bebe stores, inc.
Form 10-Q
February 09, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended January 1, 2011

OR

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

Commission File Number 0-24395

bebe stores, inc.

(Exact name of registrant as specified in its charter)

California	**94-2450490**
(State or Jurisdiction of	**(IRS Employer**
Incorporation or Organization)	**Identification Number)**

400 Valley Drive

Brisbane, California 94005

(Address of principal executive offices)

Telephone: (415) 715-3900

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

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

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

Large accelerated filer	¨	Accelerated filer	x
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 Rule12b-2 of the Exchange Act). Yes ¨ No x

The number of shares of the registrant s common stock, par value $0.001 per share, outstanding as of January 31, 2011 was 84,042,290.

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PART I. FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements

bebe stores, inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(unaudited)

	As of January 1, 2011	As of July 3, 2010	As of January 2, 2010
Assets:			
Current assets:			
Cash and equivalents	$ 119,410	$ 194,690	$ 102,874
Available for sale securities	63,165	58,038	49,738
Trading securities			72,182
Auction rate securities written put option			9,168
Receivables (net of allowance of $1,241, $1,231 and $1,283)	4,425	5,674	6,075
Inventories, net	29,989	33,458	30,381
Deferred income taxes, net	6,595	6,551	7,825
Prepaid and other	22,242	16,465	18,364
Total current assets	245,826	314,876	296,607
Available for sale securities	77,158	95,564	114,382
Property and equipment, net	92,463	104,615	114,899
Deferred income taxes, net	26,367	31,660	25,578
Other assets	3,904	5,178	5,603
Total assets	$ 445,718	$ 551,893	$ 557,069
Liabilities and Shareholders Equity:			
Current liabilities:			
Accounts payable	$ 19,346	$ 22,257	$ 19,039
Accrued liabilities	30,566	113,538	32,388
Income taxes payable		602	
Total current liabilities	49,912	136,397	51,427
Deferred rent and other lease incentives	38,844	42,978	44,383
Uncertain tax positions	2,615	3,463	3,565
Total liabilities	91,371	182,838	99,375
Commitments and contingencies			
Shareholders equity:			
Preferred stock-authorized 1,000,000 shares at $0.001 par value per share; no shares issued and outstanding			

Common stock-authorized 135,000,000 shares at $0.001 par value per share; issued and outstanding 84,041,609, 86,116,596 and 86,164,650 shares	84	86	86
Additional paid-in capital	140,836	144,035	140,657
Accumulated other comprehensive loss	(3,021)	(6,476)	(6,522)
Retained earnings	216,448	231,410	323,473
Total shareholders equity	354,347	369,055	457,694
Total liabilities and shareholders equity	$ 445,718	$ 551,893	$ 557,069

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended		Six Months Ended	
	January 1, 2011	January 2, 2010	January 1, 2011	January 2, 2010
Net sales	$ 136,209	$ 131,851	$ 251,465	$ 248,990
Cost of sales, including production and occupancy	85,743	77,932	154,368	150,335
Gross margin	50,466	53,919	97,097	98,655
Selling, general and administrative expenses	47,958	44,023	94,303	90,359
Operating income	2,508	9,896	2,794	8,296
Interest and other income, net	270	840	551	1,883
Income from continuing operations before income taxes	2,778	10,736	3,345	10,179
Income tax provision	1,150	4,731	1,390	5,379
Income from continuing operations, net of tax	1,628	6,005	1,955	4,800
Loss from discontinued operations, net of tax	(4,355)	(3,565)	(5,835)	(6,542)
Net income (loss)	$ (2,727)	$ 2,440	$ (3,880)	$ (1,742)
Basic per share amounts:				
Income from continuing operations, net of tax	$ 0.02	$ 0.07	$ 0.02	$ 0.06
Loss from discontinued operations, net of tax	(0.05)	(0.04)	(0.07)	(0.08)
Net income (loss)	$ (0.03)	$ 0.03	$ (0.05)	$ (0.02)
Diluted per share amounts:				
Income from continuing operations, net of tax	$ 0.02	$ 0.07	$ 0.02	$ 0.06
Loss from discontinued operations, net of tax	(0.05)	(0.04)	(0.07)	(0.08)
Net income (loss)	$ (0.03)	$ 0.03	$ (0.05)	$ (0.02)
Basic weighted average shares outstanding	84,035	86,663	84,385	86,715
Diluted weighted average shares outstanding	84,134	86,760	84,483	86,838

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Six Months Ended	
	January 1, 2011	January 2, 2010
Cash flows from operating activities:		
Net loss	$ (3,880)	$ (1,742)
Adjustments to reconcile net loss to cash used in operating activities:		
Non-cash compensation expense	1,659	2,223
Depreciation and amortization	11,680	13,429
Non-cash charge for asset impairment	1,060	4,246
Net loss (gain) on disposal of property	(240)	932
Gain on trading securities		(106)
Tax benefit from exercise of stock options and awards	119	63
Excess tax benefit from exercise of stock options and awards	(12)	(7)
Deferred rent and other lease incentives	(422)	(1,188)
Deferred income taxes	3,794	(407)
Changes in operating assets and liabilities:		
Receivables	596	(1,374)
Inventories	3,577	8,958
Prepaid expenses and other	(3,784)	12,547
Accounts payable	(2,920)	(7,583)
Income taxes payable	(602)	
Accrued liabilities	4,178	(4,379)
Long term income taxes payable	(848)	345
Net cash provided by operating activities	13,955	25,957
Cash flows from investing activities:		
Purchase of property and equipment	(3,676)	(6,987)
Purchase of marketable securities	(52,914)	(50,373)
Proceeds from sales of investment securities	68,088	48,168
Net cash provided (used) by investing activities	11,498	(9,192)
Cash flows from financing activities:		
Net proceeds from issuance of common stock	157	180
Excess tax benefit from exercise of stock options and awards	12	7
Cash dividends paid	(88,242)	(8,677)
Purchase of common stock	(12,472)	(3,717)
Net cash used by financing activities	(100,545)	(12,207)
Net increase (decrease) in cash and equivalents	(75,092)	4,558
Effect of exchange rate changes on cash	(188)	6,926
Cash and equivalents:		

Beginning of period	194,690	91,390
End of period	$ 119,410	$ 102,874

See accompanying notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTERIM FINANCIAL STATEMENTS

The accompanying condensed consolidated balance sheets of bebe stores, inc. (the Company) as of January 1, 2011, July 3, 2010 and January 2, 2010, the condensed consolidated statements of operations for the three and six months ended January 1, 2011 and January 2, 2010 and the condensed consolidated statements of cash flows for the six months ended January 1, 2011 and January 2, 2010 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, without audit. Accordingly, they do not include all of the information required by accounting principles generally accepted in the United States of America for annual financial statements. Therefore, these condensed consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the fiscal year ended July 3, 2010.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to present fairly the financial position at the balance sheet dates and the results of operations for the periods presented have been included. The condensed consolidated balance sheet at July 3, 2010, presented herein, was derived from the audited balance sheet included in the Company s Annual Report on Form 10-K for the fiscal year ended July 3, 2010.

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

FISCAL YEAR

The Company s fiscal year is a 52 or 53 week period, each period ending on the first Saturday after June 30. Fiscal years 2011 and 2010 each include 52 weeks.

The three month periods ended January 1, 2011 and January 2, 2010 each include 13 weeks. The six month periods ended January 1, 2011 and January 2, 2010 each include 26 weeks.

DISCONTINUED OPERATION OF PH8 STORES

In the fourth quarter of fiscal 2010, the Company decided to discontinue operations of the PH8 division, allowing the Company to focus its efforts on improving bebe sales and profitability, expanding internationally and continuing to develop its 2b bebe business. The Company closed 24 PH8 stores in the first fiscal quarter of 2011 and has closed the remaining 25 PH8 stores, converting one store to a 2b bebe, during the second quarter of fiscal 2011. The results of the PH8 stores closed to date, net of income tax benefit, which consists of 49 stores for the second fiscal quarter of 2011 and 65 stores for the prior year comparable period, have been presented as a discontinued operation in the accompanying consolidated statements of operations for all periods presented and are as follows:

	Three Months Ended		Six Months Ended	
	January 1, 2011	January 2, 2010	January 1, 2011	January 2, 2010
	(In thousands)			
Net Sales	$ 4,146	$ 9,642	$ 7,850	$ 18,162
Cost of sales, including production and occupancy	9,591	8,151	13,368	15,246
Gross Margin	(5,445)	1,491	(5,518)	2,916
Selling general and administrative expenses	1,706	7,272	4,116	13,960
Loss from discontinued operation, before income tax benefit	(7,151)	(5,781)	(9,634)	(11,044)
Add: tax benefit	(2,796)	(2,216)	(3,799)	(4,502)

Loss from discontinued operations, net of tax benefit	$ (4,355)	$ (3,565)	$ (5,835)	$ (6,542)

Costs associated with exit or disposal activities are recorded when the liability is incurred. As of January 1, 2011, the Company has reserved $2.2 million for future costs associated with discontinued operations. This reserve has been included within the Accrued liabilities line in the Condensed Consolidated Balance Sheets. The lease termination costs represent management s estimate of the amount required to terminate the leases prior to the expiration of the contractual lease terms. A roll forward of the reserve is presented below.

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	Lease Costs	Professional Fees, severance and other costs (In thousands)	Total
Balance as of July 3, 2010	$	$	$
Costs incurred in fiscal 2011	4,032	485	4,517
Cash payments	(2,152)	(149)	(2,301)
Balance at January 1, 2011	$ 1,880	$ 336	$ 2,216

INVESTMENTS

The Company s investment portfolio consists of treasury bills, certificates of deposit and auction rate securities. The Company holds a variety of interest bearing auction rate securities (ARS) consisting of federally insured student loan backed securities and insured municipal authority bonds. As of January 1, 2011, the Company s ARS portfolio totaled approximately $77.2 million classified as available for sale securities, net of a temporary impairment charge of $12.2 million. As of that date the Company s ARS portfolio included approximately 96% federally insured student loan backed securities and 4% municipal authority bonds and consisted of approximately 38% AAA rated investments, 6% AA rated investments, 30% A rated investments, 6% BBB rated investments and 20% CCC rated investments. As of July 3, 2010, the Company s ARS consisted of 47% AAA rated investments, 5% AA rated investments, 33% A rated investments, 5% BBB rated investments and 10% CCC rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected the Company s holdings in ARS investments and auctions for the Company s investments in these securities have failed to settle on their respective settlement dates. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While the Company continues to earn interest on its ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and the Company will not be able to access these funds until a future auction of these investments is successful, the issuer redeems the securities or at maturity. Maturity dates for these ARS investments range from 2016 to 2044 with principal distributions occurring on certain securities prior to maturity. To date, principal distributions and maturities of the securities held by the Company have all been at par value.

In November 2008, the Company entered into a settlement agreement related to its ARS held with UBS Financial Services, Inc. (UBS) that grants the Company the right to cause UBS to purchase all of the Company s ARS held with them at par value (the Right). On July 3, 2010, the Company elected to exercise the Right and as a result UBS has purchased all ARS held by the Company and all related assets and liabilities have been removed from the balance sheet as of July 3, 2010.

The Company also holds short term available for sale securities totaling $63.2 million as of January 1, 2011, that consisted of $50.0 million in treasury bills and $13.2 million in certificates of deposit at cost which approximates fair value.

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

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

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

	As of January 1, 2011			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(In thousands)			
Short term treasury bills	$ 50,000	$	$	$ 50,000
Short term certificates of deposit	13,165			13,165
	63,165			63,165
Long term auction rate securities	89,325		(12,167)	77,158
Total	$ 152,490	$	$ (12,167)	$ 140,323

	As of July 3, 2010			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(in thousands)			
Short term treasury bills	$ 40,000	$	$	$ 40,000
Short term certificates of deposit	18,038			18,038
	58,038			58,038
Long term auction rate securities	108,625		(13,061)	95,564
Total	$ 166,663	$	$ (13,061)	$ 153,602

	As of January 2, 2010			
	Cost	Unrealized Losses Less Than 12 Months	Unrealized Losses 12 Months or Greater	Estimated Fair Value
	(In thousands)			
Short term treasury bills	$ 40,000	$	$	$ 40,000
Short term certificates of deposit	9,738			9,738
	49,738			49,738
Long term certificates of deposit	955			955
Long term auction rate securities	127,875		(14,448)	113,427
Total	$ 178,568	$	$ (14,448)	$ 164,120

FAIR VALUE MEASUREMENTS

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

As of January 1, 2011, the Company held financial instruments that are measured at fair value on a recurring basis. These included cash equivalents and available for sale securities. Cash equivalents consist of money market funds. Short term available for sale securities consist of government treasury bills and certificates of deposit. Long term available for sale securities consist of auction rate securities (ARS). These securities consist of federally insured student loan backed securities and insured municipal authority bonds.

The Company determined the estimated fair value of its investment in ARS as of January 1, 2011 using a discounted cash flow model. The assumptions used in preparing the discounted cash flow model include estimates for liquidity, interest rates, timing, credit ratings, credit wrap and amount of cash flows and expected holding periods of the ARS.

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

Description	January 1, 2011	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		Fair value measurements at reporting date (In thousands)		
Cash equivalents	$ 65,420	$ 65,420	$	$
Current available for sale securities	63,165	63,165		
Non-current available for sale securities	77,158			77,158
Total	$ 205,743	$ 128,585	$	$ 77,158

During the quarter ended January 1, 2011 there were no transfers of assets and liabilities between Level 1 (quoted priced in active markets for identical assets) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy. An impairment charge has been recorded that reduces the carrying amount of the applicable non-current assets of $89.4 million to their fair value of $77.2 million as of January 1, 2011. The following table presents the Company s activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended January 1, 2011:

	Investments in ARS (In thousands)
Balance as of July 3, 2010	$ 95,564
Total gains or (losses) (realized or unrealized)	
Included in net loss	
Included in accumulated other comprehensive loss	894
Settlements	(19,300)
Balance as of January 1, 2011	$ 77,158

Non-Financial Assets:

The Company measures certain non-financial assets and liabilities, including long-lived assets, at fair value on a non-recurring basis. During the 13 weeks ended January 1, 2011 and January 2, 2010, the Company recorded impairment charges of approximately $0.5 million and $0.6 million, respectively, related to under-performing stores in its continuing operations. During the 26 weeks ended January 1, 2011 and January 2, 2010, the Company recorded impairment charges of approximately $1.1 million and $0.6 million, respectively, related to under-performing stores in its continuing operations. The fair market value of these assets was determined using the income approach and level 3 inputs, which required management to make significant estimates about future operating plans and projected cash flows. Management estimates the amount and timing of future cash flows based on its experience and knowledge of the retail market in which each store operates. This impairment charge is included in selling, general and administrative expenses (SG&A) in the accompanying condensed consolidated statements of operations. The Company was not required to measure any other significant non-financial assets and liabilities at fair value.

INVENTORIES

The Company s inventories consisted of:

As of

	January 1, 2011	July 3, 2010 (In thousands)	January 2, 2010
Merchandise available for sale	$ 29,497	$ 32,927	$ 29,349
Raw materials	492	531	1,032
Inventories, net	$ 29,989	$ 33,458	$ 30,381

CREDIT FACILITIES

The Company has an unsecured commercial line of credit agreement which provides for borrowings and issuance of letters of credit of up to a combined total of $25.0 million and expires on March 31, 2012. The outstanding balance bears interest at either the bank s reference rate (which was 3.25% as of January 1, 2011) or the LIBOR rate (which was 0.26% as of January 1, 2011) plus 1.75 percentage points. As of January 1, 2011, there were no outstanding cash borrowings and there was $0.3 million of trade letters of credit outstanding as well as $3.0 million of an outstanding stand-by letter of credit. To date, no benificiary has drawn upon the stand-by letter of credit.

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This credit facility requires the Company to maintain a $2.5 million compensating balance and to comply with certain financial covenants, including amounts for minimum tangible net worth, unencumbered liquid assets and profitability, and certain restrictions on making loans and investments. As of January 1, 2011, the Company was in compliance with all financial covenants.

UNCERTAIN TAX POSITIONS

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

COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended		Six Months Ended	
	January 1, 2011	January 2, 2010	January 1, 2011	January 2, 2010
	(In thousands)			
Net income (loss)	$ (2,727)	$ 2,440	$ (3,880)	$ (1,742)
Gain on available for sale securities	619	147	894	2,390
Accumulated translation adjustments	992	1,084	2,561	3,349
Total comprehensive income (loss)	$ (1,116)	$ 3,671	$ (425)	$ 3,997

EARNINGS PER SHARE

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

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

	Three Months Ended		Six Months Ended	
	January 1, 2011	January 2, 2010	January 1, 2011	January 2, 2010
	(In thousands)			
Basic weighted average number of shares outstanding	84,035	86,663	84,385	86,715
Incremental shares from the assumed issuance of stock options	99	97	98	123
Diluted weighted average number of shares outstanding	84,134	86,760	84,483	86,838

Excluded from the computation of the number of diluted weighted average shares outstanding were options to purchase 4,356,782 and 4,733,258 shares of common stock for the three months ended January 1, 2011 and January 2, 2010, respectively, and 4,276,992 and 4,849,604 for the six months ended January 1, 2011 and January 2, 2010, respectively, which would have been anti-dilutive.

COMMON STOCK PURCHASES

Share repurchases were as follows:

	Three Months Ended		Six Months Ended	
	January 1, 2011	**January 2, 2010**	**January 1, 2011**	**January 2, 2010**
	(In thousands, except per share data)			
Number of shares repurchased		644	2,137	644
Total cost	$	$ 3,717	$ 12,472	$ 3,717
Average per share cost including commissions	$	$ 5.77	$ 5.84	$ 5.77

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In October 2008, the board of directors authorized a program to repurchase up to $30 million of the Company s common stock. The Company intends, from time to time, as business conditions warrant, to purchase stock in the open market or through private transactions. Purchases may be increased, decreased or discontinued at any time without prior notice. The plan does not obligate the Company to repurchase any specific number of shares and may be suspended at any time at management s discretion. As of January 1, 2011, the Company has repurchased the full authorization of $30 million of shares, but the board of directors may authorize the repurchase of additional shares in the future.

STOCK BASED COMPENSATION

The following table summarizes the stock based compensation expense recognized under the Company s stock plan during the three months and the six months ended January 1, 2011 and January 2, 2010:

	Three Months Ended		Six Months Ended	
	January 1, 2011	January 2, 2010	January 1, 2011	January 2, 2010
	(In thousands)			
Stock options	$ 499	$ 1,475	$ 1,539	$ 2,174
Nonvested stock awards/units	79	117	120	49
Total stock based compensation expense	$ 578	$ 1,592	$ 1,659	$ 2,223

Unrecognized compensation cost related to nonvested stock options and nonvested stock awards/units totaled approximately $4.2 million and $0.4 million, respectively, as of January 1, 2011. This cost is expected to be recognized over a weighted average period of 2.9 years. The weighted average fair value of stock options at their grant date during the three months ended January 1, 2011 and January 2, 2010 was $2.35 and $2.76, respectively. For the six month periods ended January 1, 2011 and January 2, 2010, the weighted average fair values of stock options at their grant date were $2.30 and $2.82, respectively.

During the first quarter of fiscal 2010, the Company filed a Tender Offer Statement on Schedule TO with the SEC pursuant to which the Company extended an offer to employees and non-employee directors to exchange up to an aggregate of 2,058,475 options to purchase shares of our common stock, whether vested or unvested. Options with an exercise price greater than $10.74 per share and an expiration date after September 29, 2009 were eligible to be tendered pursuant to the offer. The closing market price on September 29, 2009 was $7.64. In accordance with the Tender Offer (the TO), the number of new options issued was based on exchange ratios as set forth in the table below:

Exercise Price Range	Shares Subject to Option Surrendered	Shares Subject to Replacement Option To Be Granted
$10.75-$14.99	1.14	1
$15.00-$19.99	1.84	1
$20.00 and above	2.06	1

A total of 1,710,735 options were tendered and cancelled, and a total of 1,126,267 options were granted on September 29, 2009 with an exercise price of $7.64 per share. Replacement options granted in exchange for fully or partially unvested surrendered options at the time they were surrendered for cancellation will vest as follows: (A) vested shares subject to eligible options and unvested shares subject to eligible options scheduled to vest prior to the one-year anniversary of the replacement grant date shall vest on the one-year anniversary of the replacement grant date and (B) unvested shares subject to eligible options scheduled to vest after the one-year anniversary of the replacement grant date shall vest according to the original vest dates of the eligible option. The TO was subject to modification accounting pursuant to FASB ASC 718-20-35-3 whereby the total compensation cost measured at the date of modification was the incremental cost resulting from the modification. The incremental cost resulting from the modification is measured as the excess of the fair value of the modified award over the fair value of the original award immediately before its terms are modified. The incremental fair value of $0.3 million for the new awards was computed using an expected life of 4.07 years, a risk-free interest rate of 1.94% and a volatility of 54%. The incremental fair value of the unvested awards is being amortized over the remaining service period.

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LEGAL MATTERS

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

A former employee sued the Company in a complaint filed July 27, 2006 in the Superior Court of California, San Mateo County (case No. CIV 456550) alleging a failure to pay all wages, failure to pay overtime wages, failure to pay minimum wages, failure to provide meal periods, violation of Labor Code §450, violation of Labor Code §2802 and California Code of Regulations §11040(9)(A), statutory wage violations (late payment of wages), unlawful business practices under Business and Professions Code §16720 and §17200, conversion of wages and violation of Civil Code §52.1. The plaintiff also purports to bring the action on behalf of current and former California bebe employees who are similarly situated. The lawsuit seeks compensatory, statutory and punitive damages as well as restitution and injunctive relief. The Court s previous stay has been lifted and discovery continues.

A former employee sued the Company in a complaint filed November 2, 2010 in the Superior Court of California, County of San Bernadino (case No. CIV RS 1011823) alleging wage and hour claims similar to those found in the case named above, a failure to pay for certain time worked (including while employees bags are being checked at the door), a failure to timely pay vacation pay upon separation and a failure to provide for adequate seating while on the job. The plaintiff also purports to bring the action on behalf of current and former California bebe employees who are similarly situated. The lawsuit seeks compensatory, statutory and punitive damages, as well as restitution and injunctive relief. In February 2011, the Court granted the Company s motion and ordered the action stayed (based on the existence of overlapping claims in both the above and below named cases) until August 2011, at which time the Court will reassess the propriety of the stay order.

A former employee sued the Company in a Second Amended Complaint filed on approximately September 7, 2010 in the Superior Court of California, County of Los Angeles (case No. BC 429140) alleging the Company made unlawful paycheck charge-backs, failed to pay overtime wages at proper rates and failed to pay certain wages timely. The plaintiff also purports to bring the action on behalf of current and former California bebe employees who are similarly situated. The lawsuit seeks compensatory, statutory and punitive damages as well as restitution and injunctive relief. The Company has answered the complaint and the case is in its early stages of discovery.

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

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

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

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

OVERVIEW

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

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

We market our products under the bebe, BEBE SPORT, bbsp and 2b bebe brand names through our 253 retail stores, of which 216 are bebe stores, 36 are 2b bebe stores and 1 is a bebe accessories store as of January 1, 2011. These stores are located in 36 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Canada. In addition, we have an on-line store at www.bebe.com, and our licensees operate 56 international stores as of January 1, 2011. During the six months ended January 1, 2011, we opened 3 bebe stores and a 2b bebe store and closed 49 PH8 stores. We expect to open approximately 2 bebe stores, including 1 bebe shop-in-shop in Japan, and 3 2b bebe stores during the remainder of fiscal 2011.

bebe stores. We were founded by Manny Mashouf, our Chief Executive Officer and Chairman of the Board. We opened our first store in San Francisco, California in 1976, which was also the year we incorporated. We also operate one bebe accessory store that features a limited assortment of bebe merchandise, including outerwear, shoes and accessories.

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

2b bebe stores. As of January 1, 2011, we operated 18 2b bebe stores and 18 stores operating in the outlet store design under the 2b bebe name. The stores operating in the 2b bebe design sell bebe logo, 2b bebe merchandise and a small percentage of bebe retail markdowns. The stores operating in the outlet design sell bebe logo, 2b bebe merchandise and a large percentage of bebe retail markdowns.

On-line. bebe.com is our on-line retail store and an extension of the bebe store experience that provides a complete assortment of bebe, 2b bebe and BEBE SPORT merchandise. It is also used as a vehicle to communicate with our customers.

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CRITICAL ACCOUNTING POLICIES

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

The preparation of these financial statements requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the financial statements. We believe our application of accounting policies, and the estimates inherently required therein, are reasonable. Our most critical accounting policies are those related to revenue recognition, stock based compensation, inventories, marketable securities, impairment of long lived assets and uncertain tax positions. We continually evaluate these accounting policies and estimates, and we make adjustments when facts and circumstances dictate a change. Our accounting policies are described in Note 1 to the consolidated financial statements in our annual report on Form 10-K for the fiscal year ended July 3, 2010. This discussion and analysis should be read in conjunction with such discussion and with our condensed consolidated financials statements and related notes included in Part 1, Item 1 of this quarterly report.

RESULTS OF OPERATIONS

Our fiscal year is a 52 or 53 week period, each period ending on the first Saturday after June 30. Fiscal years 2011 and 2010 each include 52 weeks. The three months ended January 1, 2011 and January 2, 2010 each include 13 weeks. The six months ended January 1, 2011 and January 2, 2010 each include 26 weeks.

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

	Three Months Ended		Six Months Ended	
	January 1, 2011	January 2, 2010	January 1, 2011	January 2, 2010
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales, including production and occupancy (1)	62.9	59.1	61.4	60.4
Gross margin	37.1	40.9	38.6	39.6
Selling, general and administrative expenses (2)	35.3	33.4	37.5	36.3
Operating income	1.8	7.5	1.1	3.3
Interest and other income, net	0.2	0.6	0.2	0.8
Income from continuing operations before income taxes	2.0	8.1	1.3	4.1
Provision for income taxes	0.8	3.6	0.5	2.2
Income from continuing operations, net of tax	1.2	4.5	0.8	1.9
Loss from discontinued operations, net of tax	(3.2)	(2.7)	(2.3)	(2.6)
Net income (loss)	(2.0)%	1.8%	(1.5)%	(0.7)%

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

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

Net Sales. Net sales from continuing operations increased to $136.2 million during the three months ended January 1, 2011 from $131.9 million for the comparable period of the prior year, an increase of $4.3 million, or 3.3%. The increase in net sales was primarily driven by a 37.1% increase in wholesale sales to our international licensees. Comparable store sales were flat compared to the prior year.

For the six months ended January 1, 2011, net sales from continuing operations increased to $251.5 million from $249.0 million for the comparable period of the prior year, an increase of $2.5 million, or 1.0%. The increase in net sales was primarily driven by a 34.5% increase in wholesale sales to our international licensees.

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	Three Months Ended		Six Months Ended	
	January 1, 2011	January 2, 2010	January 1, 2011	January 2, 2010
Net sales (In thousands)	$ 136,209	$ 131,851	$ 251,465	$ 248,990
Total net sales increase (decrease) percentage	3.3%	(22.1) %	1.0%	(21.0) %
Comparable store decrease percentage	0.0%	(22.5)%	(2.3)%	(24.1)%
Net sales per average square foot (1)	$ 130	$ 122	$ 234	$ 231
Square footage at end of period (In thousands)	1,022	1,157	1,022	1,157
Number of store locations:				
Beginning of period	276	307	298	308
New store locations	2	2	4	4
Closed store locations (2)	25		49	3
Number of stores open at end of period	253	309	253	309

(1) We calculate net sales per average square foot using net store sales and monthly average store square footage.

(2) In fiscal 2011, closed store locations relate to the discontinuation of PH8 operations.

Gross Margin. Gross margin from continuing operations decreased to $50.5 million during the three months ended January 1, 2011 from $53.9 million for the comparable period of the prior year, a decrease of $3.4 million, or 6.3%. As a percentage of net sales, gross margin decreased to 37.1% for the three months ended January 1, 2011 from 40.9% in the comparable period of the prior year. The decrease in gross margin as a percentage of net sales was primarily due to decrease in initial mark-up and higher than anticipated markdowns and promotions during December 2010.

For the six months ended January 1, 2011, gross margin from continuing operations decreased to $97.1 million from $98.7 million for the comparable period of the prior year, a decrease of $1.6 million, or 1.6%. As a percentage of net sales, gross margin from continuing operations decreased to 38.6% for the six months ended January 1, 2011 from 39.6% in the comparable period of the prior year. The decrease in gross margin as a percentage of net sales was primarily due to decrease in initial mark-up and higher than anticipated markdowns and promotions during December 2010.

Selling, General and Administrative Expenses. Selling, general and administrative expenses from continuing operations increased to $48.0 million during the three months ended January 1, 2011 from $44.0 million for the comparable period of the prior year, an increase of $4.0 million, or 9.0 %. As a percentage of net sales, selling, general and administrative expenses increased to 35.2% during the three months ended January 1, 2011 from 33.4% in the comparable period of the prior year. The increase over the prior year was primarily due to $1.5 million of legal and employment settlement costs and the initial recognition of gift card breakage income in the prior year, which was a $1.1 million reduction to expense versus $0.3 million in the comparable period of the current year.

For the six months ended January 1, 2011, selling, general and administrative expenses from continuing operations increased to $94.3 million from $90.4 million for the comparable period of the prior year, an increase of $3.9 million, or 4.3%. As a percentage of net sales, selling, general and administrative expenses increased to 37.5% from 36.3% in the comparable period of the prior year. The increase over the prior year primarily relates to under-leveraged occupancy costs, $1.5 million in legal and employment settlement costs as well as $1.1 million in store impairment costs in the current year versus $0.6 million in the comparable period of the prior year.

Interest and Other Income, Net. We generated approximately $0.3 million of interest and other income, net of other expenses during the three months ended January 1, 2011 compared to approximately $0.8 million in the comparable period of the prior year. The decrease in interest and other income resulted from investments in lower-yielding tax-exempt investments and money market funds.

For the six month period ended January 1, 2011, we recorded approximately $0.6 million of interest and other income, compared to $1.9 million in the comparable period of the prior year. The decrease in interest and other income resulted from investments in lower-yielding tax-exempt investments and money market funds.

Provision for Income Taxes. Our effective tax rate from continuing operations decreased to 41.4% for the three months ended January 1, 2011 from 44.1% for the comparable period in the prior year. While we expect the effective tax rate to fluctuate from quarter to quarter due to discrete items, the higher effective tax rate in the prior year second quarter was primarily due to various discrete items in the areas of depreciation and stock compensation adjustments.

For the six months ended January 1, 2011, our effective tax rate from continuing operations decreased to 41.6% from 52.9% for the comparable period for the prior year. The higher tax rate in the prior year was primarily due to several discrete items recorded in the year related to adjustments to stock options compensation expense and adjustments of temporary and permanent items.

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Discontinued Operations. In the fourth quarter of fiscal 2010, the Company decided to discontinue operations of the PH8 division, allowing the Company to focus its efforts on improving bebe sales and profitability, expanding internationally and continuing to develop its 2b bebe business. The Company closed 24 PH8 stores in the first fiscal quarter of 2011 and has closed the remaining 25 PH8 stores, converting one store to a 2b bebe, during the second quarter of fiscal 2011. The results of the PH8 stores closed to date, net of income tax benefit, which consists of 49 stores for the second fiscal quarter of 2011 and 65 stores for the prior year comparable period, have been presented as a discontinued operation in the accompanying consolidated statements of operations for all periods presented and are as follows:

	Three Months Ended		Six Months Ended	
	January 1, 2011	January 2, 2010	January 1, 2011	January 2, 2010
	(In thousands)			
Net sales	$ 4,146	$ 9,642	$ 7,850	$ 18,162
Cost of sales, including production and occupancy	9,591	8,151	13,368	15,246
Gross margin	(5,445)	1,491	(5,518)	2,916
Selling general and administrative expenses	1,706	7,272	4,116	13,960
Loss from discontinued operation, before income tax benefit	(7,151)	(5,781)	(9,634)	(11,044)
Income tax benefit	(2,796)	(2,216)	(3,799)	(4,502)
Loss from discontinued operations, net of tax benefit	$ (4,355)	$ (3,565)	$ (5,835)	$ (6,542)

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SEASONALITY OF BUSINESS AND QUARTERLY RESULTS

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

LIQUIDITY AND CAPITAL RESOURCES

Our working capital requirements vary widely throughout the year and generally peak during the first and second fiscal quarters. As of January 1, 2011, we had approximately $259.7 million of cash and equivalents and investments on hand of which $119.4 million were cash and equivalents, approximately $50.0 million were invested in government treasury bills, approximately $13.2 million were invested in certificates of deposit and approximately $77.2 million, net of temporary impairment charges of $12.2 million, were invested in auction rate securities (ARS). We do not anticipate the lack of liquidity in the ARS to impact our ability to fund our operations in the foreseeable future and believe we have sufficient cash and equivalents to fund ongoing operations. In addition, we have a revolving line of credit, under which we may borrow or issue letters of credit up to a combined total of $25 million. As of January 1, 2011, there were no cash borrowings outstanding under the line of credit, and letters of credit outstanding totaled $0.3 million. This credit facility requires us to maintain a $2.5 million compensating balance and to comply with certain financial covenants, including amounts for minimum tangible net worth, unencumbered liquid assets and profitability, and certain restrictions on making loans and investments. As of January 1, 2011, we were in compliance with all financial covenants.

As of January 1, 2011, we had cash and equivalents of $119.4 million held in accounts managed by third-party financial institutions consisting of invested cash and cash in our operating accounts. The invested cash is invested in interest bearing funds managed by third party financial institutions. These funds invest in direct obligations of the government of the United States. To date, we have experienced no loss or lack of access to our invested cash or equivalents; however, we can provide no assurances that access to our invested cash and equivalents will not be impacted by adverse conditions in the financial markets.

At any point in time we also have approximately $90 to $200 million of invested cash and cash in operating accounts that are with third party financial institutions. These balances exceed the Federal Deposit Insurance Corporation insurance limits. While we monitor daily the cash balances in our operating accounts and adjust the cash balances as appropriate, these cash balances could be impacted if the underlying financial institutions fail or could be subject to other adverse conditions in the financial markets. To date, we have experienced no loss or lack of access to invested cash or cash in our operating accounts.

Net cash provided by operating activities for the six months ended January 1, 2011 was $14.0 million versus $26.0 million for the six months ended January 2, 2010. The decrease of $12.0 million from the comparable period was primarily due to an increase in net loss of $2.1 million, non-cash deferred rent write-offs related to store closures and decreased changes in working capital of $8.3 million primarily related to lower prepaid and other expenses resulting from changes in prepaid income tax due to discontinued operations and a change in bonus depreciation rules as well as inventory and accrued expense changes related to timing of payments.

Net cash provided by investing activities for the six months ended January 1, 2011 was $11.5 million versus $9.2 million used for investing activities for the six months ended January 2, 2010. The increase of $20.7 million versus the prior year comparable period was primarily due to increased investments in cash equivalent securities. We expect that total capital expenditures will be below $20 million in fiscal 2011.

Net cash used by financing activities was $100.5 million for the six months ended January 1, 2011 versus $12.2 million for the six months ended January 2, 2010. The increase of $88.3 million from the prior year comparable period was primarily due to the payout of the special $1 per share dividend declared in the fourth quarter of fiscal 2010 and the increased purchases of common stock made during the period.

We hold a variety of interest bearing ARS consisting of federally insured student loan backed securities and insured municipal authority bonds. As of January 1, 2011, our ARS portfolio totaled approximately $77.2 million classified as available for sale securities. As of that date, our ARS portfolio included approximately 96% federally insured student loan backed securities and 4% municipal authority bonds and consisted of approximately 38% AAA rated investments, 6% AA rated investments, 30% A rated investments, 6% BBB rated investments and 20% CCC rated investments. As of July 3, 2010, our ARS portfolio consisted of 47% AAA rated investments, 5% AA rated investments, 33% A rated investments, 5% BBB rated investments and 10% CCC rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The uncertainties in the credit markets that began in February 2008 have affected our holdings in ARS investments

and auctions for our investments in these securities have failed to settle on their respective settlement dates. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While we continue to earn

interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. Consequently, the investments are not currently liquid, and we will not be able to access these funds until a future auction of these investments is successful, the issuer redeems the securities, or at maturity. Maturity dates for these ARS investments range from 2016 to 2044 with principal distributions occurring on certain securities prior to maturity.

We also hold short-term available for sale securities totaling $63.2 million at January 1, 2011 that consist of treasury bills and certificates of deposit.

In October 2008, our board of directors authorized a program to repurchase up to $30 million of our common stock. We may, from time to time, as business conditions warrant, purchase stock in the open market or through private transactions. Purchases may be increased, decreased or discontinued at any time without prior notice. The plan does not obligate us to repurchase any specific number of shares and may be suspended at any time at management s discretion. During the six months ended January 1, 2011, we repurchased 2,137,344 shares at an average price per share of $5.84. During the six months ended January 2, 2010, we repurchased 644,200 shares at an average price per share of $5.77. As of January 1, 2011, we have repurchased the full authorization of $30 million of shares, but may repurchase additional shares in the future.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk

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

All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents. Investments are considered short-term available for sale securities if the original maturity is between three months and twelve months, or long term investments if the original maturity is greater than twelve months. Historically the fair value of ARS investments had approximated par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. We determined the estimated fair value of our investment in ARS as of January 1, 2011 using a discounted cash flow model to estimate the fair value of our investments in ARS. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows and expected holding periods of the ARS. We have modified our investment strategy and increased our investments in more liquid money market investments.

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The following table lists our cash, cash equivalents and investments as of January 1, 2011:

		Fair Value (Dollars in thousands)
Cash	$	53,990
Weighted average interest rate		0.00%
Cash equivalents	$	65,420
Weighted average interest rate		0.19%
Current available for sale securities	$	63,165
Weighted average interest rate		0.36%
Non-current available for sale securities	$	77,158
Weighted average interest rate		0.61%
Total	$	259,733

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

Foreign Currency Risks

We enter into a significant amount of purchase obligations outside of the United States, substantially all of which are negotiated and settled in U.S. Dollars and, therefore, have only minimal exposure to foreign currency exchange risks. We also operate a subsidiary for which the functional currency is the Canadian Dollar. We translate assets and liabilities of Canada s operations into U.S. dollars at month-end rates, while we translate income and expenses at the weighted average exchange rates for the month. We record the related translation adjustments in accumulated other comprehensive income as a separate component of shareholders equity. Fluctuations in exchange rates therefore impact our financial condition and results of operations, as reported in U.S. Dollars. We do not hedge against foreign currency risks and believe that foreign currency exchange risk is immaterial.

ITEM 4. CONTROLS AND PROCEDURES

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

There has been no change in our internal control over financial reporting during the quarter ended January 1, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Our past performance may not be a reliable indicator of future performance because actual future results and trends may differ materially depending on a variety of factors, including, but not limited to, the risks and uncertainties discussed below. In addition, historical trends should not be used to anticipate results or trends in future periods.

Factors that might cause our actual results to differ materially from the forward looking statements discussed elsewhere in this report, as well as affect our ability to achieve our financial and other goals, include, but are not limited to, those set forth below. Except for changes to the general economic conditions risk factor, there have been no material changes in our risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended July 3, 2010.

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

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

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

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

4. If we are unable to obtain raw materials or unable to find manufacturing facilities or our manufacturers perform unacceptably, our sales may be negatively affected and our financial condition may be harmed. We do not own any manufacturing facilities and therefore depend on contractors and third parties to manufacture our products. We place all of our orders for production of merchandise and raw materials by purchase order and do not have any long-term contracts with any manufacturer or supplier. If we fail to maintain favorable relationships with our manufacturers and suppliers or are unable to obtain sufficient quantities of quality raw materials on commercially reasonable terms, it could harm our business and results of operations. We cannot assure you that contractors and third-party manufacturers (1) will not supply similar products to our competitors, (2) will not stop supplying products to us completely or (3) will supply products in a timely manner. Untimely receipt of products may result in lower than anticipated sales and markdowns which would have a negative impact on earnings. Furthermore, we have received in the past, and may receive in the future, shipments of products from manufacturers that fail to conform to our quality control standards. In such event, unless we are able to obtain replacement products in a timely manner, we may lose sales. Certain of our third-party manufacturers store our raw materials. In the event our inventory was damaged or destroyed and we were unable to obtain replacement raw materials, our earnings could be negatively impacted.

5. We cannot assure that future store openings will be successful and new store openings may impact existing stores. We expect to open approximately 4 bebe stores, one bebe shop-in-shop and 4 2b bebe stores in fiscal 2011. In the past, we have closed stores as a result of poor performance, and we cannot assure that the stores that we plan to open in fiscal 2011, or any other stores that we might open in the future, will be successful or that our overall operating profit will increase as a result of opening these stores. During fiscal 2011, we have closed 49 stores related to the PH8 store closures discussed previously and anticipate closing up to 7 non-PH8 stores. Most of our new store openings in fiscal 2011 will be in existing markets. These openings may affect the existing stores net sales and profitability. Our failure to predict accurately the demographic or retail environment at any future store location could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

Such fluctuations may adversely affect the market price of our common stock.

7. Our success depends on our ability to attract and retain key employees in order to support our existing businesses and future expansion. From time to time we actively recruit qualified candidates to fill key executive positions from within our company. There is substantial competition for experienced personnel, which we expect will continue. We compete for experienced personnel with companies who have greater financial resources than we do. In the past, we have experienced significant turnover of our executive management team and retail store personnel. We are also exposed to employment practice litigation due to the large number of employees and high turnover of our sales associates. If we fail to attract, motivate and retain qualified personnel, it could harm our business and limit our ability to expand.

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

8. Because Manny Mashouf beneficially owns a substantial portion of the outstanding shares, other shareholders may not be able to influence the direction the company takes. As of January 31, 2011, Manny Mashouf, our Chief Executive Officer and Chairman of the Board, beneficially owned approximately 55% of the outstanding shares of our common stock. As a result, he can control the election of directors and the outcome of all issues submitted to the shareholders. This may make it more difficult for a third party to acquire shares, may discourage acquisition bids, and could limit the price that certain investors might be willing to pay for shares of common stock. This concentration of stock ownership may have the effect of delaying, deferring or preventing a change in control of our company.

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9. We rely on information technology, the disruption of which could adversely impact our business. We rely on various information systems to manage our operations and regularly make investments to upgrade, enhance or replace such systems. Any delays or difficulties in transitioning to these or other new systems, or in integrating these systems with our current systems, or any other disruptions affecting our information systems, could have a material adverse impact on our business. Any failure to maintain adequate system security controls to protect our computer assets and sensitive data, including client data, from unauthorized access, disclosure or use could also damage our reputation with our clients.

10. We are subject to risks associated with our on-line sales. We operate an on-line store at *www.bebe.com* to sell our merchandise, which we migrated to a third-party platform in February 2006. Although our on-line sales encompass a relatively small percentage of our total sales, our on-line operations are subject to numerous risks, including unanticipated operating problems, reliance on third-party computer hardware and software providers, system failures and the need to invest in additional computer systems. The on-line operations also involve other risks that could have an impact on our results of operations including but not limited to diversion of sales from our other stores, rapid technological change, liability for on-line content, credit card fraud and risks related to the failure of the computer systems that operate the website and its related support systems. In addition, with the migration to a third-party platform, we no longer have direct control of certain aspects of our on-line business. We cannot assure that our on-line store will continue to achieve sales and profitability growth or even remain at its current level.

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

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

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

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We are seeking to register our trademarks domestically and internationally. Obstacles may exist that may prevent us from obtaining a trademark for the bebe, BEBE SPORT, bbsp, 2b bebe and PH8 names or related names. We may not be able to register certain trademarks, purchase the right or obtain a license to use these names or related names on commercially reasonable terms. If we fail to obtain trademark, ownership or license the requisite rights, it would limit our ability to expand. In some jurisdictions, despite successful registration of our trademarks, third parties may allege infringement and bring actions against us. In addition, if our licensees fail to use our intellectual property correctly, the reputation and value associated with our trademarks may be diluted. Furthermore, if we do not demonstrate use of our trademarks, our trademark rights may lapse over time.

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

15. We may be required to record losses in future quarters as a result of the decline in value of our investments in auction rates securities or as a result of a change in our ability to hold our investments in auction rate securities. We hold a variety of interest bearing ARS comprised of federally insured student loan backed securities and insured municipal authority bonds. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The recent uncertainties in the credit markets that began in February 2008 have affected our holdings in ARS investments and the majority of auctions for our investments in these securities have failed to settle on their respective settlement dates. Consequently, $77.2 million of our ARS are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful or securities are purchased or redeemed outside of the auction process. Maturity dates for these ARS investments range from 2016 to 2044, with principal distributions occurring on certain securities prior to maturity.

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

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

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

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

Exhibit	Description
31.1	Section 302 Certification of Chief Executive Officer.
31.2	Section 302 Certification of Chief Financial Officer.
32.1	Section 906 Certification of Chief Executive Officer.
32.2	Section 906 Certification of Chief Financial Officer.

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SIGNATURE

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

Dated February 9, 2011

bebe stores, inc.

/s/ Walter Parks
Walter Parks, Chief Operating Officer and Chief Financial Officer

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