosure Committee, including our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of May 2, 2015. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to our management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of May 2, 2015, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Inherent Limitations on Effectiveness of Controls**

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These

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inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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**Table of Contents****Part II. Other Information****Item 1. 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 **Risk Factors** in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015 for important factors that could adversely impact us and our results of operations.

*Kristin Christiansen, Shellie Smith and Paul Haug, on behalf of themselves and all others similarly situated vs. World of Jeans & Tops, Superior Court of California, County of Sacramento, Case No. 34-2013-00139010.* On January 29, 2013, the plaintiffs in this matter filed a putative class action lawsuit against 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, subject to exceptions. In June 2013, the Court granted our motion to strike portions of the plaintiffs' complaint and granted plaintiffs leave to amend. Plaintiffs have amended the complaint and the parties are proceeding with discovery on class certification issues. Class certification briefing is currently expected to conclude in July 2015 with a hearing in August 2015. 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 putative class action 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 22, 2013, to add a claim for penalties under the California Private Attorneys General Act. In March 2013, we filed a motion to compel arbitration, which was denied in June 2013 and later affirmed on appeal. In October 2014, we filed an answer to the amended complaint. We intend to defend this case vigorously.

*Karina Whitten, on behalf of herself and all others similarly situated, v. Tilly's Inc., Superior Court of California, County of Los Angeles, Case No. BC 548252.* On June 10, 2014, plaintiff filed a putative class action and representative Private Attorney General Act 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. The complaint seeks class certification, penalties, restitution, injunctive relief and attorneys' fees and costs. Plaintiff filed a first amended complaint on December 3, 2014, removing the expense reimbursement claim. We answered the complaint on January 8, 2015. We intend to defend this case vigorously.

*Herbert Ortiz and Audra Haynes, individually, and on behalf of the generally public, v. Tilly's Inc., United States District Court for the Eastern District of California, Case No. 1:15-CV-00108-MJS.* On November 6, 2014, plaintiff filed a putative class action and representative Private Attorney General Act lawsuit against the Company in the Superior Court of California, County of Fresno, alleging violations of California's wage and hour, meal break and rest break rules and regulations, and unfair competition law, among other things. The complaint seeks class certification,



penalties, restitution, injunctive relief and attorneys' fees and costs. On January 21, 2015, we answered the complaint and removed the action to the United States District Court for the Eastern District of California. On March 2, 2015, the parties stipulated to stay the action while they discuss settlement. The parties also stipulated that if settlement negotiations are unsuccessful, the plaintiffs' claims will be arbitrated on an individual, and not a class or representative, basis, as required under the terms of the arbitration agreements they signed. If the matter does not settle, the Company intends to defend the case vigorously.

On June 10, 2015, we and one of our vendors entered into a settlement arrangement with a plaintiff who filed a copyright infringement lawsuit against us and the vendor related to certain vendor products we sell. The settlement requires that the vendor pay \$2.0 million to the plaintiff over three years and we have agreed to guarantee such payments. In connection with the settlement: (i) we have agreed to advance an initial payment of \$0.2 million to the plaintiff in exchange for a promissory note from the vendor in the amount of \$0.2 million, (ii) we entered into an agreement to purchase a minimum of \$1.0 million in merchandise from our vendor, some of which may be offset against our obligation under the settlement arrangement in the event of the vendor's default, and (iii) we have received a security interest in certain of our vendor's intellectual property. In the event of the vendor's default, it is reasonably possible that we could incur a loss as the guarantor and we would attempt to enforce our security interest in certain of the vendor's intellectual property. The current estimated range of a reasonably possible loss is zero to \$2.0 million representing our best estimate with respect to this matter and is based on currently available information.

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**Item 1A. Risk Factors**

We operate in a rapidly changing environment that involves a number of risks that could materially and adversely affect our business, financial condition, prospects, operating results or cash flows. For a detailed discussion of the risks that affect our business, please refer to the section entitled "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015. There have been no material changes to our risk factors as previously disclosed in our Annual Report on Form 10-K.

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**Item 6. Exhibits**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive data files from Tilly's, Inc.'s Quarterly Report on Form 10-Q for the quarter ended May 2, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Income; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statement of Stockholders' Equity; (v) the Consolidated Statements of Cash Flows and (iv) Notes to Consolidated Financial Statements.

\* Furnished herewith and not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

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**SIGNATURES**

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

Date: June 11, 2015

Tilly's, Inc.

/s/ Daniel Griesemer

Daniel Griesemer

*President, Chief Executive Officer and Director  
(Principal Executive Officer)*

Date: June 11, 2015

/s/ Jennifer L. Ehrhardt

Jennifer L. Ehrhardt

*Chief Financial Officer*

*(Principal Financial Officer)*