

CLAIRE'S STORES INC  
Form 10-K  
April 04, 2012  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, DC 20549

**FORM 10-K**

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

**For the Fiscal Year Ended January 28, 2012**

**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 Nos. 1-8899, 333-148108 and 333-175171**

**Claire's Stores, Inc.**

(Exact name of registrant as specified in its charter)

**Florida**  
(State or other jurisdiction of

**59-0940416**  
(I.R.S. Employer

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

incorporation or organization)

Identification No.)

2400 West Central Road,

Hoffman Estates, Illinois  
(Address of principal executive offices)

60192  
(Zip Code)

Registrant's telephone number, including area code: (847) 765-1100

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

None

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

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

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐

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

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant is zero. The registrant is a privately held corporation.

As of April 1, 2012, 100 shares of the Registrant's common stock, \$.001 par value were outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

None



**Table of Contents**

**TABLE OF CONTENTS**

<b>Item</b>	<b>Page No.</b>
<b><u>PART I</u></b>	<b>3</b>
<b>Item 1.</b> <u>Business</u>	<b>5</b>
<b>Item 1A.</b> <u>Risk Factors</u>	<b>11</b>
<b>Item 1B.</b> <u>Unresolved Staff Comments</u>	<b>21</b>
<b>Item 2.</b> <u>Properties</u>	<b>21</b>
<b>Item 3.</b> <u>Legal Proceedings</u>	<b>22</b>
<b>Item 4.</b> <u>Mine Safety Disclosures</u>	<b>22</b>
<b><u>PART II</u></b>	<b>23</b>
<b>Item 5.</b> <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<b>23</b>
<b>Item 6.</b> <u>Selected Financial Data</u>	<b>24</b>
<b>Item 7.</b> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<b>25</b>
<b>Item 7A.</b> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<b>45</b>
<b>Item 8.</b> <u>Financial Statements and Supplementary Data</u>	<b>47</b>
<b>Item 9.</b> <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<b>94</b>
<b>Item 9A.</b> <u>Controls and Procedures</u>	<b>94</b>
<b>Item 9B.</b> <u>Other Information</u>	<b>95</b>
<b><u>PART III</u></b>	<b>95</b>
<b>Item 10.</b> <u>Directors, Executive Officers and Corporate Governance</u>	<b>95</b>
<b>Item 11.</b> <u>Executive Compensation</u>	<b>95</b>
<b>Item 12.</b> <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<b>95</b>
<b>Item 13.</b> <u>Certain Relationships and Related Transactions and Director Independence</u>	<b>95</b>
<b>Item 14.</b> <u>Principal Accountant Fees and Services</u>	<b>95</b>
<b><u>PART IV</u></b>	<b>96</b>
<b>Item 15.</b> <u>Exhibits, Financial Statement Schedules</u>	<b>96</b>
<b><u>Signatures</u></b>	<b>101</b>

## **Table of Contents**

### **PART I.**

#### **Explanatory Notes**

We refer to Claire's Stores, Inc., a Florida corporation, as Claire's, the Company, we, our or similar terms, and typically these references include our subsidiaries.

In May 2007, the Company was acquired by Apollo Management VI, L.P. (Apollo Management), together with certain affiliated co-investment partnerships (collectively the Sponsors), through a merger (the Merger) and Claire's Stores, Inc. became a wholly-owned subsidiary of Claire's Inc. The Merger was financed by the issuance of \$250.0 million of 9.25% senior notes due 2015 (the Senior Fixed Rate Notes), \$350.0 million of 9.625%/10.375% senior toggle notes due 2015 (the Senior Toggle Notes) and together with the Senior Fixed Rate Notes, the Senior Notes), \$335.0 million of 10.50% senior subordinated notes due 2017 (the Senior Subordinated Notes) and together with the Senior Notes, the Merger Notes) and borrowings under the senior secured term loan facility and revolving credit facility, the (Revolver), (collectively the Credit Facility) of \$1.65 billion. The aforementioned transactions, including the Merger and payment of costs related to these transactions as well as the related borrowings, are collectively referred to as the Transactions. The purchase of the Company by the Sponsors is referred to as the Acquisition.

On March 4, 2011, we issued \$450.0 million aggregate principal amount of 8.875% senior secured second lien notes that mature on March 15, 2019 (the Senior Secured Second Lien Notes) and together with the Merger Notes, the Notes). We used the net proceeds of the offering of the Senior Secured Second Lien Notes to reduce the entire amount outstanding under our Revolver (without terminating the commitment) and indebtedness under our senior secured term loan Credit Facility.

On February 28, 2012 and March 12, 2012, we issued \$400.0 million and \$100.0 million, respectively, aggregate principal amount of 9.00% Senior Secured First Lien Notes that mature on March 15, 2019 (the Senior Secured First Lien Notes). We used the net proceeds of the Senior Secured First Lien Notes to reduce indebtedness under our senior secured term loan Credit Facility.

Our fiscal year ends on the Saturday closest to January 31. We refer to our fiscal year end based on the year in which the fiscal year begins.

An amendment to this Annual Report on Form 10-K to include Part III of the Form 10-K will be filed with the Securities and Exchange Commission no later than 120 days after the end of Fiscal 2011.

#### **Statement Regarding Forward-Looking Disclosures**

This Annual Report on Form 10-K contains 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. We and our representatives may from time to time make written or oral forward-looking statements, including statements contained in this and other filings with the Securities and Exchange Commission and in our press releases and reports to stockholders. All statements which address operating performance, events or developments that we expect or anticipate will occur in the future, including statements relating to our future financial performance, business strategy, planned capital expenditures, ability to service our debt, and new store openings for future fiscal years, are forward-looking statements. The forward-looking statements are and will be based on management's then current views and assumptions regarding future events and operating performance, and we assume no obligation to update any forward-looking statement. The forward-looking statements may use the words expect, anticipate, plan, intend, project, may, believe, forecast, and similar expressions. Forward-looking statements involve known or unknown risks, uncertainties and other factors, including changes in estimates and judgments discussed under Critical Accounting Policies and Estimates which may cause our actual results, performance or achievements, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Some of these risks, uncertainties and other factors are as follows: our level of indebtedness; general economic conditions; changes in consumer preferences and consumer spending; competition; general political and social conditions such as war, political unrest and terrorism; natural disasters or severe

**Table of Contents**

weather events; currency fluctuations and exchange rate adjustments; failure to maintain our favorable brand recognition; failure to successfully market our products through new channels, such as e-commerce; uncertainties generally associated with the specialty retailing business; disruptions in our supply of inventory; inability to increase same store sales; inability to renew, replace or enter into new store leases on favorable terms; significant increases in our merchandise markdowns; inability to grow our store base in Europe; inability to grow our international store base through franchise or similar licensing arrangements; inability to design and implement new information systems; delays in anticipated store openings or renovations; changes in applicable laws, rules and regulations, including changes in North American, European or other international laws and regulations governing the sale of our products, particularly regulations relating to heavy metal and chemical content in our products; changes in employment laws relating to overtime pay, tax laws and import laws; product recalls; loss of key members of management; increase in the costs of healthcare for our employees; increases in the cost of labor; labor disputes; unwillingness of vendors and service providers to supply goods or services pursuant to historical customary credit arrangements; increases in the cost of borrowings; unavailability of additional debt or equity capital; and the impact of our substantial indebtedness on our operating income and our ability to grow. In addition, we typically earn a disproportionate share of our operating income in the fourth quarter due to seasonal buying patterns, which are difficult to forecast with certainty. The Company undertakes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances.

## Table of Contents

### **Item 1. Business** **The Company**

We are one of the world's leading specialty retailers of fashionable accessories and jewelry at affordable prices for young women, teens, tweens, and girls ages 3 to 27. We are organized based on our geographic markets, which include our North America division and our Europe division. As of January 28, 2012, we operated a total of 3,071 stores, of which 1,953 were located in all 50 states of the United States, Puerto Rico, Canada, and the U.S. Virgin Islands (our North America division) and 1,118 stores were located in the United Kingdom, France, Switzerland, Spain, Ireland, Austria, Germany, Netherlands, Portugal, Belgium, Poland, Czech Republic and Hungary (our Europe division). We operate our stores under two brand names: Claire's®, on a global basis, and Icing®, in North America.

As of January 28, 2012, we also franchised or licensed 381 stores in Japan, the Middle East, Turkey, Russia, Greece, Guatemala, Malta, Ukraine, Mexico and India. We account for the goods we sell to third parties under franchising agreements within Net sales and Cost of sales, occupancy and buying expenses in our Consolidated Statements of Operations and Comprehensive Income. The franchise fees we charge under the franchising agreements are reported in Other (income) expense, net in our Consolidated Statements of Operations and Comprehensive Income.

Until September 2, 2010, we operated the stores in Japan through our former Claire's Nippon 50:50 joint venture with Aeon Co., Ltd. We accounted for the results of operations of Claire's Nippon under the equity method and included the results within Other (income) expense, net in our Consolidated Statements of Operations and Comprehensive Income. Beginning September 2, 2010, these stores began to operate as licensed stores.

Our primary brand in North America and exclusively in Europe is Claire's. Our Claire's customers are predominantly teens (ages 13 to 18), tweens (ages 7 to 12) and kids (ages 3 to 6), or referred to as our Young, Younger and Youngest target customer groups.

Our second brand in North America is Icing, which targets a single edit point customer represented by a 23 year old young woman just graduating from college and entering the work force who dresses consistent with the current fashion influences. We believe this niche strategy enables us to create a well defined merchandise point of view and attract a broad group of customers from 19 to 27 years of age.

We believe that we are the leading accessories and jewelry destination for our target customers, which is embodied in our mission statement to be a fashion authority and fun destination offering a compelling, focused assortment of value-priced accessories, jewelry and other emerging fashion categories targeted to the lifestyles of kids, tweens, teens and young women. In addition to age segmentation, we use multiple lifestyle aesthetics to further differentiate our merchandise assortments for our Young and Younger target customer groups.

We provide our target customer groups with a significant selection of fashionable merchandise across a wide range of categories, all with a compelling value proposition. In Fiscal 2011, the average global selling price of our merchandise increased 4% from the prior year to \$6.24 and the net average global transaction sales value increased 4% to \$15.26. In Fiscal 2011, our accessories categories represented approximately 54% of our business.

Our major categories of business are:

Accessories includes fashion accessories for year-round use, including legwear, headwear, attitude glasses, scarves, armwear and belts, and seasonal use, including sunglasses, hats, fall footwear, sandals, scarves, gloves, boots, slippers and earmuffs; and other accessories, including hairgoods, handbags, and small leather goods, as well as cosmetics

Jewelry includes earrings, necklaces, bracelets, body jewelry and rings, as well as ear piercing

## **Table of Contents**

In North America, our stores are located primarily in shopping malls and average approximately 976 square feet of selling space. The differentiation of our Claire's and Icing brands allows us to operate multiple store locations within a single mall. In Europe, our stores are located primarily on high streets, in shopping malls and in high traffic urban areas and average approximately 650 square feet of selling space.

### **Our Competitive Strengths**

***Strong Claire's Name Brand Recognition Across the Globe.*** A Claire's store is located in approximately 90% of all major U.S. shopping malls and in 32 countries outside of the U.S., including stores that we franchise or license. According to our estimates, more than 95% of our target demographics recognize the Claire's brand. In 2011, we launched our e-commerce platform, partly to enhance our brand awareness and strengthen our relationships with our customers. In addition, we leverage our Facebook fan base and employ social media, email and text campaigns to ensure we are constantly communicating with our customers. Our Claire's brand is regularly featured in editorial coverage and relevant fashion periodicals.

***Diversification Across Geographies and Merchandise Categories.*** As of January 28, 2012, we operated a total of 3,071 stores, of which 1,953 were located across all 50 states of the United States, plus Puerto Rico, Canada, and the U.S. Virgin Islands. As of January 28, 2012, we also operated 1,118 stores in 13 countries throughout Europe, and 381 stores in 18 countries mainly outside of Europe and North America through our franchise and licensed operations.

During Fiscal 2011 and Fiscal 2010, we generated approximately 63% and 64%, respectively, of our net sales from the North America division and 37% and 36%, respectively, from the 13 countries in our Europe division. Our net sales are not dependent on any one category, product or style and are diversified across approximately 8,000 ongoing stock-keeping units (SKUs) in our stores. This multi-classification approach allows us to capitalize across a broad spectrum of trends, ideas and merchandise concepts, while not being dependent on any one of them.

***Cost-Efficient Global Sourcing Capabilities.*** Our merchandising strategy is supported by efficient, low-cost global sourcing capabilities diversified across approximately 650 suppliers located primarily outside the United States. Our contracts with vendors are short-term in nature and do not require a significant lead time. A significant portion of our product offering is designed and developed internally. This aspect of our merchandise strategy, together with our vertically-integrated global buying and sourcing group based in Hong Kong, enable us to buy and source merchandise rapidly and cost effectively. Approximately 90% of our merchandise offering is proprietary.

***Highly Leverageable and Flexible Cost Structure.*** We have enhanced the flexibility and scalability of our cost structure and realized significant cost savings, primarily by employing a new store labor staffing model, managing our occupancy costs and completing a Pan-European transformation. Our store staffing model has enabled us to allocate hours based on sales per labor hour, thereby improving our labor productivity. We improved our store portfolio position and slowed the growth rate of occupancy costs by closing 115 unprofitable stores and favorably renegotiating 965 leases. We continue to seek opportunities to lower costs and to improve the profitability flow-through of incremental sales.

***Substantial Free Cash Flow Generation.*** We generate substantial free cash flow to service interest cost and repay debt. Our cash flow generation is driven by our strong gross margins, efficient operating structure, low annual maintenance capital expenditures and flexible growth capital expenditure initiatives. Our minimal working capital requirements result from high merchandise margins, low unit cost of merchandise and the limited seasonality of our business. Over the past three fiscal years, no single quarter represented less than 22% or more than 31% of annual net sales for the respective year.

***Strong and Experienced Senior Management Team.*** We have a strong and experienced senior management team with extensive global, retail experience and complementary expertise. Jim Conroy, our Corporate President, oversees the global business. Mr. Conroy has over 20 years of retail experience, including as a management consultant and retail executive. Jay Friedman, President of our North America Division, has over 26 years of experience in operating and managing major divisions of several large-scale, multi-unit retail and apparel businesses, including, most recently, Jones Apparel Group, and, previously Footlocker and Etienne Aigner. Messrs. Conroy and Friedman are currently jointly serving as interim chief executive.



## **Table of Contents**

officers while we conduct a search for a new chief executive officer. Beatrice Lafon, President of our Europe Division, brings to the Company 30 years of Pan-European retail experience, including executive positions with TJ Hughes and Animal Ltd. in the UK, Etam Group in the Netherlands, and Woolworths Group, as well as serving as a retail consultant. Per Brodin, our Executive Vice President and Chief Financial Officer, has extensive financial accounting and management skills within and outside of the retail industry.

### **Business Strategy**

Our business strategy is built on two key components:

*Drive organic growth through our merchandise, stores, and customer offense.* In order to maximize our organic growth potential, drive same store sales improvement and sustain margins, our efforts are focused on three foundational areas of the business:

Enhance Relevance of Merchandise Assortment: We are focused on enhancing the fashion-orientation and quality of our product offering to deliver a unique, proprietary assortment that is highly relevant to our target customers. We are enabling these enhancements through investments in fashion and trend forecasting, product design and development, and in the enhancement of our Hong Kong-based sourcing office. We continue to focus on growing the breadth and quality of our multi-classification accessories assortment offering, while maintaining our market leadership in jewelry.

Improve Quality and Consistency of In-Store Experience: In our over 3,400 owned, franchised and licensed stores worldwide, our objective is to provide a consistent, engaging, and brand-right customer experience. We are continually improving our in-store presentation of merchandise and marketing collateral through a rigorous planning and communication process, resulting in improved execution and increased consistency across the chain and, ultimately, a superior shopping experience. We have invested in our store management teams and taken specific actions to improve the sales productivity of our store associates.

Strengthen Customer Relationships: We have made significant strides to build deeper customer relationships and support our brands. We launched a new, innovative *claires.com* website that uses customer-generated content, conveys a real-life interaction with our customers, and presents an authoritative fashion position. We further drive brand awareness and relevance with our ongoing social media, email, and text campaigns, which leverage our Facebook fan base and proprietary customer database. In parallel with our digital efforts, we have significantly upgraded our in-store marketing collateral in order to present a much more fashionable brand image that appeals to our target customers.

*Expand our global reach.* Our Claire's concept is portable across diverse geographies and approximately 95% of our stores worldwide are cash flow positive. We have compelling unit economics that enable us to realize an attractive return on investment for new stores.

We will extend our global reach in four primary ways:

Build New Company-owned Claire's Stores: We opened 157 new stores in 2011; 129 in Europe and 28 in North America. In addition, we have plans to open approximately 125-130 new stores in 2012, the majority of which will be in Europe.

Build New Company-owned Icing Stores: As we refine the Icing brand concept, we believe there is significant opportunity to increase the store penetration in North America, as well as to roll out the concept on a global basis to markets where we can leverage the existing Claire's infrastructure.

Open International Markets: Building on our refined franchising model, which is present in multiple geographies worldwide, we will pursue high potential white space opportunities in new markets globally. In 2011, we entered into Mexico and India under our franchise model. We have initiated our brand entrance strategy for China and intend to open Company-owned stores in 2012. We are further developing our brand entrance strategies for Southeast Asia and other countries in Latin America and are pursuing

development opportunities through either our franchise model or company-owned stores.

**Table of Contents**

**Grow Our E-commerce Sales:** In fiscal 2011, we launched our U.S. e-commerce business, enabling our customers to browse and purchase our product offerings online and to enjoy editorial content and product information. We believe our online platform allows our technology-savvy target customers to shop Claire's at her convenience. We intend to scale our e-commerce business domestically, including through the addition of a mobile site this year, and explore international e-commerce opportunities in the future. In addition, we believe that, over time, our online platform will evolve into an important tool for gathering customer feedback on our customers' preferences and enhancing our product testing capabilities, both of which should drive higher sales productivity.

This business strategy will allow us to maximize our sales opportunities, while driving our earnings with commensurate flow through and cash flow.

**Stores**

Our stores in North America are located primarily in shopping malls and average approximately 976 square feet of selling space. Our stores in Europe are located primarily on high streets, in shopping malls and in high traffic urban locations and average approximately 650 square feet of selling space. Our store hours are dictated by shopping mall operators and our stores are typically open from 10:00 a.m. to 9:00 p.m. Monday through Saturday and, where permitted by law, from noon to 5:00 p.m. on Sunday. Approximately 79% of our sales in Fiscal 2011 were made in cash (including checks and debit card transactions), with the balance made by credit cards. We permit, with restrictions on certain items, returns for exchange or refund.

**Store Management**

Our stores are organized and controlled on a district level. We employ District Managers, each of whom supervises store managers and the business in their respective geographic area and report to Regional Managers.

In North America, each Regional Manager reports to Territorial Vice Presidents, who report to the Senior Vice President of Stores. Each store is typically staffed by a Manager, an Assistant Manager and one or more part-time employees.

In Europe, District Sales Managers report to Regional Sales Managers who report to either Country Managers or directly to the Senior Vice President of Stores. We now have four operating zones within Europe: (Zone 1) United Kingdom and Ireland; (Zone 2) France, Spain, Portugal and Belgium; (Zone 3) Switzerland, Austria, Netherlands and Germany; and (Zone 4) Poland, Czech Republic and Hungary.

**Store Openings, Closings and Future Growth**

In Fiscal 2011, we opened 157 stores and closed 67 underperforming stores, for a net increase of 90 stores. In Europe, we increased our store count by 109 stores, net, resulting in a total of 1,118 stores. In North America, we decreased our store count by 19 stores, net, to 1,953 stores. Stores, net refers to stores opened, net of closings.

	January 28, 2012	January 29, 2011	January 30, 2010
<b>Store Count as of:</b>			
North America	1,953	1,972	1,993
Europe	1,118	1,009	955
Subtotal Company-Owned	3,071	2,981	2,948
Joint Venture			211
Franchise and License	381	395	195
Subtotal Non-Owned	381	395	406
Total	3,452	3,376	3,354



## **Table of Contents**

We plan to open approximately 125-130 Company-owned stores globally in Fiscal 2012. We also plan to continue opening stores when suitable locations are found and satisfactory lease negotiations are concluded. Our initial investment in new stores opened during Fiscal 2011, which includes leasehold improvements and fixtures, averaged approximately \$238,000 per store globally. In addition to the investment in leasehold improvements and fixtures, we may also purchase intangible assets or incur initial direct costs for leases relating to certain store locations in our Europe operations.

### **Purchasing and Distribution**

In Fiscal 2011, our global purchasing unit purchased 90% of its merchandise inventories from approximately 100 suppliers, none of which represented more than five percent of total purchases made by our global purchasing unit. Approximately 87% of our merchandise in Fiscal 2011 was purchased from vendors based outside the United States, including approximately 69% purchased from China. We are not dependent on any single supplier for merchandise purchased. Merchandise for our North America stores is shipped from our distribution facility in Hoffman Estates, Illinois, a suburb of Chicago. Our distribution facility in Birmingham, United Kingdom services all of our stores in Europe. We distribute merchandise to our franchisees and licensee from a third party operated distribution center in Hong Kong. Merchandise is shipped from our distribution centers by common carrier to our individual store locations. To keep our assortment fresh and exciting, we typically ship merchandise to our stores three to five times a week.

### **Trademarks and Service Marks**

We are the owner in the United States of various marks, including Claire's, Claire's Accessories, Icing, and Icing by Claire's. We have also registered these marks outside of the United States. We currently license certain of our marks under franchising and licensing arrangements in Japan, the Middle East, Turkey, Russia, Greece, Guatemala, Malta, Ukraine, Mexico and India. We believe our rights in our marks are important to our business and intend to maintain our marks and the related registrations.

### **Information Technology**

Information technology is important to our business success. Our information and operational systems use a broad range of both purchased and internally developed applications to support our retail operations, financial, real estate, merchandising, inventory management and marketing processes. Sales information is generally collected from point of sale terminals in our stores on a daily basis. We have developed proprietary software to support key decisions in various areas of our business including merchandising, allocation and operations. We periodically review our critical systems to evaluate disaster recovery plans and the security of our systems.

### **Competition**

The specialty retail business is highly competitive. We compete on a global, national, regional, and local level with other specialty and discount store chains and independent retail stores. Our competition also includes Internet, direct marketing to consumer, and catalog businesses. We also compete with department stores, mass merchants, and other chain store concepts. We cannot estimate the number of our competitors because of the large number of companies in the retail industry that fall into one of these categories. We believe the main competitive factors in our business are brand recognition, merchandise assortments for each target customer, compelling value, store location and the shopping experience.

### **Seasonality**

Sales of each category of merchandise vary from period to period depending on current trends. We experience traditional retail patterns of peak sales during the Christmas, Easter, and back-to-school periods. Sales as a percentage of total sales in each of the four quarters of Fiscal 2011 were 23%, 24%, 24% and 29%, respectively.

**Table of Contents**

**Employees**

On January 28, 2012, we employed approximately 18,300 employees, 61% of whom were part-time. Part-time employees typically work up to 20 hours per week. We do not have collective bargaining agreements with any labor unions, and we consider employee relations to be good.

**Further Information**

We make available free of charge through the financial page of our website at [www.clairestores.com](http://www.clairestores.com) our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission.

## **Table of Contents**

### **Item 1A. Risk Factors**

*These risks could have a material adverse effect on our business, financial position or results of operations. The following risk factors may not include all of the important factors that could affect our business or our industry or that could cause our future financial results to differ materially from historic or expected results.*

#### **Risks Relating to Economic Conditions**

***Economic conditions may adversely impact demand for our merchandise, reduce access to credit and cause our customers and others with whom we do business to suffer financial hardship, all of which could adversely impact our business, results of operations, financial condition and cash flows.***

Consumer purchases of discretionary items, including our merchandise, generally decline during recessionary periods and other periods where disposable income is adversely affected. Some of the factors impacting discretionary consumer spending include general economic conditions, wages and employment, consumer debt, the availability of customer credit, currency exchange rates, taxation, fuel and energy prices, interest rates, consumer confidence and other macroeconomic factors. Downturns in the economy typically affect consumer purchases of merchandise and could adversely impact our results of operations and continued growth.

The distress in the financial markets experienced in the last several years, including the recent European debt crisis, resulted in volatility in security prices and has had a negative impact on credit availability, and there can be no assurance that our liquidity will not be affected by future changes in the financial markets and the global economy or that our capital resources will at all times be sufficient to satisfy our liquidity needs. Distress in the financial markets also had a negative impact on businesses around the world, and the future impact to our suppliers cannot be predicted. The inability of our suppliers to access liquidity or trade credit could lead to delays or failures in delivery of merchandise to us.

We have significant amounts of cash and cash equivalents at financial institutions that are in excess of federally insured limits. With the current financial environment and the instability of financial institutions, we cannot be assured that we will not experience losses on our deposits.

#### **Risks Relating to Our Company**

***Fluctuations in consumer preference may adversely affect the demand for our products and result in a decline in our sales.***

Our retail fashion accessories and jewelry business fluctuates according to changes in consumer preferences. If we are unable to anticipate, identify or react to changing styles or trends, our sales may decline, and we may be faced with excess inventories. If this occurs, we may be forced to rely on additional markdowns or promotional sales to dispose of excess or slow moving inventory, which could have a material adverse effect on our results of operations and adversely affect our gross margins. In addition, if we miscalculate customer tastes and our customers come to believe that we are no longer able to offer merchandise that appeals to them, our brand image may suffer.

***Advance purchases of our merchandise make us vulnerable to changes in consumer preferences and pricing shifts and may negatively affect our results of operations.***

Fluctuations in the demand for retail accessories and jewelry especially affect the inventory we sell because we order our merchandise in advance of the applicable season and sometimes before trends are identified or evidenced by customer purchases. In addition, the cyclical nature of the retail business requires us to carry a significant amount of inventory, especially prior to peak selling seasons when we and other retailers generally build up inventory levels. We must enter into contracts for the purchase and manufacture of merchandise with our suppliers in advance of the applicable selling season. As a result, we are vulnerable to demand and pricing shifts and it is more difficult for us to respond to new or changing customer needs. Our financial condition could be materially adversely affected if we are unable to manage

## **Table of Contents**

inventory levels and respond to short-term shifts in client demand patterns. Inventory levels in excess of client demand may result in excessive markdowns and, therefore, lower than planned margins. If we underestimate demand for our merchandise, on the other hand, we may experience inventory shortages resulting in missed sales and lost revenues. Either of these events could negatively affect our operating results and brand image.

### ***A disruption of imports from our foreign suppliers may increase our costs and reduce our supply of merchandise.***

We do not own or operate any manufacturing facilities. We purchased merchandise from approximately 650 suppliers in Fiscal 2011. Approximately 87% of our Fiscal 2011 merchandise was purchased from suppliers outside the United States, including approximately 69% purchased from China. Any event causing a sudden disruption of imports from China or other foreign countries, including political and financial instability, would likely have a material adverse effect on our operations. We cannot predict whether any of the countries in which our products currently are manufactured or may be manufactured in the future will be subject to additional trade restrictions imposed by the United States and other foreign governments, including the likelihood, type or effect of any such restrictions. Trade restrictions, including increased tariffs or quotas, embargoes and customs restrictions, on merchandise that we purchase could increase the cost or reduce the supply of merchandise available to us and adversely affect our business, financial condition and results of operations. The United States has previously imposed trade quotas on specific categories of goods and apparel imported from China, and may impose additional quotas in the future. There has been increased international pressure on China regarding revaluation of the Chinese yuan, including U.S. Federal legislation to impose tariffs on imports from China unless the Chinese government revalues the Chinese yuan. Such legislation has passed the U.S. Senate but remains pending before the U.S. House of Representatives.

### ***Fluctuations in foreign currency exchange rates could negatively impact our results of operations.***

Substantially all of our foreign purchases of merchandise are negotiated and paid for in U.S. dollars. As a result, our sourcing operations may be adversely affected by significant fluctuation in the value of the U.S. dollar against foreign currencies. We are also exposed to the gains and losses resulting from the effect that fluctuations in foreign currency exchange rates have on the reported results in our Consolidated Financial Statements due to the translation of operating results and financial position of our foreign subsidiaries. We purchased approximately 69% of our merchandise from China in Fiscal 2011. During Fiscal 2011, the Chinese yuan strengthened against the U.S. dollar, and this trend may continue in Fiscal 2012. An increase in the Chinese yuan against the dollar means that we will have to pay more in U.S. dollars for our purchases from China. If we are unable to negotiate commensurate price decreases from our Chinese suppliers, these higher prices would eventually translate into higher costs of sales, which could have a material adverse effect on our operating results.

### ***Our business depends on the willingness of vendors and service providers to supply us with goods and services pursuant to customary credit arrangements which may not be available to us in the future.***

Like most companies in the retail sector, we purchase goods and services from trade creditors pursuant to customary credit arrangements. If we are unable to maintain or obtain trade credit from vendors and service providers on terms favorable to us, or at all, or if vendors and service providers are unable to obtain trade credit or factor their receivables, then we may not be able to execute our business plan, develop or enhance our products or services, take advantage of business opportunities or respond to competitive pressures, any of which could have a material adverse effect on our business. In addition, the tightening of trade credit could limit our available liquidity.

### ***The failure to grow our store base outside of North America or expand our international franchising may adversely affect our business.***

Our growth plans include expanding our store base outside of North America, with plans to expand our store base in Europe, Asia, and South America. Our ability to grow successfully outside of North America depends in part on determining a sustainable formula to build customer loyalty and gain market share in certain especially challenging international retail environments. Additionally, the integration of our operations in foreign countries presents certain challenges not necessarily presented in the integration of our North America operations.



## **Table of Contents**

We plan to expand into new countries by entering into franchising and licensing agreements with unaffiliated third parties who are familiar with the local retail environment and have sufficient retail experience to operate stores in accordance with our business model, which requires strict adherence to the guidelines established by us in our franchising agreements. Failure to identify appropriate franchisees or negotiate acceptable terms in our franchising and licensing agreements that meet our financial targets would adversely affect our international expansion goals, and could have a material adverse effect on our operating results and impede our strategy of increasing our net sales through expansion.

***Our cost of doing business could increase as a result of changes in federal, state, local and international regulations regarding the content of our merchandise.***

The Consumer Product Safety Improvement Act of 2008 ( CPSIA ), in general, bans the sale of children's products containing lead in excess of certain maximum standards, and imposes other restrictions and requirements on the sale of children's products, including importing, testing and labeling requirements. Accordingly, merchandise covered by the CPSIA that is sold to our Younger and Youngest customers is subject to the CPSIA. In addition, various states, from time to time, propose or enact legislation regarding heavy metals or chemicals in products that differ from federal laws. We are also subject to various other health and safety rules and regulations, such as the Federal Food Drug and Cosmetic Act and the Federal Hazardous Substance Act. Our inability to comply with these regulatory requirements, or other existing or newly adopted regulatory requirements, could increase our cost of doing business or result in significant fines or penalties that could have a material adverse effect on our business, results of operations, financial condition and cash flows.

In addition to regulations governing the sale of our merchandise in the United States and Canada, we are also subject to regulations governing the sale of our merchandise in our Europe stores. The European Union REACH legislation requires identification and disclosure of chemicals in consumer products, including chemicals that might be in the merchandise that we sell. Over time, this regulation, among other items, may require us to substitute certain chemicals contained in our products with substances the EU considers safer. Our failure to comply with this European Union legislation could result in significant fines or penalties and increase our cost of doing business.

***Recalls, product liability claims, and government, customer or consumer concerns about product safety could harm our reputation, increase costs or reduce sales.***

We are subject to regulation by the Consumer Product Safety Commission and similar state and international regulatory authorities, and our products could be subject to involuntary recalls and other actions by these authorities. Concerns about product safety, including but not limited to concerns about the safety of products manufactured in China (where most of our products are manufactured), could lead us to recall selected products. Recalls and government, customer or consumer concerns about product safety could harm our reputation, increase costs or reduce sales, any of which could have a material adverse effect on our financial results.

***If we are unable to renew or replace our store leases or enter into leases for new stores on favorable terms, or if any of our current leases are terminated prior to the expiration of their stated term and we cannot find suitable alternate locations, our growth and profitability could be adversely harmed.***

All of our stores are leased. Our ability to renew any expired lease or, if such lease cannot be renewed, our ability to lease a suitable alternate location, and our ability to enter into leases for new stores on favorable terms will depend on many factors which are not within our control, such as conditions in the local real estate market, competition for desirable properties, our relationships with current and prospective landlords, and negotiating acceptable lease terms that meet our financial targets. Our ability to operate stores on a profitable basis depends on various factors, including whether we have to take additional merchandise markdowns due to excessive inventory levels compared to sales trends, whether we can reduce the number of under-performing stores which have a higher level of fixed costs in comparison to net sales, and our ability to maintain a proportion of new stores to mature stores that does not harm existing sales. If we are unable to renew existing leases or lease suitable alternate locations, enter into leases for new stores on favorable terms, or increase our same store sales, our growth and our profitability could be adversely affected.

## **Table of Contents**

***Natural disasters or unusually adverse weather conditions or potential emergence of disease or pandemic could adversely affect our net sales or supply of inventory.***

Unusually adverse weather conditions, natural disasters, potential emergence of disease or pandemic or similar disruptions, especially during peak holiday selling seasons, but also at other times, could significantly reduce our net sales. In addition, these disruptions could also adversely affect our supply chain efficiency and make it more difficult for us to obtain sufficient quantities of merchandise from suppliers, which could have a material adverse effect on our financial position, earnings, and cash flow.

***Information technology systems changes may disrupt our supply of merchandise.***

Our success depends, in large part, on our ability to source and distribute merchandise efficiently. We continue to evaluate and leverage the best of both our North America and Europe information systems to support our product supply chain, including merchandise planning and allocation, inventory and price management. We also continue to evaluate and implement modifications and upgrades to our information technology systems. Modifications involve replacing legacy systems with successor systems or making changes to the legacy systems and our ability to maintain effective internal controls. We are aware of inherent risks associated with replacing and changing these core systems, including accurately capturing data, and possibly encountering supply chain disruptions. There can be no assurances that we will successfully launch these new systems as planned or that they will occur without disruptions to our operations. Information technology system disruptions, if not anticipated and appropriately mitigated, could have a material adverse effect on our operations.

***If we experience a data security breach and confidential customer information is disclosed, we may be subject to penalties and experience negative publicity, which could affect our customer relationships and have a material adverse effect on our business.***

We and our customers could suffer harm if customer information were accessed by third parties due to a security failure in our systems. The collection of data and processing of transactions require us to receive and store a large amount of personally identifiable data. This type of data is subject to legislation and regulation in various jurisdictions. Data security breaches suffered by well-known companies and institutions have attracted a substantial amount of media attention, prompting state and federal legislative proposals addressing data privacy and security. We may become exposed to potential liabilities with respect to the data that we collect, manage and process, and may incur legal costs if our information security policies and procedures are not effective or if we are required to defend our methods of collection, processing and storage of personal data. Future investigations, lawsuits or adverse publicity relating to our methods of handling personal data could adversely affect our business, results of operations, financial condition and cash flows due to the costs and negative market reaction relating to such developments.

***Changes in the anticipated seasonal business pattern could adversely affect our sales and profits and our quarterly results may fluctuate due to a variety of factors.***

Our business typically follows a seasonal pattern, peaking during the Christmas, Easter and back-to-school periods. Seasonal fluctuations also affect inventory levels, because we usually order merchandise in advance of peak selling periods. Our quarterly results of operations may also fluctuate significantly as a result of a variety of factors, including the time of store openings, the amount of revenue contributed by new stores, the timing and level of markdowns, the timing of store closings, expansions and relocations, competitive factors and general economic conditions.

***A decline in number of people who go to shopping malls, particularly in North America, could reduce the number of our customers and reduce our net sales.***

Substantially all of our North America stores are located in shopping malls. Our North America sales are derived, in part, from the high volume of traffic in those shopping malls. We benefit from the ability of the shopping mall's anchor tenants, generally large department stores and other area attractions, to

## **Table of Contents**

generate consumer traffic around our stores. We also benefit from the continuing popularity of shopping malls as shopping destinations for girls and young women. Sales volume and shopping mall traffic may be adversely affected by economic downturns in a particular area, competition from non-shopping mall retailers, other shopping malls where we do not have stores and the closing of anchor tenants in a particular shopping mall. In addition, a decline in the popularity of shopping malls among our target customers that may curtail customer visits to shopping malls, could result in decreased sales that would have a material adverse affect on our business, financial condition and results of operations.

### ***Our industry is highly competitive.***

The specialty retail business is highly competitive. We compete with international, national and local department stores, specialty and discount store chains, independent retail stores, e-commerce services, digital content and digital media devices, web services, direct marketing to consumers and catalog businesses that market similar lines of merchandise. Many of our competitors are companies with substantially greater financial, marketing and other resources. Given the large number of companies in the retail industry, we cannot estimate the number of our competitors. Although we launched our e-commerce site in 2011, significant shifts in customer buying patterns to purchasing fashionable accessories and jewelry at affordable prices through channels other than traditional shopping malls, such as e-commerce, could have a material adverse effect on our financial results.

### ***Adoption of new or revised employment and labor laws and regulations could make it easier for our employees to obtain union representation and our business could be adversely impacted.***

Currently, none of our employees in North America are represented by unions. However, our employees have the right at any time under the National Labor Relations Act to form or affiliate with a union. If some or all of our workforce were to become unionized and the terms of the collective bargaining agreement were significantly different from our current compensation arrangements, it could increase our costs and adversely impact our profitability. Any changes in regulations, the imposition of new regulations, or the enactment of new legislation could have an adverse impact on our business, to the extent it becomes easier for workers to obtain union representation.

### ***Higher health care costs and labor costs could adversely affect our business.***

With the passage in 2010 of the *U.S. Patient Protection and Affordable Care Act*, we are required to, provide affordable coverage, as defined in the Act, to all employees, or otherwise be subject to a payment per employee based on the affordability criteria in the Act: cover adult children of our employees to age 26; delete lifetime limits; and delete pre-existing condition limitations. Many of these requirements, some of which have been challenged on legal grounds, will be phased in over a period of time. Additionally, some states and localities have passed state and local laws mandating the provision of certain levels of health benefits by some employers. Increased health care and insurance costs could have a material adverse effect on our business, financial condition and results of operations. In addition, changes in the federal or state minimum wage or living wage requirements or changes in other workplace regulations could adversely affect our ability to meet our financial targets.

### ***Our profitability could be adversely affected by high petroleum prices.***

The profitability of our business depends to a certain degree upon the price of petroleum products, both as a component of the transportation costs for delivery of inventory from our vendors to our stores and as a raw material used in the production of our merchandise. We are unable to predict what the price of crude oil and the resulting petroleum products will be in the future. We may be unable to pass along to our customers the increased costs that would result from higher petroleum prices. Therefore, any such increase could have a material adverse impact on our business and profitability.

### ***The possibility of war and acts of terrorism could disrupt our information or distribution systems and increase our costs of doing business.***

A significant act of terrorism could have a material adverse impact on us by, among other things, disrupting our information or distributions systems, causing dramatic increases in fuel prices, thereby increasing the costs of doing business and affecting consumer spending, or impeding the flow of imports or domestic products to us.

## **Table of Contents**

### ***We depend on our key personnel.***

Our ability to anticipate and effectively respond to changing trends and consumer preferences depends in part on our ability to attract and retain key personnel in our design, merchandising, marketing and other functions. We cannot be sure that we will be able to attract and retain a sufficient number of qualified personnel in future periods. We are currently conducting a search for a new Chief Executive Officer to replace our former Chief Executive Officer who resigned in January 2012. The loss of services of other key members of our senior management team or of certain other key employees could also negatively affect our business.

### ***Litigation matters incidental to our business could be adversely determined against us.***

We are involved from time to time in litigation incidental to our business. Management believes that the outcome of current litigation will not have a material adverse effect on our results of operations or financial condition. Depending on the actual outcome of pending litigation, charges would be recorded in the future that may have an adverse effect on our operating results.

### ***Goodwill and indefinite-lived intangible assets comprise a significant portion of our total assets. We must test goodwill and indefinite-lived intangible assets for impairment at least annually or whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable; which could result in a material, non-cash write-down of goodwill or indefinite-lived intangible assets and could have a material adverse impact on our results of operations.***

Goodwill and indefinite-lived intangible assets are subject to impairment assessments at least annually (or more frequently when events or circumstances indicate that an impairment may have occurred) by applying a fair-value test. Our principal intangible assets, other than goodwill, are tradenames, franchise agreements, and leases that existed at date of acquisition with terms that were favorable to market at that date. We may be required to recognize additional impairment charges in the future. Additional impairment losses could have a material adverse impact on our results of operations and stockholder's deficit.

### ***There are factors that can affect our provision for income taxes.***

We are subject to income taxes in numerous jurisdictions, including the United States, individual states and localities, and internationally. Our provision for income taxes in the future could be adversely affected by numerous factors including, but not limited to, the mix of income and losses from our foreign and domestic operations that may be taxed at different rates, changes in the valuation of deferred tax assets and liabilities, and changes in tax laws, regulations, accounting principles or interpretations thereof, which could adversely impact earnings in future periods. In addition, the estimates we make regarding domestic and foreign taxes are based on tax positions that we believe are supportable, but could potentially be subject to successful challenge by the Internal Revenue Service or other authoritative agencies. If we are required to settle matters in excess of our established accruals for uncertain tax positions, it could result in a charge to our earnings.

### ***If our independent manufacturers, franchisees or licensees do not use ethical business practices or comply with applicable laws and regulations, our brand name could be harmed due to negative publicity and our results of operations could be adversely affected.***

While our internal and vendor operating guidelines promote ethical business practices, we do not control our independent manufacturers, franchisees or licensees, or their business practices. Accordingly, we cannot guarantee their compliance with our guidelines. Violation of labor or other laws, such as the Foreign Corrupt Practices Act and the U.K. Bribery Act, by our independent manufacturers, franchisees or licensees, or the divergence from labor practices generally accepted as ethical in the United States, could diminish the value of our brand and reduce demand for our merchandise if, as a result of such violation, we were to attract negative publicity. As a result, our results of operations could be adversely affected.

## **Table of Contents**

***We rely on third parties to deliver our merchandise and if these third parties do not adequately perform this function, our business would be disrupted.***

The efficient operation of our business depends on the ability of our third party carriers to ship merchandise directly to our distribution facilities and individual stores. These carriers typically employ personnel represented by labor unions and have experienced labor difficulties in the past. Due to our reliance on these parties for our shipments, interruptions in the ability of our vendors to ship our merchandise to our distribution facilities or the ability of carriers to fulfill the distribution of merchandise to our stores could adversely affect our business, financial condition and results of operations.

***We depend on single North America, Europe and International distribution facilities.***

We handle merchandise distribution for all of our North America stores from a single facility in Hoffman Estates, Illinois, a suburb of Chicago, Illinois. We handle merchandise distribution for all of our Europe operations from a single facility in Birmingham, United Kingdom. We handle merchandise distribution for all of our international franchise operations from a single facility in Hong Kong. Independent third party transportation companies deliver our merchandise to our stores and our clients. Any significant interruption in the operation of our distribution facilities or the domestic transportation infrastructure due to natural disasters, accidents, inclement weather, system failures, work stoppages, slowdowns or strikes by employees of the transportation companies, or other unforeseen causes could delay or impair our ability to distribute merchandise to our stores, which could result in lower sales, a loss of loyalty to our brands and excess inventory and would have a material adverse effect on our business, financial condition and results of operations.

***We may be unable to protect our tradenames and other intellectual property rights.***

We believe that our tradenames and service marks are important to our success and our competitive position due to their name recognition with our customers. There can be no assurance that the actions we have taken to establish and protect our tradenames and service marks will be adequate to prevent imitation of our products by others or to prevent others from seeking to block sales of our products as a violation of the tradenames, service marks and proprietary rights of others. The laws of some foreign countries may not protect proprietary rights to the same extent as do the laws of the United States, and it may be more difficult for us to successfully challenge the use of our proprietary rights by other parties in these countries. Also, others may assert rights in, or ownership of, our tradenames and other proprietary rights, and we may be unable to successfully resolve those types of conflicts to our satisfaction.

***Our success depends on our ability to maintain the value of our brands.***

Our success depends on the value of our Claire's and Icing brands. The Claire's and Icing names are integral to our business as well as to the implementation of our strategies for expanding our business. Maintaining, promoting and positioning our brands will depend largely on the success of our design, merchandising, and marketing efforts and our ability to provide a consistent, enjoyable quality client experience. Our brands could be adversely affected if we fail to achieve these objectives for one or both of these brands and our public image and reputation could be tarnished by negative publicity. Any of these events could negatively impact sales.

***We may be unable to rely on liability indemnities given by foreign vendors which could adversely affect our financial results.***

The quality of our globally sourced products may vary from our expectations and sources of our supply may prove to be unreliable. In the event we seek indemnification from our suppliers for claims relating to the merchandise shipped to us, our ability to obtain indemnification may be hindered by the supplier's lack of understanding of U.S. and European product liability laws. Our ability to successfully pursue indemnification claims may also be adversely affected by the financial condition of the supplier. Any of these circumstances could have a material adverse effect on our business and financial results.

## **Table of Contents**

*We are controlled by Affiliates of Apollo, and its interests as an equity holder may conflict with the interest of our creditors.*

We are controlled by Affiliates of Apollo Global Management, LLC and its subsidiaries, including Apollo Management (collectively, Apollo), and Apollo has the ability to elect all of the members of our board of directors and thereby control our policies and operations, including the appointment of management, future issuances of our common stock or other securities, the payments of dividends, if any, on our common stock, the incurrence of debt by us, amendments to our articles of incorporation and bylaws and the entering into of extraordinary transactions. The interests of Apollo may not in all cases be aligned with the interests of our creditors. For example, if we encounter financial difficulties or are unable to pay our indebtedness as it matures, the interests of Apollo as an equity holder might conflict with the interests of our creditors. In addition, Apollo may have an interest in pursuing acquisitions, divestitures, financings or other transactions that, in its judgment, could enhance its equity investments, even though such transactions might involve risks to our creditors. Furthermore, Apollo may in the future own businesses that directly or indirectly compete with us. Apollo also may pursue acquisition opportunities that may be complementary to our business, and as a result, those acquisition opportunities may not be available to us. So long as Apollo continues to own a significant amount of our combined voting power, even if such amount is less than 50%, it will continue to be able to strongly influence or effectively control our decisions. Because our equity securities are not registered under the Exchange Act and are not listed on any U.S. securities exchange, we are not subject to any of the corporate governance requirements of any U.S. securities exchange.

### **Risks Relating to Our Indebtedness**

*Our substantial leverage could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry and prevent us from meeting our obligations under the Credit Facility and Notes.*

We are significantly leveraged. As of January 28, 2012, our total debt was approximately \$2.40 billion, consisting of borrowings under our Credit Facility, the Notes and a capital lease obligation. In March 2012, we issued \$500.0 million aggregate principal amount of the Senior Secured First Lien Notes. We used the net proceeds from the note offering to reduce \$489.8 million of indebtedness under our senior secured term loan facility. As a result of our initial prepayment under the senior secured term loan Credit Facility in Fiscal 2011, we are no longer required to make any quarterly payments through the maturity date. Our Revolver matures in May 2013 and our senior secured term loan Credit Facility matures in May 2014. We cannot assure you that we will have the financial resources required, or that the conditions of the capital markets will support, any future refinancing or restructuring of those facilities or other indebtedness.

Our substantial leverage could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk to the extent of our variable rate debt and prevent us from meeting our obligations under the Credit Facility and Notes. Our high degree of leverage could have important consequences, including:

increasing our vulnerability to adverse economic, industry or competitive developments;

requiring a substantial portion of cash flow from operations to be dedicated to the payment of principal and interest on our indebtedness, therefore reducing our ability to use our cash flow to fund our operations, capital expenditures and future business opportunities;

exposing us to the risk of increased interest rates because certain of our borrowings, including borrowings under our Credit Facility, will be at variable rates of interest;

making it more difficult for us to satisfy our obligations with respect to our indebtedness, including the Notes, and any failure to comply with the obligations of any of our debt instruments, including restrictive covenants and borrowing conditions, could result in an event of default under the indentures governing the Notes and the agreements governing such other indebtedness;

restricting us from making strategic acquisitions or causing us to make non-strategic divestitures;



## **Table of Contents**

imposing restrictions on the operating of our business that may hinder our ability to take advantage of strategic opportunities to grow our business;

limiting our ability to obtain additional financing for working capital, capital expenditures, product development, debt service requirements, acquisitions and general corporate or other purposes, which could be exacerbated by further volatility in the credit markets; and

limiting our flexibility in planning for, or reacting to, changes in our business or market conditions and placing us at a competitive disadvantage compared to our competitors who are less highly leveraged and who therefore, may be able to take advantage of opportunities that our leverage prevents us from exploiting.

***Despite our high indebtedness level, we and our subsidiaries are still able to incur significant additional amounts of debt, which could further exacerbate the risks associated with our substantial indebtedness.***

We and our subsidiaries may be able to incur substantial additional indebtedness in the future. The indentures governing the Notes, and the Senior Secured First Lien Notes and our Credit Facility each contain restrictions on the incurrence of additional indebtedness. However, these restrictions are subject to a number of significant qualifications and exceptions, and under certain circumstances, the amount of indebtedness that could be incurred in compliance with these restrictions could be substantial. Accordingly, we and our subsidiaries may be able to incur substantial additional indebtedness in the future. As of January 28, 2012, we had undrawn availability under our Revolver of \$195.3 million. If new debt is added to our and our subsidiaries' existing debt levels, the related risks that we now face would increase. In addition, the indentures governing the Notes and the Senior Secured Second Lien Notes and our Credit Facility will not prevent us from incurring obligations that do not constitute indebtedness under those agreements.

On May 14, 2008, we notified the holders of the Senior Toggle Notes of our intent to elect the payment in kind (PIK) interest option to satisfy interest payment obligations. The PIK election is in effect through June 1, 2011, and had the effect of increasing the amount of Senior Toggle Notes. This election, net of reductions for note repurchases, increased the principal amount of our Senior Toggle Notes by \$109.5 million and \$98.1 million as of January 28, 2012 and January 29, 2011, respectively. The accrued payment in kind interest is included in Long-term debt in the Consolidated Balance Sheets. Effective June 2, 2011, the Company began accruing cash interest.

***Our debt agreements contain restrictions that limit our flexibility in operating our business.***

Our Credit Facility and the indentures governing the Notes and the Senior Secured First Lien Notes contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit our, our parent's and our restricted subsidiaries' ability to, among other things:

incur additional indebtedness or issue certain preferred shares;

pay dividends on, repurchase or make distributions in respect of our capital stock or make other restricted payments;

make certain investments;

transfer or sell certain assets;

create liens;

consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; and



enter into certain transactions with our affiliates.

A breach of any of these covenants could result in a default under one or more of these agreements, including as a result of cross default provisions, and, in the case of our revolving Credit Facility, permit the lenders to cease making loans to us. Upon the occurrence of an event of default under our Credit Facility, the lenders could elect to declare all amounts outstanding under our Credit Facility to be immediately due and payable and terminate all commitments to extend further credit. Such actions by those lenders could

## **Table of Contents**

cause cross defaults under our other indebtedness. If we were unable to repay those amounts, the lenders under our Credit Facility could proceed against the collateral granted to them to secure that indebtedness. We have pledged a significant portion of our assets as collateral under our Credit Facility. Our obligations under the Senior Secured Second Lien Notes are secured by a second-priority lien on substantially all of the assets pledged as collateral under the Credit Facility. Our obligations under the Senior Secured First Lien Notes are secured by a first-priority lien on substantially all of the assets pledged as collateral under the Credit Facility. If the lenders under our Credit Facility accelerate the repayment of borrowings, we may not have sufficient assets to repay our Credit Facility as well as our other indebtedness, including the Merger Notes, the Senior Secured Second Lien Notes, and Senior Secured First Lien Notes.

***We may not be able to generate sufficient cash to service all of our indebtedness, and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.***

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We may not be able to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal and interest on our indebtedness.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness, including the Notes. Our ability to restructure or refinance our debt will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of our debt could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business operations. The terms of our Credit Facility and the indentures governing the Notes and the Senior Secured First Lien Notes or any future debt instruments that we may enter into may restrict us from adopting some of these alternatives. In addition, any failure to make payments of interest and principal on our outstanding indebtedness on a timely basis would likely result in a reduction of our credit rating, which could harm our ability to incur additional indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

***Repayment of our debt is dependent on cash flow generated by our subsidiaries.***

Our subsidiaries own a significant portion of our assets and conduct a significant portion of our operations. Accordingly, repayment of our indebtedness is dependent, to a significant extent, on the generation of cash flow by our subsidiaries and their ability to make such cash available to us, by dividend, debt repayment or otherwise. Unless they are guarantors of the notes, our subsidiaries do not have any obligation to pay amounts due on the notes or to make funds available for that purpose. Our subsidiaries may not be able to, or may not be permitted to, make distributions to enable us to make payments in respect of our indebtedness. Each subsidiary is a distinct legal entity and, under certain circumstances, legal and contractual restrictions may limit our ability to obtain cash from our subsidiaries. While the indentures governing the Notes and the Senior Secured First Lien Notes limit the ability of our subsidiaries to incur consensual restrictions on their ability to pay dividends or make other intercompany payments to us, these limitations are subject to certain qualifications and exceptions. In the event that we do not receive distributions from our subsidiaries, we may be unable to make required principal and interest payments on our indebtedness.

***To service our debt obligations, we may need to increase the portion of the income of our foreign subsidiaries that is expected to be remitted to the United States, which could increase our income tax expense.***

The amount of the income of our foreign subsidiaries that we expect to remit to the United States may significantly impact our U.S. federal income tax expense. We record U.S. federal income taxes on that portion of the income of our foreign subsidiaries that is expected to be remitted to the United States. In order to service our debt obligations, we may need to increase the portion of the income of our foreign subsidiaries that we expect to remit to the United States, which may significantly increase our income tax expense. Consequently, our income tax expense has been, and will continue to be, impacted by our strategic initiative to make substantial capital investments outside the United States.

## **Table of Contents**

*If we default on our obligations to pay our other indebtedness, the holders of our debt could exercise rights that could have a material effect on us.*

If we are unable to generate sufficient cash flow and are otherwise unable to obtain funds necessary to meet required payments of principal, premium, if any, and interest on our indebtedness, or if we otherwise fail to comply with the various covenants, including financial and operating covenants in the instruments governing our indebtedness, we could be in default under the terms of the agreements governing such indebtedness. In the event of such default,

the holders of such indebtedness may be able to cause all of our available cash flow to be used to pay such indebtedness and, in any event, could elect to declare all the funds borrowed thereunder to be due and payable, together with accrued and unpaid interest;

the lenders under our Credit Facility could elect to terminate their commitments thereunder, cease making further loans and institute foreclosure proceedings against our assets; and

we could be forced into bankruptcy or liquidation.

If our operating performance declines, we may in the future need to obtain waivers from the required lenders under our Credit Facility to avoid being in default. If we breach our covenants under our Credit Facility and seek a waiver, we may not be able to obtain a waiver from the required lenders. If this occurs, we would be in default under our Credit Facility, the lenders could exercise their rights, as described above, and we could be forced into bankruptcy or liquidation.

### **Item 1B. Unresolved Staff Comments**

None.

### **Item 2. Properties**

Our stores are located in all 50 states of the United States, Puerto Rico, Canada, the Virgin Islands, the United Kingdom, Ireland, France, Spain, Portugal, Belgium, Switzerland, Austria, Netherlands, Germany, Poland, Czech Republic and Hungary. We lease all of our 3,071 store locations, generally for terms ranging from five to approximately 10 years. Under the terms of the leases, we pay a fixed minimum rent and/or rentals based on a percentage of net sales. We also pay certain other expenses (e.g., common area maintenance charges and real estate taxes) under the leases. The internal layout and fixtures of each store are designed by management and third parties and constructed by external contractors.

Most of our stores in the North America and the Europe divisions are located in enclosed shopping malls, while other stores are located within central business districts, power centers, lifestyle centers, open-air outlet malls or strip centers. Our criteria for opening new stores includes geographic location, demographic aspects of communities surrounding the store site, quality of anchor tenants, advantageous location within a mall or central business district, appropriate space availability, and rental rates. We believe that sufficient desirable locations are available to accommodate our expansion plans. We refurbish our existing stores on a regular basis.

**Table of Contents**

The following table sets forth the location, use and size of our distribution, sourcing, buying, merchandising, and corporate facilities as of January 28, 2012. The properties are leased with the leases expiring at various times through 2030, subject to renewal options.

Location	Use	Approximate Square Footage
Hoffman Estates, Illinois	Corporate and North America management and distribution center	538,000(1)
Birmingham, United Kingdom	Europe management and distribution center	105,600(2)
Pembroke Pines, Florida	Accounting and finance	36,000
Hong Kong	Sourcing and buying	10,400
Paris, France	Zone support	5,900(3)
Madrid, Spain	Zone support	2,700(3)

- (1) On February 19, 2010, we sold the Property to a third party. Contemporaneously with the sale of the Property, we entered into a lease agreement that provides for (a) an initial expiration date of February 28, 2030 with two (2) five (5) year renewal periods, each at our option, and (b) basic rent of \$2.1 million per annum (subject to annual increases). This transaction is accounted for as a capital lease. Prior to February 19, 2010, we owned central buying and store operations offices and the North America distribution center located in Hoffman Estates, Illinois (the Property) which is on approximately 28.4 acres of land. The Property has buildings with approximately 538,000 total square feet of space, of which 371,000 square feet is devoted to receiving and distribution and 167,000 square feet is devoted to office space.
  - (2) Our subsidiary, Claire's Accessories UK Ltd., or Claire's UK, leases distribution and office space in Birmingham, United Kingdom. The facility consists of approximately 23,900 square feet of office space and approximately 81,700 square feet of distribution space. The lease expires in December 2024, and Claire's UK has the right to assign or sublet this lease at any time during the term of the lease, subject to landlord approval. The Birmingham, United Kingdom distribution center currently services our owned stores in Europe.
  - (3) We maintain our human resource and select operating functions for these countries.
- In addition, we have contracted a third party vendor in Hong Kong to provide distribution center services for our franchise stores.

**Item 3. Legal Proceedings**

We are, from time to time, involved in routine litigation incidental to the conduct of our business, including litigation instituted by persons injured upon premises under our control; litigation regarding the merchandise that we sell, including product and safety concerns regarding heavy metal and chemical content in our merchandise; litigation with respect to various employment matters, including wage and hour litigation; litigation with present or former employees; and litigation regarding intellectual property rights. Although litigation is routine and incidental to the conduct of our business, like any business of our size which employs a significant number of employees and sells a significant amount of merchandise, such litigation can result in large monetary awards when judges, juries or other finders of facts do not agree with management's evaluation of possible liability or outcome of litigation. Accordingly, the consequences of these matters cannot be finally determined by management. However, in the opinion of management, we believe that current pending litigation will not have a material adverse effect on our consolidated financial results.

**Item 4. Mine Safety Disclosure**

Not applicable.

**Table of Contents**

**PART II**

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

There is no established public trading market for our common stock.

***Holders***

As of April 1, 2012, there was one holder of record of our common stock, our parent, Claire's Inc.

***Dividends***

We have paid no cash dividends since the Merger. Our Credit Facility and the indentures governing the Notes and the Senior Secured First Lien Notes restrict our ability to pay dividends.

**Table of Contents****Item 6. Selected Financial Data**

The balance sheet data as of January 28, 2012 and January 29, 2011 and statement of operations data for the fiscal years ended January 28, 2012, January 29, 2011 and January 30, 2010 are derived from our Consolidated Financial Statements included herein and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and the related notes thereto appearing elsewhere in this Annual Report. The Consolidated Balance Sheet data as of January 30, 2010, January 31, 2009, February 2, 2008 and May 28, 2007 and the Consolidated Statement of Operations and Comprehensive Income data for the fiscal year ended January 31, 2009, the period May 29, 2007 through February 2, 2008 and the period February 4, 2007 through May 28, 2007 are derived from our Consolidated Financial Statements which are not included herein.

As a result of the consummation of the Transactions, the Company is sometimes referred to as the Successor Entity for periods on or after May 29, 2007, and the Predecessor Entity for periods prior to May 29, 2007. The Consolidated Financial Statements for the period on or after May 29, 2007 are presented on a different basis than for the periods before May 29, 2007, as a result of the application of purchase accounting as of May 29, 2007 and therefore are not comparable. The acquisition of Claire's Stores, Inc. was accounted for as a business combination using the purchase method of accounting, whereby the purchase price was allocated to the assets and liabilities based on the estimated fair market values at the date of acquisition.

	Successor Entity					Predecessor Entity
	Fiscal Year Ended January 28, 2012	Fiscal Year Ended January 29, 2011	Fiscal Year Ended January 30, 2010	Fiscal Year Ended January 31, 2009	May 29, 2007 Through Feb. 2, 2008	Feb. 4, 2007 Through May 28, 2007
(In thousands, except for ratios and store data)						
<b>Statement of Operations Data:</b>						
Net sales	\$ 1,495,900	\$ 1,426,397	\$ 1,342,389	\$ 1,412,960	\$ 1,085,932	\$ 424,899
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	724,775	685,111	663,269	724,832	521,384	206,438
Gross profit	771,125	741,286	679,120	688,128	564,548	218,461
Other expenses:						
Selling, general and administrative	504,360	493,081	466,965	513,752	354,875	154,409
Depreciation and amortization	68,753	65,198	71,471	85,093	61,451	19,652
Impairment of assets		12,262	3,142	498,490	3,478	73
Severance and transaction-related costs	6,928	741	921	15,928	7,319	72,672
Other (income) expense, net	(1,254)	5,542	(5,493)	(4,499)	(3,088)	(1,476)
	578,787	576,824	537,006	1,108,764	424,035	245,330
Operating income (loss)	192,338	164,462	142,114	(420,636)	140,513	(26,869)
Gain on early debt extinguishment	6,405	13,388	36,412			
Impairment of equity investment		6,030		25,500		
Interest expense (income), net	176,475	157,706	177,418	195,947	147,892	(4,876)
Income (loss) from continuing operations before income taxes	22,268	14,114	1,108	(642,083)	(7,379)	(21,993)
Income tax expense (benefit)	10,636	9,791	11,510	1,509	(8,020)	21,779
Income (loss) from continuing operations	\$ 11,632	\$ 4,323	\$ (10,402)	\$ (643,592)	\$ 641	\$ (43,772)
<b>Other Financial Data:</b>						
Capital expenditures:						
New stores and remodels	\$ 57,996	\$ 39,022	\$ 16,557	\$ 36,270	\$ 46,225	\$ 24,231
Other	12,912	9,689	8,395	23,135	12,259	3,757
Total capital expenditures	70,908	48,711	24,952	59,405	58,484	27,988

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Cash interest expense (1)	136,533	108,923	126,733	168,567	123,620	86
<b>Store Data:</b>						
Number of stores (at period end)						
North America	1,953	1,972	1,993	2,026	2,135	2,124
Europe	1,118	1,009	955	943	905	879
Total number of stores (at period end)	3,071	2,981	2,948	2,969	3,040	3,003
Total gross square footage (000 s) (at period end)	3,092	3,012	2,982	3,011	3,105	3,043
Net sales per store (000 s) (2)	\$ 494	\$ 481	\$ 454	\$ 461	\$ 359	\$ 142
Net sales per square foot (3)	490	476	448	453	353	140
<b>Balance Sheet Data (at period end)</b>						
Cash and cash equivalents (4)	\$ 174,374	\$ 279,766	\$ 198,708	\$ 204,574	\$ 85,974	\$ 350,476
Total assets	2,763,025	2,866,449	2,834,105	2,881,095	3,348,497	1,119,047
Total debt	2,403,672	2,524,286	2,521,878	2,581,772	2,377,750	
Total stockholders' (deficit) equity	(22,296)	(26,515)	(34,642)	(55,843)	605,200	792,071

- (1) Cash interest expense does not include amortization of debt issuance costs or interest expense paid in kind.
- (2) Net sales per store are calculated based on the average number of stores during the period.
- (3) Net sales per square foot are calculated based on the average gross square feet during the period.
- (4) At January 28, 2012 and January 29, 2011, cash and cash equivalents included restricted cash of \$4.4 million and \$23.9 million, respectively.

## **Table of Contents**

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

Management's Discussion and Analysis of Financial Condition and Results of Operations is designed to provide the reader of the financial statements with a narrative on our results of operations, financial position and liquidity, risk management activities, and significant accounting policies and critical estimates. Management's Discussion and Analysis should be read in conjunction with the Consolidated Financial Statements and related notes thereto contained elsewhere in this document.

Our fiscal year ends on the Saturday closest to January 31, and we refer to the fiscal year by the calendar year in which it began. Our fiscal year ended January 28, 2012 ( Fiscal 2011 ), January 29, 2011 ( Fiscal 2010 ) and January 30, 2010 ( Fiscal 2009 ) consisted of 52 weeks, respectively.

We include a store in the calculation of same store sales once it has been in operation sixty weeks after its initial opening. A store which is temporarily closed, such as for remodeling, is removed from the same store sales computation if it is closed for nine consecutive weeks. The removal is effective prospectively upon the completion of the ninth consecutive week of closure. A store which is closed permanently, such as upon termination of the lease, is immediately removed from the same store sales computation. We compute same store sales on a local currency basis, which eliminates any impact for changes in foreign currency rates.

### **Acquisition of the Company by Apollo Management VI, L.P.**

As a result of the Merger on May 29, 2007, described under Explanatory Notes in this Annual Report, there was a significant change in the Company's capital structure, including:

the closing of the Company's senior secured term loan facility and revolving credit facility, (the Revolver ), (collectively the Credit Facility ) of \$1.65 billion;

the closing of the Company's senior notes offering (the Merger Notes ) in the aggregate principal amount of \$935.0 million; and

the equity investment by Apollo Management VI, L.P. ( Apollo Management ), together with certain affiliated co-investment partnerships (collectively the Sponsors ), of approximately \$595.7 million.

The purchase of the Company and the related fees and expenses were financed through the issuance of the Merger Notes, borrowing under the Credit Facility, equity investment by the Sponsors, and cash on hand at the Company.

The aforementioned transactions, including the Merger and payment of costs related to these transactions, are collectively referred to as the Transactions.

The acquisition of Claire's Stores, Inc. was accounted for as a business combination using the purchase method of accounting, whereby the purchase price was allocated to the assets and liabilities based on the estimated fair market values at the date of acquisition.

See Note 1 Nature of Operations and Acquisition of Claire's Stores, Inc. and Note 5 Debt, respectively, in the Notes to Consolidated Financial Statements for details of the acquisition and current indebtedness.



## **Table of Contents**

### **Results of Consolidated Operations**

#### *Management overview*

We are one of the world's leading specialty retailers of fashionable accessories and jewelry at affordable prices for young women, teens, tweens, and girls ages 3 to 27. We are organized into two operating segments: North America and Europe. We identify our operating segments by how we manage and evaluate our business activities. We operate owned stores throughout the United States, Puerto Rico, Canada, and the U.S. Virgin Islands (North America segment) and the United Kingdom, Switzerland, Austria, Germany, France, Ireland, Spain, Portugal, Netherlands, Belgium, Poland, Czech Republic and Hungary (Europe segment). Until September 2, 2010, the Company operated stores in Japan through a 50:50 joint venture. Beginning September 2, 2010, these stores began to operate as licensed stores.

#### **Financial activity for 2011 include the following:**

Same store sales performance:

	<b>Fiscal 2011</b>
Consolidated	0.1%
North America	2.8%
Europe	(4.4)%

Operating income increase of \$27.9 million or 17.0% to \$192.3 million.

Net income increase of \$7.3 million to \$11.6 million from \$4.3 million.

Paid \$78.3 million to retire \$85.3 million of the Merger Notes.

During Fiscal 2011, we issued \$450.0 million aggregate principal amount of the Senior Secured Second Lien Notes and the net proceeds were used to pay down existing indebtedness under our senior secured Credit Facility. Later in Fiscal 2011, we paid \$54.7 million to retire our Euro Loan and received the cash deposit of \$19.6 million that secured the Euro Loan. In March 2012, after our fiscal year end, we issued \$500.0 million aggregate principal amount of the Senior Secured First Lien Notes and the net proceeds were used to pay down existing indebtedness under our senior secured Credit Facility.

#### **Operational activity for 2011 include the following:**

Opened 157 new company-owned stores

Entered two new large franchised markets, Mexico and India

Launched Claire's E-commerce in the U.S.

Remodeled six stores to test the new Icing store concept



**Table of Contents**

A summary of our consolidated results of operations is as follows (dollars in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Net sales	\$ 1,495,900	\$ 1,426,397	\$ 1,342,389
Increase (decrease) in same store sales	0.1%	6.5%	(1.7)%
Gross profit percentage	51.5%	52.0%	50.6%
Selling, general and administrative expenses as a percentage of net sales	33.7%	34.6%	34.8%
Depreciation and amortization as a percentage of net sales	4.6%	4.6%	5.3%
Severance and transaction-related costs as percentage of net sales	0.5%	0.1%	0.1%
Impairment of assets	\$	\$ 12,262	\$ 3,142
Operating income	\$ 192,338	\$ 164,462	\$ 142,114
Gain on early debt extinguishment	\$ 6,405	\$ 13,388	\$ 36,412
Impairment of equity investment	\$	\$ 6,030	\$
Net income (loss)	\$ 11,632	\$ 4,323	\$ (10,402)
Number of stores at the end of the period (1)	3,071	2,981	2,948

(1) Number of stores excludes stores operated under franchise and license agreements.

*Net sales*

Net sales in Fiscal 2011 increased \$69.5 million, or 4.9%, from Fiscal 2010. This increase was attributable to new store sales of \$59.7 million, a favorable foreign currency translation effect of our foreign locations sales of \$30.7 million, increased shipments to franchisees of \$2.4 million and an increase in same stores sales of \$1.4 million, or 0.1%, partially offset by a decrease of \$24.7 million due to the effect of store closures. Net sales would have increased 2.7% excluding the impact from foreign currency rate changes.

The increase in same store sales was primarily attributable to an increase in average transaction value of 4.0%, partially offset by a decrease in average number of transactions per store of 3.9%.

Net sales in Fiscal 2010 increased \$84.0 million, or 6.3%, from Fiscal 2009. This increase was attributable to an increase in same store sales of \$84.8 million, or 6.5%, and new store sales of \$27.2 million, partially offset by an unfavorable \$14.8 million of foreign currency translation effect of our foreign locations sales, a decrease of \$11.2 million due to the effect of store closures and reduced shipments to franchisees of \$2.0 million. Net sales would have increased 7.4% excluding the impact from foreign currency rate changes.

The increase in same store sales was primarily attributable to an increase in average transaction value of 6.7% and an increase in average number of transactions per store of 0.9%.

The following table compares our sales of each product category for the last three fiscal years:

<b>Product Category</b>	<b>Fiscal 2011</b>	<b>Percentage of Total Fiscal 2010</b>	<b>Fiscal 2009</b>
Accessories	53.9	54.5	53.6
Jewelry	46.1	45.5	46.4
	100.0	100.0	100.0

*Gross profit*

In calculating gross profit and gross profit percentages, we exclude our distribution center costs. These costs are included instead in Selling, general and administrative expenses in our Consolidated Statements of Operations and Comprehensive Income. Other retail companies may

## Edgar Filing: CLAIRE'S STORES INC - Form 10-K

include these costs in cost of sales, so our gross profit percentages may not be comparable to those retailers.

In Fiscal 2011, gross profit percentage decreased 50 basis points to 51.5% compared to the prior fiscal year of 52.0%. The decrease in gross profit percentage consisted of a 40 basis point increase in occupancy costs and a 20 basis point decrease in merchandise margin, partially offset by a 10 basis point decrease in buying and buying-related costs. The increase in the occupancy rate resulted primarily from the deleveraging effect of a reduction in same store sales in Europe. The decrease in merchandise margin resulted primarily from an increase in markdowns.

## **Table of Contents**

In Fiscal 2010, gross profit percentage increased 140 basis points to 52.0% compared to the prior fiscal year of 50.6%. This increase consisted of a 30 basis point improvement in merchandise margin and a 130 basis point decrease in occupancy costs, offset by a 20 basis point increase in buying and buying-related costs. Merchandise margin benefited by 30 basis points from reduced inventory shrink. Occupancy costs increased approximately \$0.6 million, but increased approximately \$3.5 million including foreign currency translation effect.

### *Selling, general and administrative expenses*

In Fiscal 2011, selling, general and administrative expenses increased \$11.3 million, or 2.3%, over the prior fiscal year. As a percentage of net sales, selling, general and administrative expenses decreased 90 basis points compared to the prior year. Excluding an unfavorable \$10.1 million foreign currency translation effect, selling, general and administrative expenses would have increased \$0.3 million.

In Fiscal 2010, selling, general and administrative expenses increased \$26.1 million, or 5.6%, over the prior fiscal year. As a percentage of net sales, selling, general and administrative expenses decreased 20 basis points compared to the prior year. Excluding a favorable \$5.8 million foreign currency translation effect, selling, general and administrative expenses would have increased \$31.9 million. The majority of this increase was for store-related expenses resulting from increased sales.

### *Depreciation and amortization expense*

Depreciation and amortization expense increased \$3.6 million to \$68.8 million during Fiscal 2011 compared to Fiscal 2010. Excluding an unfavorable \$1.1 million foreign currency translation effect, the increase in depreciation and amortization expense would have been \$2.5 million. The majority of this increase is due to the effect of asset additions during Fiscal 2011.

Depreciation and amortization expense decreased \$6.3 million to \$65.2 million during Fiscal 2010 compared to Fiscal 2009. Excluding a favorable \$0.6 million foreign currency translation effect, the decrease in depreciation and amortization expense would have been \$5.7 million. The majority of this decrease is due to the effect of assets becoming fully depreciated or amortized.

### *Impairment charges*

During the fourth quarter of Fiscal 2010, management performed a strategic review of its franchising business. The inability of certain franchisees to achieve store development expectations in select markets prompted us to reevaluate our franchise development strategy and to perform a valuation of the franchise agreements, which are definite-lived intangible assets. We utilized a discounted cash flow model and determined the franchise agreements intangible assets were impaired. This resulted in us recording a non-cash impairment charge of \$12.3 million in Fiscal 2010, which was included in Impairment of assets on the Company's Consolidated Statements of Operations and Comprehensive Income.

During the second quarter of Fiscal 2010, we recorded a non-cash impairment charge related to the investment in Claire's Nippon of \$6.0 million. The joint venture's continuing operating losses prompted us to perform a valuation of our investment in Claire's Nippon.

The deterioration in the economy and resulting effect on consumer confidence and discretionary spending that occurred during Fiscal 2009 and Fiscal 2008 had a significant impact on the retail industry. We performed our tests for goodwill, intangible assets, property and equipment and other asset impairment following relevant accounting standards pertaining to the particular asset being tested. The impairment testing conducted in Fiscal 2009 resulted in the recognition of non-cash impairment charges of \$3.1 million related to property and equipment. See Note 3 Impairment Charges in the Notes to Consolidated Financial Statements for further discussion of the impairment charges.

**Table of Contents***Severance and transaction-related costs*

Since 2007, we have incurred severance and various transaction-related costs. These costs consisted primarily of severance costs resulting from reductions in workforce occurring time-to-time and financial advisory and legal fees. During Fiscal 2011, we incurred \$6.9 million of such costs, including costs for the remaining payments due under the employment contract of our former Chief Executive Officer. During Fiscal 2010 and Fiscal 2009, we incurred \$0.7 million and \$0.9 million of such costs, respectively.

*Gain on early debt extinguishment*

The following is a summary of our note repurchase activity during Fiscal 2011, Fiscal 2010 and Fiscal 2009 (in thousands):

Notes Repurchased	Principal Amount	Fiscal 2011 Repurchase Price	Recognized Gain (1)
Senior Fixed Rate Notes	\$ 15,730	\$ 15,213	\$ 260
Senior Toggle Notes	69,617	63,130	6,145
	\$ 85,347	\$ 78,343	\$ 6,405

- (1) Net of deferred issuance cost write-offs of \$257 for the Senior Fixed Rate Notes and \$796 for the Senior Toggle Notes, and accrued interest write-off of \$455 for the Senior Toggle Notes.

Notes Repurchased	Principal Amount	Fiscal 2010 Repurchase Price	Recognized Gain (1)
Senior Fixed Rate Notes	\$ 14,000	\$ 12,268	\$ 1,467
Senior Toggle Notes	57,173	49,798	7,612
Senior Subordinated Notes	22,625	17,799	4,309
	\$ 93,798	\$ 79,865	\$ 13,388

- (1) Net of deferred issuance cost write-offs of \$265 for the Senior Fixed Rate Notes, \$922 for the Senior Toggle Notes and \$517 for the Senior Subordinated Notes, and accrued interest write-off of \$1,159 for the Senior Toggle Notes.

Notes Repurchased	Principal Amount	Fiscal 2009 Repurchase Price	Recognized Gain (1)
Senior Toggle Notes	\$ 30,500	\$ 19,744	\$ 11,297
Senior Subordinated Notes	52,763	26,347	25,115
	\$ 83,263	\$ 46,091	\$ 36,412

- (1) Net of deferred issuance cost write-offs of \$603 and \$1,301 for the Senior Toggle Notes and Senior Subordinated Notes, respectively, and accrued interest write-off of \$1,144 for the Senior Toggle Notes.

*Other (income) expense, net*

## Edgar Filing: CLAIRE'S STORES INC - Form 10-K

The following is a summary of other (income) expense activity for Fiscal 2011, Fiscal 2010 and Fiscal 2009 (in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Foreign currency exchange loss (gain), net	\$ 899	\$ 5,131	\$ (1,259)
Franchise fees	(1,904)	(1,638)	(1,943)
Equity loss		2,529	1,014
Gain on sale of assets			(1,935)
Other income	(249)	(480)	(1,370)
	\$ (1,254)	\$ 5,542	\$ (5,493)

**Table of Contents***Interest expense (income), net*

Interest expense for Fiscal 2011 aggregated \$176.5 million, an increase of \$18.8 million compared to the prior year. This increase is primarily due to indebtedness incurred under the \$450.0 million Senior Secured Second Lien Notes that bears a higher rate of interest than the Credit Facility and additional indebtedness incurred under the Euro Loan, partially offset by lower outstanding balances under our Credit Facility and Senior Notes. For Fiscal 2011, interest expense includes approximately \$13.1 million of amortization of deferred debt issuance costs and \$11.8 million of paid in kind interest.

Interest expense for Fiscal 2010 aggregated \$157.7 million, a decrease of \$19.7 million compared to the prior year. This decrease is primarily the result of Merger Notes repurchases. For Fiscal 2010, interest expense includes approximately \$10.0 million of amortization of deferred debt issuance costs and \$36.9 million of paid in kind interest.

See Note 5 Debt in the Notes to Consolidated Financial Statements for components of interest expense (income), net.

*Income taxes*

In Fiscal 2011, our income tax expense was \$10.6 million and our effective income tax rate was 47.8%. Our effective income tax rate for Fiscal 2011 reflects income tax expense of \$6.1 million on earnings of foreign subsidiaries, plus income tax expense of \$3.6 million related to the effect of changes to our valuation allowance on deferred tax assets, offset by income tax benefits of \$9.2 million on income in our foreign jurisdictions that are taxed at lower income tax rates. In Fiscal 2011, we made net cash income tax payments of \$14.3 million primarily for Europe.

In Fiscal 2010, our income tax expense was \$9.8 million and our effective income tax rate was 69.4%. Our effective income tax rate for Fiscal 2010 reflects income tax expense of \$0.4 million on earnings of foreign subsidiaries, plus income tax expense of \$12.7 million related to the effect of changes to our valuation allowance on deferred tax assets, plus income tax expense of \$2.6 million relating to other permanent items, offset by income tax benefits of \$11.6 million on income for our foreign jurisdictions that are taxed at lower income tax rates. In Fiscal 2010, we made net cash income tax payments of \$6.3 million.

In Fiscal 2009, our income tax expense was \$11.5 million and our effective income tax rate was 1,038.8%. Our effective income tax rate for Fiscal 2009 reflects income tax expense of \$18.6 million on earnings of foreign subsidiaries, plus income tax expense of \$17.5 million related to the effect of changes to our valuation allowance on deferred tax assets, offset by income tax benefits of \$21.4 million on income for our foreign jurisdictions that are taxed at lower income tax rates, and \$4.7 million relating to other permanent income tax benefits. In Fiscal 2009, we made net cash income tax payments of \$3.2 million.

See Note 11 Income Taxes in the Notes to Consolidated Financial Statements for further details.

**Segment Operations**

We are organized into two business segments North America and Europe. The following is a discussion of results of operations by business segment.

*North America*

Key statistics and results of operations for our North America division are as follows (dollars in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Net sales	\$ 942,278	\$ 914,149	\$ 850,313
Increase (decrease) in same store sales	2.8%	7.8%	(3.2)%
Gross profit percentage	52.6%	52.1%	50.0%
Number of stores at the end of the period (1)	1,953	1,972	1,993

(1) Number of stores excludes stores operated under franchise and licensing agreements.





**Table of Contents***Net sales*

Net sales in North America during Fiscal 2011 increased \$28.1 million, or 3.1%, from Fiscal 2010. This increase was attributable to an increase in same store sales of \$24.7 million, or 2.8%, new store sales of \$9.8 million, an increase in shipments to franchisees of \$2.3 million and a favorable foreign currency translation effect of our Canadian operations sales of \$2.1 million, partially offset by a decrease of \$10.8 million due to the effect of store closures.

The increase in same store sales was primarily attributable to an increase in average transaction value of 5.4%, partially offset by a decrease in average number of transactions per store of 2.3%.

Net sales in North America during Fiscal 2010 increased \$63.8 million, or 7.5%, from Fiscal 2009. This increase was attributable to an increase in same store sales of \$64.8 million, or 7.8%, a favorable foreign currency translation effect of our Canadian operations sales of \$4.9 million and new store sales of \$3.6 million, partially offset by a decrease of \$6.8 million due to the effect of store closures and reduced shipments to franchisees of \$2.7 million.

The increase in same store sales was primarily attributable to an increase in average transaction value of 5.8% and an increase in average number of transactions per store of 2.9%.

*Gross profit*

In Fiscal 2011, gross profit percentage increased 50 basis points to 52.6% compared to the gross profit percentage for Fiscal 2010 of 52.1%. The increase in gross profit percentage consisted of a 40 basis point decrease in occupancy costs and a 10 basis point increase in merchandise margin. The improvement in occupancy rate is due to the leveraging effect of higher sales.

In Fiscal 2010, gross profit percentage increased 210 basis points to 52.1% compared to the gross profit percentage for Fiscal 2009 of 50.0%. This increase in gross profit percentage consisted of a 90 basis point improvement in merchandise margin and a 150 basis point decrease in occupancy costs, partially offset by a 30 basis point increase in buying and buying-related costs. Merchandise margin benefited by 30 basis points from reduced inventory shrink. The 150 basis point improvement in occupancy costs is due to the leveraging effect of higher sales partially offset by an unfavorable foreign currency translation effect.

The following table compares our sales of each product category for the last three fiscal years:

Product Category	Percentage of Total		
	Fiscal 2011	Fiscal 2010	Fiscal 2009
Accessories	49.2	49.8	48.5
Jewelry	50.8	50.2	51.5
	100.0	100.0	100.0

*Europe*

Key statistics and results of operations for our Europe division are as follows (dollars in thousands):

	Fiscal 2011	Fiscal 2010	Fiscal 2009
Net sales	\$ 553,622	\$ 512,248	\$ 492,076
Increase (decrease) in same store sales	(4.4)%	4.3%	1.1%
Gross profit percentage	49.8%	51.7%	51.7%
Number of stores at the end of the period (1)	1,118	1,009	955

## Edgar Filing: CLAIRE'S STORES INC - Form 10-K

(1) Number of stores excludes stores operated under franchise and licensing agreements.

### *Net sales*

Net sales in our Europe division during Fiscal 2011 increased \$41.4 million, or 8.1%, from Fiscal 2010. This increase was attributable to new store sales of \$49.9 million and favorable foreign currency translation of our Europe operations sales of \$28.7 million, partially offset by a decrease in same stores sales of \$23.3 million, (4.4)%, and a decrease of \$13.9 million due to the effect of store closures.

**Table of Contents**

The decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 7.6%, partially offset by an increase in average transaction value of 2.0%.

Net sales in our Europe division during Fiscal 2010 increased \$20.2 million, or 4.1%, from Fiscal 2009. This increase was attributable to new store sales of \$23.6 million, an increase in same store sales of \$20.0 million, or 4.3%, and an increase in shipments to franchisees of \$0.7 million, partially offset by an unfavorable foreign currency translation of our Europe operations sales of \$19.6 million and a decrease of \$4.5 million due to the effect of store closures.

The increase in same store sales was primarily attributable to an increase in average transaction value of 7.8% partially offset by a decrease in average number of transaction per store of 2.4%.

*Gross profit*

In Fiscal 2011, gross profit percentage decreased 190 basis points to 49.8% compared to the gross profit percentage for Fiscal 2010 of 51.7%. The decrease in gross profit percentage consisted of a 130 basis point increase in occupancy costs and a 70 basis point decrease in merchandise margin, partially offset by a 10 basis point decrease in buying and buying-related costs. The increase in occupancy rate resulted primarily from the deleveraging effect of a reduction in same store sales. The decrease in merchandise margin resulted primarily from an increase in markdowns.

In Fiscal 2010, gross profit percentage remained consistent with Fiscal 2009 at 51.7%. Although the gross profit percentage did not change, our Europe division saw an 80 basis point decrease in occupancy costs and a 10 basis point decrease in buying and buying-related costs, offset by a 90 basis point decrease in merchandise margin. The 80 basis point improvement in occupancy costs is due to the leveraging effect of higher sales and a favorable foreign currency translation effect.

The following table compares our sales of each product category for the last three fiscal years:

Product Category	Percentage of Total		
	Fiscal 2011	Fiscal 2010	Fiscal 2009
Accessories	61.8	62.7	62.2
Jewelry	38.2	37.3	37.8
	100.0	100.0	100.0

**Liquidity and Capital Resources**

Our operating liquidity requirements are funded through internally generated cash flow from net sales and cash on hand. Our primary uses of cash are debt service requirements, new store expenditures, and working capital requirements. Cash outlays for the payment of interest are significantly higher in Fiscal 2011 than in prior years as a result of cash interest payments for the Senior Secured Toggle Notes, Senior Secured Second Lien Notes and the Euro Loan. Our current capital structure generates tax losses in our U.S. operations because of debt service requirements. Accordingly, we expect to pay minimal cash taxes in the U.S. in the near term, while our foreign cash taxes are less affected by our capital structure and debt service requirements. We anticipate that the existing cash and cash equivalents and cash generated from operations will be sufficient to meet our debt service requirements as they become due, new store expenditures, and future working capital requirements for at least the next twelve months. However, our ability to make scheduled payments of interest on, to pay principal on, or refinance indebtedness, to satisfy any other present or future debt obligations and our ability to fund future capital expenditures and operating expenses will depend on future operating performance. Our future operating performance and liquidity may also be adversely affected by general economic, financial, and other factors beyond the Company's control, including those disclosed in Part I, Item 1A Risk Factors.

## **Table of Contents**

### *Short-term Debt*

On January 24, 2011, we entered into a Euro ( ) denominated loan (the Euro loan ) in the amount of 42.4 million that was due on January 24, 2012. The Euro loan bore interest at the three month Euro Interbank Offered Rate ( EURIBOR ) rate plus 8.00% per year and was payable quarterly. As of January 29, 2011, there was 42.4 million, or the equivalent of \$57.7 million, outstanding under the Euro loan, and the weighted-average interest rate for borrowings outstanding was 9.02%. We used the net proceeds of the borrowings for general corporate purposes.

The obligation under the Euro loan was secured by a cash deposit in the amount of 15.0 million, or the equivalent of \$20.4 million at January 29, 2011, and a perfected first lien security interest in all of the issued and outstanding equity interest of one of our international subsidiaries, Claire's Holdings S.a.r.l. The cash deposit is classified as Cash and cash equivalents and restricted cash in our Consolidated Balance Sheet.

On January 24, 2012, we paid \$54.7 million to retire the Euro loan and received the cash deposit of \$19.6 million that secured the Euro loan. See Note 2 Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements for further details.

### *Credit Facility*

Our Credit Facility provides senior secured financing of up to \$1.65 billion, consisting of a \$1.45 billion senior secured term loan Credit Facility and a \$200.0 million senior secured revolving credit facility. On May 29, 2007, upon closing of the Transactions, we borrowed \$1.45 billion under our senior secured term loan Credit Facility and were issued a \$4.5 million letter of credit. The letter of credit was subsequently increased to \$6.0 million and later reduced to \$4.8 million. As of January 28, 2012, we were in compliance with the covenants in our Credit Facility.

Borrowings under our Credit Facility bear interest at a rate equal to, at our option, either (a) an alternate base rate determined by reference to the higher of (1) prime rate in effect on such day and (2) the federal funds effective rate plus 0.50% or (b) a LIBOR rate, with respect to any Eurodollar borrowing, determined by reference to the costs of funds for U.S. dollar deposits in the London Interbank Market for the interest period relevant to such borrowing, adjusted for certain additional costs, in each case plus an applicable margin. The initial applicable margin for borrowings under our Credit Facility is 1.75% per annum with respect to the alternate base rate borrowing and 2.75% per annum in the case of any LIBOR borrowings. The applicable margin for our revolving credit loans under our Credit Facility will be subject to one or more stepdowns, in each case based upon the ratio of our net senior secured debt to earnings before interest, taxes, depreciation and amortization ( EBITDA ) for the period of four consecutive fiscal quarters most recently ended as of such date (the Total Net Secured Leverage Ratio ).

On July 28, 2010, we entered into an interest rate swap agreement (the Swap ) to manage exposure to fluctuations in interest rate changes related to the senior secured term loan Credit Facility. The Swap has been designated and accounted for as a cash flow hedge and expires on July 30, 2013. The Swap represents a contract to exchange floating rate for fixed interest payments periodically over the life of the Swap without exchange of the underlying notional amount. The Swap covers an aggregate notional amount of \$200.0 million of the outstanding principal balance of the senior secured term loan Credit Facility and has a fixed rate of 1.2235%. The interest rate Swap results in the Company paying a fixed rate plus the applicable margin then in effect for LIBOR borrowings resulting in an interest rate of 3.97% at January 28, 2012, on a notional amount of \$200.0 million of the senior secured term loan Credit Facility.

In addition to paying interest on outstanding principal under our Credit Facility, we are required to pay a commitment fee, initially 0.50% per annum, in respect of the revolving credit commitments thereunder. The commitment fee will be subject to one stepdown, based upon our Total Net Secured Leverage Ratio. We must also pay customary letter of credit fees and agency fees. At January 28, 2012, the weighted average interest rate for borrowings outstanding under our Credit Facility was 3.07% per annum. Any principal amount outstanding of the loans under our Revolver, plus interest accrued and unpaid thereon, will be due and payable in full at maturity on May 29, 2013.

## Table of Contents

All obligations under our Credit Facility are unconditionally guaranteed by (i) Claire's Inc., our parent, prior to an initial public offering of Claire's Stores, Inc. stock, and (ii) certain of our existing and future wholly-owned domestic subsidiaries, subject to certain exceptions.

All obligations under our Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by (i) all of Claire's Stores, Inc. capital stock, prior to an initial public offering of Claire's Stores, Inc. stock, and (ii) substantially all of our material owned assets and the material owned assets of subsidiary guarantors, including:

a perfected pledge of all the equity interests held by us or any subsidiary guarantor, which pledge, in the case of any foreign subsidiary, is limited to 100% of the non-voting equity interests and 65% of the voting equity interests of such foreign subsidiary held directly by us and the subsidiary guarantors; and

perfected security interests in, and mortgages on, substantially all material tangible and intangible assets owned by us and each subsidiary guarantor, subject to certain exceptions.

Our Credit Facility contains customary provisions relating to mandatory prepayments, voluntary payments, affirmative and negative covenants, and events of default; however, it does not contain any covenants that require the Company to maintain any particular financial ratio or other measure of financial performance.

Although we did not need to do so, during the quarter ended November 1, 2008, we drew down the remaining \$194.0 million available under our Revolver. An affiliate of Lehman Brothers is a member of the facility syndicate, and so immediately after Lehman Brothers filed for bankruptcy, in order to preserve the availability of the commitment, we drew down the full available amount under the Revolver. We received the entire \$194.0 million, including the remaining portion of Lehman Brothers affiliate's commitment of \$33 million. We were not required to repay any of the Revolver until the due date of May 29, 2013, therefore, the Revolver was classified as a long-term liability in the accompanying Consolidated Balance Sheet as of January 29, 2011. During Fiscal 2011, we paid down the entire \$194.0 million of the Revolver (without terminating the commitment) and \$241.0 million of indebtedness under the senior secured term loan Credit Facility with the net proceeds from our Senior Secured Second Lien Notes offering. Subsequent to January 28, 2012, we paid \$489.8 million of indebtedness under the senior secured term loan Credit Facility with the net proceeds from our Senior Secured First Lien Notes offering. As a result of our initial prepayment under the senior secured term loan Credit Facility, we are no longer required to make any quarterly payments and have a final payment of \$664.6 million due May 29, 2014. See *Senior Secured First Lien Notes* below and Note 16 Subsequent Events in the Notes to Consolidated Financial Statements.

### *Senior Notes and Senior Subordinated Notes ( Merger Notes )*

In connection with the Transactions, we also issued a series of notes.

Our senior notes were issued in two series: (1) \$250.0 million of 9.25% senior notes due 2015; and (2) \$350.0 million of 9.625%/10.375% senior toggle notes due 2015. The \$250.0 million senior notes are unsecured obligations, mature on June 1, 2015 and bear interest at a rate of 9.25% per annum. The \$350.0 million senior toggle notes are senior obligations and will mature on June 1, 2015. For any interest period through June 1, 2011, we may, at our option, elect to pay interest on the senior toggle notes (i) entirely in cash, (ii) entirely by increasing the principal amount of the outstanding senior toggle notes or by issuing payment in kind (PIK) Notes, or (iii) 50% as cash interest and 50% as PIK interest. After June 1, 2011, we will make all interest payments on the senior toggle notes in cash. Cash interest on the senior toggle notes will accrue at the rate of 9.625% per annum and be payable in cash. PIK interest on the senior toggle notes will accrue at the cash interest rate per annum plus 0.75% and be payable by issuing PIK notes. When we made a PIK interest election, our debt increased by the amount of such interest and we issued PIK notes on the scheduled semi-annual payment dates. Effective June 2, 2011, the Company began accruing cash interest.

## **Table of Contents**

We also issued 10.50% senior subordinated notes due 2017 in an initial aggregate principal amount of \$335.0 million. The senior subordinated notes are senior subordinated obligations, will mature on June 1, 2017 and bear interest at a rate of 10.50% per annum.

Interest on the Merger Notes is payable semi-annually to holders of record at the close of business on May 15 or November 15 immediately preceding the interest payment date on June 1 and December 1 of each year, commencing December 1, 2007. The Merger Notes are also subject to certain redemption and repurchase rights as described in Note 5 Debt in the Notes to Consolidated Financial Statements.

### *Senior Secured Second Lien Notes*

On March 4, 2011, we issued \$450.0 million aggregate principal amount of 8.875% senior secured second lien notes that mature on March 15, 2019 (the Senior Secured Second Lien Notes). The Senior Secured Second Lien Notes are guaranteed on a second-priority senior secured basis by all of our existing and future direct or indirect wholly-owned domestic subsidiaries that guarantee the Credit Facility. The Senior Secured Second Lien Notes and related guarantees are secured by a second-priority lien on substantially all of the assets that secure our and our subsidiary's guarantors' obligations under the Credit Facility. We used the net proceeds of the offering of the Senior Secured Second Lien Notes to reduce the entire amount outstanding under our Revolver (without terminating the commitment) and indebtedness under our senior secured term loan Credit Facility.

Interest on the Senior Secured Second Lien Notes is payable semi-annually to holders of record at the close of business on March 1 or September 1 immediately preceding the interest payment date on March 15 and September 15 of each year, commencing on September 15, 2011. The notes are also subject to certain redemption and repurchase rights as discussed in Note 5 Debt in the Notes to Consolidated Financial Statements.

### *Senior Secured First Lien Notes*

On February 28, 2012, the Company issued \$400.0 million aggregate principal amount of 9.00% senior secured first lien notes that mature on March 15, 2019 (the Senior Secured First Lien Notes). The notes were issued at a price equal to 100.00% of the principal amount. On March 12, 2012, the Company issued an additional \$100.0 million aggregate principal amount of the same series of Senior Secured First Lien Notes at a price equal to 101.50% of the principal amount. Interest on the Senior Secured First Lien Notes is payable semi-annually to holders of record at the close of business on March 1 or September 1 immediately preceding the interest payment date on March 15 and September 15 of each year, commencing on September 15, 2012. The Senior Secured First Lien Notes are guaranteed on a first-priority senior secured basis by all of the Company's existing and future direct or indirect wholly-owned domestic subsidiaries that guarantee the Company's Credit Facility. The Senior Secured First Lien Notes and related guarantees are secured by a first-priority lien on substantially all of the assets that secure the Company's and its subsidiary guarantors' obligations under the Company's Credit Facility. The Company used the net proceeds of the offering of the Senior Secured First Lien Notes to reduce \$489.8 million of indebtedness under the Company's senior secured term loan Credit Facility.

Our Merger Notes, Senior Secured Second Lien Notes and the Senior Secured First Lien Notes contain certain covenants that, among other things, and subject to certain exceptions and other basket amounts, restrict our ability and the ability of our subsidiaries to:

incur additional indebtedness;

pay dividends or distributions on our capital stock, repurchase or retire our capital stock and redeem, repurchase or defease any subordinated indebtedness;

make certain investments;

create or incur certain liens;

create restrictions on the payment of dividends or other distributions to us from our subsidiaries;

transfer or sell assets;

engage in certain transactions with our affiliates; and

merge or consolidate with other companies or transfer all or substantially all of our assets.



**Table of Contents**

Certain of these covenants, such as limitations on our ability to make certain payments such as dividends, or incur debt, will no longer apply if such notes have investment grade ratings from both of the rating agencies of Moody's Investor Services, Inc. (Moody's) and Standard & Poor's Ratings Group (S&P) and no event of default has occurred. Since the respective dates of issuance, such notes have not received investment grade ratings from Moody's or S&P. Accordingly, all of the covenants currently apply to us. None of these covenants, however, require the Company to maintain any particular financial ratio or other measure of financial performance. As of January 28, 2012, we were in compliance with the covenants.

We elected to pay interest in kind on our 9.625%/10.375% Senior Toggle Notes for the interest periods beginning June 2, 2008 through June 1, 2011. This election, net of reductions for note repurchases, increased the principal amount on the Senior Toggle Notes by \$109.5 million and \$98.1 million as of January 28, 2012 and January 29, 2011, respectively. The accrued payment in kind interest is included in Long-term debt in the Consolidated Balance Sheets.

*Europe Credit Facilities*

Our non-U.S. subsidiaries have bank credit facilities totaling \$2.2 million. These facilities are used for working capital requirements, letters of credit and various guarantees. These credit facilities have been arranged in accordance with customary lending practices in their respective countries of operation. At January 28, 2012, the entire amount of \$2.2 million was available for borrowing by us, subject to a reduction of \$2.2 million for outstanding bank guarantees.

*Analysis of Consolidated Financial Condition*

A summary of cash flows provided by (used in) operating, investing and financing activities is outlined in the table below (in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Operating activities	\$ 102,560	\$ 151,259	\$ 75,476
Investing activities	(57,384)	(56,952)	(21,259)
Financing activities	(132,687)	(38,139)	(60,591)

Our working capital at the end of Fiscal 2011 was \$154.6 million compared to \$195.9 million at the end of Fiscal 2010, a decrease of \$41.3 million. The decrease in working capital mainly reflects a decrease in cash and cash equivalents and restricted cash of \$29.3 million net of debt payments, an increase in trade accounts and income tax payables of \$4.8 million, an increase in accrued liabilities of \$12.5 million, and a decrease in prepaid expenses and other of \$0.7 million, partially offset by an increase in inventories of \$6.0 million.

*Cash flows from operating activities*

In Fiscal 2011, cash provided by operations activities decreased \$48.7 million compared to Fiscal 2010. The primary reasons for the decrease were an increase in interest payments of \$27.6 million; an increase in net change in working capital items, excluding cash and cash equivalents and restricted cash, of \$25.6 million; an increase in income tax payments of \$8.0 million; partially offset by an increase in operating income before impairment of assets, depreciation and amortization expense and stock compensation expense of \$12.5 million.

In Fiscal 2010, cash provided by operating activities increased \$75.8 million compared to Fiscal 2009. The primary reasons for the increase were an increase in operating income before impairment of assets and depreciation and amortization expense of \$25.2 million; a decrease in working capital, excluding cash and cash equivalents and restricted cash, of \$34.8 million; and lower cash interest payments of \$17.8 million; partially offset by higher cash tax payments of \$3.2 million.

## **Table of Contents**

### *Cash flows from investing activities*

In Fiscal 2011, cash used in investing activities was \$57.4 million and primarily consisted of \$76.6 million for capital expenditures, partially offset by a decrease in restricted cash primarily resulting from a return of our deposit securing the Euro Loan. Cash used in investing activities was \$57.0 million in Fiscal 2010 and primarily consists of capital expenditures for new store openings, the remodeling of existing stores, improvements to technology systems, acquisitions of lease rights and an increase in restricted cash, partially offset by proceeds received from our sale-leaseback transaction.

In Fiscal 2010, cash used in investing activities increased \$35.7 million compared to Fiscal 2009. In Fiscal 2010, restricted cash increased \$23.9 million for deposits securing certain debt obligations. In February 2010, we completed a sale-leaseback transaction that generated proceeds of approximately \$16.8 million, offset by increased capital expenditures of \$24.4 million for the remodeling of existing stores, new store openings, and improvements to technology systems. In Fiscal 2009, we received \$1.8 million from the sale of property and \$2.4 million from the sale of intangible assets.

In Fiscal 2012, we currently expect to incur approximately \$75.0 million to \$80.0 million of capital expenditures to open new stores, remodel existing stores and to improve technology systems.

### *Cash flows from financing activities*

In Fiscal 2011, cash used in financing activities was \$132.7 million which consisted primarily of note repurchases of \$78.3 million to retire \$15.7 million of Senior Fixed Rate Notes and \$69.6 million of Senior Toggle Notes, payment of \$54.7 to retire the Euro Loan and net proceeds from the issuance of \$450.0 million senior secured second lien notes used to reduce the entire \$194.0 million outstanding under the Revolver and repay \$244.9 million of indebtedness under the senior secured term loan Credit Facility.

In Fiscal 2010, cash used in financing activities decreased \$22.5 million compared to Fiscal 2009. In Fiscal 2010, we received \$57.5 million from the Euro Loan and paid \$0.5 million of debt issuance costs. In both Fiscal 2010 and Fiscal 2009, we paid \$14.5 million for the scheduled principal payments on our Credit Facility. In Fiscal 2010, we paid \$79.9 million to retire \$14.0 million of Senior Fixed Rate Notes, \$57.2 million of Senior Toggle Notes and \$22.6 million of Senior Subordinated Notes. We also paid \$0.7 million in capital lease payments during Fiscal 2010. During Fiscal 2009, we paid \$46.1 million to retire \$30.5 million of Senior Toggle Notes and \$52.8 million of Senior Subordinated Notes.

We or our affiliates have purchased and may, from time to time, purchase portions of our indebtedness. All of our purchases have been privately-negotiated, open market transactions.

### *Cash position*

As of January 28, 2012, we had cash and cash equivalents and restricted cash of \$174.4 million and all cash equivalents were maintained in one money market fund invested exclusively in U.S. Treasury Securities.

As of January 28, 2012, our foreign subsidiaries held cash and cash equivalents of \$62.2 million. In 2011, we did not repatriate any cash held by foreign subsidiaries, but we expect a portion of our foreign subsidiaries' future cash flow generation to be repatriated to the U.S. to meet certain liquidity needs. Based upon the amount of our remaining U.S. net operating loss carryforwards at January 28, 2012, we do not expect to pay U.S. income tax on fiscal 2012 repatriations. When our U.S. net operating loss carryforwards are no longer available, we would be required to accrue and pay U.S. income taxes on any such repatriation.

## **Table of Contents**

### *Current market conditions*

Continued distress in the financial markets has resulted in declines in consumer confidence and spending, extreme volatility in securities prices, and has had a negative impact on credit availability and declining valuations of certain investments. We have assessed the implications of these factors on our current business and have responded with pursuit of cost reduction opportunities and are proceeding cautiously to support increased sales. If the national, or global, economies or credit market conditions in general were to deteriorate further in the future, it is possible that such deterioration could put additional negative pressure on consumer spending and negatively affect our cash flows or cause a tightening of trade credit that may negatively affect our liquidity.

### **Critical Accounting Policies and Estimates**

Our Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which require us to make certain estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures regarding contingent assets and liabilities and reported amounts of revenues and expenses. Such estimates include, but are not limited to, the value of inventories, goodwill, intangible assets and other long-lived assets, legal contingencies and assumptions used in the calculation of income taxes, retirement and other post-retirement benefits, stock-based compensation, derivative and hedging activities, residual values and other items. These estimates and assumptions are based on our best estimates and judgment. We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which we believe to be reasonable under the circumstances. We adjust such estimates and assumptions when facts and circumstances dictate. Illiquidity in credit markets, volatility in each of the equity, foreign currency, and energy markets and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates will be reflected in the financial statements in those future periods when the changes occur.

### *Inventory Valuation*

Our inventories in North America are valued at the lower of cost or market, with cost determined using the retail method. Inherent in the retail inventory calculation are certain significant management judgments and estimates including, among others, merchandise markups, markdowns and shrinkage, which impact the ending inventory valuation at cost as well as resulting gross margins. The methodologies used to value merchandise inventories include the development of the cost-to-retail ratios, the groupings of homogeneous classes of merchandise, development of shrinkage reserves and the accounting for retail price changes. Our inventories in Europe are accounted for under the lower of cost or market method, with cost determined using the average cost method at an individual item level. Market is determined based on the estimated net realizable value, which is generally the merchandise selling price. Inventory valuation is impacted by the estimation of slow moving goods, shrinkage and markdowns. Management monitors merchandise inventory levels to identify slow-moving items and uses markdowns to clear such inventories. Changes in consumer demand of our products could affect our retail prices, and therefore impact the retail method and lower of cost or market valuations.

### *Valuation of Long-Lived Assets*

We evaluate the carrying value of long-lived assets whenever events or changes in circumstances indicate that a potential impairment has occurred. A potential impairment has occurred if the projected future undiscounted cash flows are less than the carrying value of the assets. The estimate of cash flows includes management's assumptions of cash inflows and outflows directly resulting from the use of the asset in operations. When a potential impairment has occurred, an impairment charge is recorded if the carrying value of the long-lived asset exceeds its fair value. Fair value is measured based on a projected discounted cash flow model using a discount rate we feel is commensurate with the risk inherent in our business. A prolonged decrease in consumer spending would require us to modify our models and cash flow estimates, and could create a risk of an impairment triggering event in the future. Our impairment analyses contain estimates due to the inherently judgmental nature of forecasting long-term estimated cash flows and determining the ultimate useful lives of assets. Actual results may differ, which could materially impact our impairment assessment.

## **Table of Contents**

During Fiscal 2010, we recorded a non-cash impairment charge of \$6.0 million related to our former investment in our joint venture, Claire's Nippon.

During Fiscal 2009, an impairment charge of approximately \$3.1 million was recorded related to our central buying and store operations offices and the North America distribution center located in Hoffman Estates, Illinois.

### *Goodwill Impairment*

We continually evaluate whether events and changes in circumstances warrant recognition of an impairment of goodwill. The conditions that would trigger an impairment assessment of goodwill include a significant, sustained negative trend in our operating results or cash flows, a decrease in demand for our products, a change in the competitive environment, and other industry and economic factors. We conduct our annual impairment test to determine whether an impairment of the value of goodwill has occurred in accordance with the guidance set forth in Accounting Standards Codification (ASC) Topic 350, *Intangibles - Goodwill and Other*. ASC Topic 350 requires a two-step process for determining goodwill impairment. The first step in this process compares the fair value of the reporting unit to its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second step of the impairment test is performed to measure the impairment. In the second step, the fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit to determine an implied goodwill value. This allocation is similar to a purchase price allocation performed in purchase accounting. If the carrying amount of the reporting unit's goodwill exceeds the implied goodwill value, an impairment loss is recognized in an amount equal to that excess. We have two reporting units as defined under ASC Topic 350. These reporting units are our North America segment and our Europe segment.

Fair value is determined using appropriate valuation techniques. All valuation methodologies applied in a valuation of any form of property can be broadly classified into one of three approaches: the asset approach, the market approach and the income approach. We rely on the income approach using discounted cash flows and market approach using comparable public company entities in deriving the fair values of our reporting units. The asset approach is not used as our reporting units have significant intangible assets, the value of which is dependent on cash flow.

The fair value of each reporting unit determined under Step 1 of the goodwill impairment test was based on a three-fourths weighting of a discounted cash flow analysis under the income approach using forward-looking projections of estimated future operating results and a one-fourth weighting of a guideline company methodology under the market approach using earnings before interest, taxes, depreciation and amortization (EBITDA) multiples. Our determination of the fair value of each reporting unit incorporates multiple assumptions and contains inherent uncertainties, including significant estimates relating to future business growth, earnings projections, and the weighted average cost of capital used for purposes of discounting. Decreases in revenue growth, decreases in earnings projections and increases in the weighted average cost of capital will all cause the fair value of the reporting unit to decrease, which could require us to modify future models and cash flow estimates, and could result in an impairment triggering event in the future.

We have weighted the valuation of our reporting units at three-fourths using the income approach and one-fourth using the market based approach. We believe that this weighting is appropriate since it is difficult to find other comparable publicly traded companies that are similar to our reporting units' heavy penetration of jewelry and accessories sales and margin structure. It is our view that the future discounted cash flows are more reflective of the value of the reporting units.

The projected cash flows used in the income approach cover the periods consisting of the fourth quarter fiscal 2011 and the fiscal years 2012 through 2016. Beyond fiscal year 2016, a terminal value was calculated using the Gordon Growth Model. We developed the projected cash flows based on estimates of forecasted same store sales, new store openings, operating margins and capital expenditures. Due to the inherent judgment involved in making these estimates and assumptions, actual results could differ from those estimates. The projected cash flows reflect projected same store sales increases representative of the Company's past performance post-recession.

## **Table of Contents**

A weighted average cost of capital reflecting the risk associated with the projected cash flows was calculated for each reporting unit and used to discount each reporting unit's cash flows and terminal value. Key assumptions made in calculating a weighted average cost of capital include the risk-free rate, market risk premium, volatility relative to the market, cost of debt, specific company premium, small company premium, tax rate and debt-to-equity ratio.

The calculation of fair value is significantly impacted by the reporting unit's projected cash flows and the discount interest rates used. Accordingly, any sustained volatility in the economic environment could impact these assumptions and make it reasonably possible that another impairment charge could be recorded some time in the future. However, since the terminal value is a significant portion of each reporting unit's fair value, the impact of any such near-term volatility on our fair value would be lessened.

Our annual impairment analysis did not result in any impairment of goodwill during Fiscal 2011, Fiscal 2010 and Fiscal 2009. The excess of fair value over carrying value for each of our reporting units as of October 29, 2011, the annual testing date for Fiscal 2011, ranged from approximately \$160.0 million to approximately \$526.0 million. In order to evaluate the sensitivity of the fair value calculations on the goodwill impairment test, we applied a hypothetical 10% decrease to the fair values of each reporting unit. This hypothetical 10% decrease would result in excess fair value over carrying value ranging from approximately \$70.0 million to approximately \$304.0 million for each of our reporting units.

### *Intangible Asset Impairment*

Intangible assets include tradenames, franchise agreements, lease rights, territory rights and leases that existed at the date of acquisition with terms that were favorable to market at that date. We continually evaluate whether events and changes in circumstances warrant revised estimates of the useful lives, residual values or recognition of an impairment loss for intangible assets. Future adverse changes in market and legal conditions or poor operating results of underlying assets could result in losses or an inability to recover the carrying value of the intangible asset, thereby possibly requiring an impairment charge in the future.

We evaluate the market value of the intangible assets periodically and record an impairment charge when we believe the carrying amount of the asset is not recoverable. Indefinite-lived intangible assets are tested for impairment annually or more frequently when events or circumstances indicate that impairment may have occurred. Definite-lived intangible assets are tested for impairment when events or circumstances indicate that the carrying amount may not be recoverable. We estimate the fair value of these intangible assets primarily utilizing a discounted cash flow model. The forecasted cash flows used in the model contain inherent uncertainties, including significant estimates and assumptions related to growth rates, margins and cost of capital. Changes in any of the assumptions utilized could affect the fair value of the intangible assets and result in an impairment triggering event. A prolonged decrease in consumer spending would require us to modify our models and cash flow estimates, with the risk of an impairment triggering event in the future. During Fiscal 2010, we recorded a non-cash impairment charge of \$12.3 million related to certain franchise agreements which are definite-lived intangible assets. We did not recognize any impairment charges during Fiscal 2011 and Fiscal 2009.

### *Income Taxes*

We are subject to income taxes in many jurisdictions, including the United States, individual states and localities and internationally. Our annual consolidated provision for income taxes is determined based on our income, statutory tax rates and the tax implications of items treated differently for tax purposes than for financial reporting purposes. Tax law requires certain items to be included in the tax return at different times than the items are reflected on the financial statements. Some of these differences are permanent, such as expenses that are not deductible in our tax return, and some differences are temporary, reversing over time, such as depreciation expense. We establish deferred tax assets and liabilities as a result of these temporary differences.

## **Table of Contents**

Our judgment is required in determining any valuation allowance recorded against deferred tax assets, specifically net operating loss carryforwards, tax credit carryforwards and deductible temporary differences that may reduce taxable income in future periods. In assessing the need for a valuation allowance, we consider all available evidence including past operating results, estimates of future taxable income and tax planning opportunities. In the event we change our determination as to the amount of deferred tax assets that can be realized, we will adjust our valuation allowance with a corresponding impact to income tax expense in the period in which such determination is made.

During Fiscal 2011, we reported an increase of \$4.0 million in valuation allowance against our U.S. deferred tax assets, and no change in valuation allowance against our foreign deferred tax assets. Our conclusion regarding the need for a valuation allowance against U.S. and foreign deferred tax assets could change in the future based on improvements in operating performance, which may result in the full or partial reversal of the valuation allowance.

During Fiscal 2010, we reported a decrease of \$11.8 million in valuation allowance against our U.S. deferred tax assets, and an increase of \$1.5 million in valuation allowance against our foreign deferred tax assets. The foreign increase primarily relates to foreign jurisdictions that have a history of losses. Our conclusion regarding the need for a valuation allowance against U.S. and foreign deferred tax assets could change in the future based on improvements in operating performance, which may result in the full or partial reversal of the valuation allowance.

During Fiscal 2009, we reported an increase of \$18.3 million in valuation allowance against our U.S. deferred tax assets, and an increase of \$2.1 million in valuation allowance against our foreign deferred tax assets. The foreign increase primarily relates to foreign jurisdictions that have a history of losses.

In the fourth quarter of Fiscal 2008, we recorded a charge of \$95.8 million, respectively, to establish a valuation allowance against our deferred tax assets in the U.S. We concluded that such a valuation allowance was appropriate in light of the significant negative evidence, which was objective and verifiable, such as the cumulative losses in recent fiscal years in our U.S. operations. While our long-term financial outlook in the U.S. remains positive, we concluded that our ability to rely on our long-term outlook as to future taxable income was limited due to the relative weight of the negative evidence from our recent U.S. cumulative losses.

We establish accruals for uncertain tax positions in our Consolidated Financial Statements based on tax positions that we believe are supportable, but are potentially subject to successful challenge by the taxing authorities. We believe these accruals are adequate for all open audit years based on our assessment of many factors including past experience, progress of ongoing tax audits and interpretations of tax law. If changing facts and circumstances cause us to adjust our accruals, or if we prevail in tax matters for which accruals have been established, or we are required to settle matters in excess of established accruals, our income tax expense for a particular period will be affected.

Income tax expense also reflects our best estimate and assumptions regarding, among other things, the geographic mix of income and losses from our foreign and domestic operations, interpretation of tax laws and regulations of multiple jurisdictions, earnings repatriation plans, and resolution of tax audits. Our effective income tax rates in future periods could be impacted by changes in the geographic mix of income and losses from our foreign and domestic operations that may be taxed at different rates, changes in tax laws, repatriation of foreign earnings, and the resolution of unrecognized tax benefits for amounts different from our current estimates. Given our capital structure, we will continue to experience volatility in our effective tax rate over the near term.

### *Stock-Based Compensation*

We issue stock options and other stock-based awards to executive management, key employees and directors under our stock-based compensation plans.

On January 29, 2006, we adopted ASC Topic 718, *Compensation - Stock Compensation*, using the modified prospective method. The calculation of stock-based compensation expense requires the input of highly subjective assumptions, including the expected term of the stock-based awards, stock price

## **Table of Contents**

volatility and pre-vesting forfeitures. The assumptions used in calculating the fair value of stock-based awards represent our best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we were to use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate forfeitures based on our historical experience of stock-based awards granted, exercised and cancelled, as well as considering future expected behavior. If the actual forfeiture rate is materially different from our estimate, stock-based compensation expense could be different from what we have recorded in the current period.

Under ASC Topic 718, time-vested stock awards are accounted for at fair value at date of grant. The compensation expense is recorded over the requisite service period. Stock-based compensation expense for time-vested stock awards granted in Fiscal 2011, Fiscal 2010 and Fiscal 2009 was recorded over the requisite service period using the graded-vesting method for the entire award.

Performance-vested awards, which qualified as equity plans under ASC Topic 718, were accounted for based on fair value at date of grant. The stock-based compensation expense was based on the number of shares expected to be issued when it became probable that performance targets required to receive the award would be achieved. The expense was recorded over the requisite service period.

BOGO options, which are immediately vested and exercisable upon issuance, are accounted for at fair value at date of grant. The compensation expense is recognized over a four year period due to the terms of the option requiring forfeiture in certain cases including the grantee's voluntary resignation from the Company's employ prior to May 2011.

The fair value of time-vested stock options and the buy one, get one ( BOGO ) options granted during Fiscal 2011, Fiscal 2010 and Fiscal 2009 were determined using the Black-Scholes option-pricing model. The fair value of performance based stock options issued during Fiscal 2011, Fiscal 2010 and Fiscal 2009 was based on the Monte Carlo model. Both models incorporate various assumptions such as expected dividend yield, risk-free interest rate, expected life of the options and expected stock price volatility.

## **Incentive Plan Modifications**

On May 20, 2011, the Compensation Committee of the Company approved amendments to the Company's Stock Incentive Plan (the Incentive Plan ), the form of option grant letter and certain outstanding options (the Outstanding Options ) held by various employees (collectively, the Plan Amendments ).

The Plan Amendments (which apply to Outstanding Options and, unless otherwise specified at the time of grant, any future option grants under the Amended Incentive Plan, and, where applicable, any shares held by employees) generally provide for the following:

Eliminated the holding period after vesting for Performance and Stretch Performance options;

Changed the definition of Qualified IPO ;

Eliminated certain restrictions on transfer of shares in the event of a Qualified IPO;

Provided each optionee the right to satisfy the exercise price and any withholding tax obligation triggered by such exercise by any combination of cash and/or shares (including both previously owned shares and shares otherwise to be delivered upon exercise of the option); and

Added two additional vesting events applicable to Performance Options and to certain Stretch Performance Options if they occur prior to or concurrent with the end of the Company's fiscal 2012 year.

The incremental compensation cost associated with the modifications to the Company's Incentive Plan totaled \$2.2 million, of which \$0.2 million was initially recognized in the second fiscal quarter 2011 and \$0.3 million in the third fiscal quarter 2011. The plan modification affected

## Edgar Filing: CLAIRE'S STORES INC - Form 10-K

approximately 155 employees. During the fourth quarter of Fiscal 2011, we determined that the achievement of vesting events for the Performance Stock Options was not



## **Table of Contents**

probable and therefore, reversed the stock compensation expense that was previously recognized for these options. Additionally, we recorded a reversal of stock compensation expense of \$5.1 million associated with forfeitures of stock options, including \$3.8 million for our former Chief Executive Officer.

### **Buy-One-Get-One ( BOGO ) Option Offer**

On May 20, 2011, the Compensation Committee of the Company also approved an offer pursuant to the amended Incentive Plan to certain employees to purchase a specified number of shares of the common stock of the parent of the Company at a price per share of \$10.00 (the Offer ). For each share purchased, the employee received an option to purchase an additional share at \$10.00 (a BOGO Option ). The Offer was made available to employees who had not previously accepted similar offers from the parent of the Company. The Company granted 179,000 BOGO Options and recognized stock-based compensation expense of approximately \$0.3 million in Fiscal 2011 related to these options.

Our estimates of stock price volatility, interest rate, grant date fair value and expected term of options and restricted stock are affected by illiquid credit markets, consumer spending and current and future economic conditions. As future events and their effects can not be determined with precision, actual results could differ significantly from our estimates. See Note 9 Stock Options and Stock-Based Compensation in the Notes to Consolidated Financial Statements.

### ***Derivatives and Hedging***

We account for derivative instruments in accordance with ASC Topic 815, *Derivatives and Hedging*. In accordance with ASC Topic 815, we report all derivative financial instruments on our Consolidated Balance Sheet at fair value. We formally designate and document the financial instrument as a hedge of a specific underlying exposure, as well as the risk management objectives and strategies for undertaking the hedge transaction. We formally assess both at inception and at least quarterly thereafter, whether the financial instruments that are used in hedging transactions are effective at offsetting changes in either the fair value or cash flows of the related underlying exposure. We measure the effectiveness of our cash flow hedges by evaluating the following criteria: (i) the re-pricing dates of the derivative instrument match those of the debt obligation; (ii) the interest rates of the derivative instrument and the debt obligation are based on the same interest rate index and tenor; (iii) the variable interest rate of the derivative instrument does not contain a floor or cap, or other provisions that cause a basis difference with the debt obligation; and (iv) the likelihood of the counterparty not defaulting is assessed as being probable.

We primarily employ derivative financial instruments to manage our exposure to market risk from interest rate changes and to limit the volatility and impact of interest rate changes on earnings and cash flows. We do not enter into derivative financial instruments for trading or speculative purposes. We face credit risk if the counterparties to the financial instruments are unable to perform their obligations. However, we seek to mitigate credit derivative risk by entering into transactions with counterparties that are significant and creditworthy financial institutions. We monitor the credit ratings of the counterparties.

For derivatives that qualify as cash flow hedges, we report the effective portion of the change in fair value as a component of Accumulated other comprehensive income (loss), net of tax in the Consolidated Balance Sheets and reclassifies it into earnings in the same periods in which the hedged item affects earnings, and within the same income statement line item as the impact of the hedged item. The ineffective portion of the change in fair value of a cash flow hedge is recognized into income immediately. For derivative financial instruments which do not qualify as cash flow hedges, any changes in fair value would be recorded in the Consolidated Statements of Operations and Comprehensive Income. We adopted ASC Topic 820, *Fair Value Measurements and Disclosures*, on February 3, 2008, which required the Company to include credit valuation adjustment risk in the calculation of fair value.

We may at our discretion terminate or change the designation of any such hedging instrument agreements prior to maturity. At that time, any gains or losses previously reported in accumulated other comprehensive income (loss) on termination would amortize into interest expense or interest income to correspond to the recognition of interest expense or interest income on the hedged debt. If such debt instrument was also terminated, the gain or loss associated with the terminated derivative included in accumulated other comprehensive income (loss) at the time of termination of the debt would be recognized in the Consolidated Statements of Operations and Comprehensive Income at that time.

**Table of Contents****Contractual Obligations and Off Balance Sheet Arrangements**

We finance certain equipment through transactions accounted for as non-cancelable operating leases. As a result, the rental expense for this equipment is recorded during the term of the lease contract in our Consolidated Financial Statements, generally over four to seven years. In the event that we, or our landlord, terminate a real property lease prior to its scheduled expiration, we will be required to accrue all future rent payments under any non-cancelable operating lease with respect to leasehold improvements or equipment located thereon. The following table sets forth our contractual obligations requiring the use of cash as of January 28, 2012:

Contractual Obligations (in millions)	Payments Due by Period				
	Total	1 year	2-3 years	4-5 years	More than 5 years
<b><u>Recorded Contractual Obligations:</u></b>					
Debt <sup>(1)</sup>	\$ 2,386.4	\$	\$ 1,154.3 <sup>(2)</sup>	\$ 522.5 <sup>(3)</sup>	\$ 709.6 <sup>(4)</sup>
Capital lease obligation	46.5	2.2	4.6	4.7	35.0
<b><u>Unrecorded Contractual Obligations:</u></b>					
Operating lease obligations <sup>(5)</sup>	1,060.2	205.3	342.6	245.9	266.4
Interest <sup>(6)</sup>	709.6	152.6	282.4	159.2	115.4
Letters of credit	4.8	4.8			
Total	\$ 4,207.5	\$ 364.9	\$ 1,783.9	\$ 932.3	\$ 1,126.4

(1) Represents debt expected to be paid and does not assume any note repurchases or prepayments.

(2) Includes \$1,154.3 million under our senior secured term loan Credit Facility.

(3) Includes \$302.2 million under our Senior Toggle notes and \$220.3 million under our Senior Fixed Rate Notes.

(4) Includes \$259.6 million under our Senior Subordinated Notes and \$450.0 million under our Senior Secured Second Lien Notes.

(5) Operating lease obligations consists of future minimum lease commitments related to store operating leases, distribution center leases, office leases and equipment leases. Operating lease obligations do not include common area maintenance ( CAM ), contingent rent, insurance, marketing or tax payments for which the Company is also obligated.

(6) Represents interest expected to be paid on our debt and does not assume any note repurchases or prepayments. Projected interest on variable rate debt is calculated using the applicable interest rate at January 28, 2012, and the effect of the interest rate swap through July 2013 as discussed in Note 6 Derivatives and Hedging Activities in the Notes to Consolidated Financial Statements.

We have no material off-balance sheet arrangements (as such term is defined in Item 303(a) (4) (ii) under Regulation S-K of the Securities Exchange Act) other than disclosed herein.

**Seasonality and Quarterly Results**

Sales of each category of merchandise vary from period to period depending on current trends. We experience traditional retail patterns of peak sales during the Christmas, Easter and back-to-school periods. Sales as a percentage of total sales in each of the four quarters of Fiscal 2011 were 23%, 24%, 24% and 29%, respectively. See Note 13 Selected Quarterly Financial Data in the Notes to Consolidated Financial Statements for our quarterly results of operations.

## **Table of Contents**

### **Impact of Inflation**

Inflation impacts our operating costs including, but not limited to, cost of goods and supplies, occupancy costs and labor expenses. We seek to mitigate these effects by passing along inflationary increases in costs through increased sales prices of our products where competitively practical or by increasing sales volumes.

### **Recent Accounting Pronouncements**

See Note 2 Summary of Significant Accounting Policies, in the Notes to the Consolidated Financial Statements.

There are no recently issued accounting standards that are expected to have a material effect on our financial condition, results of operations or cash flows.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

#### *Cash and Cash Equivalents*

We have significant amounts of cash and cash equivalents, excluding restricted cash, at financial institutions that are in excess of federally insured limits. With the current financial environment and the instability of financial institutions, we cannot be assured that we will not experience losses on our deposits. We mitigate this risk by investing in money market funds that are invested exclusively in U.S. Treasury securities, maintaining bank accounts with a group of credit worthy financial institutions and limiting the cash balance in any one bank account. As of January 28, 2012, all cash equivalents, excluding restricted cash, were maintained in one money market fund that was invested exclusively in U.S. Treasury securities and our restricted cash was deposited with a significant and credit worthy financial institution.

#### *Interest Rates*

On July 28, 2010, we entered into an interest rate swap agreement (the Swap) to manage exposure to fluctuations in interest rates. The Swap expires on July 30, 2013. The Swap represents a contract to exchange floating rate for fixed interest payments periodically over the life of the Swap without exchange of the underlying notional amount. The Swap covers an aggregate notional amount of \$200.0 million of the outstanding principal balance of the senior secured term loan facility. The fixed rate of the Swap is 1.2235% and has been designated and accounted for as a cash flow hedge. At January 28, 2012 and January 29, 2011, the estimated fair value of the Swap was a liability of approximately \$2.2 million and \$1.2 million, respectively, and was recorded, net of tax, as a component of Accumulated other comprehensive income (loss), net of tax in our Consolidated Balance Sheets.

At January 28, 2012, we had fixed rate debt of \$1,249.4 million and variable rate debt of \$1,154.3 million. Based on our variable rate debt balance (less \$200 million hedged by interest rate swaps) as of January 28, 2012, a 1% change in interest rates would increase or decrease our annual interest expense by approximately \$9.5 million.

#### *Foreign Currency*

We are exposed to market risk from foreign currency exchange rate fluctuations on the United States dollar (USD or dollar) value of foreign currency denominated transactions and our investments in foreign subsidiaries. We manage this exposure to market risk through our regular operating and financing activities, and may from time to time, use foreign currency options. Exposure to market risk for changes in foreign currency exchange rates relates primarily to our foreign operations buying, selling, and financing in currencies other than local currencies and to the carrying value of net investments in foreign subsidiaries. At January 28, 2012, we maintained no foreign currency options. We generally do not hedge the translation exposure related to our net investment in foreign subsidiaries. Included in Comprehensive income are \$(4.8) million, \$0.8 million and \$15.5 million, net of tax, reflecting the unrealized gain (loss) on foreign currency translations during Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively.

## **Table of Contents**

Certain of our subsidiaries make significant USD purchases from Asian suppliers, particularly in China. Until July 2005, the Chinese government pegged its currency, the yuan renminbi ( RMB ), to the USD, adjusting the relative value only slightly and on infrequent occasion. Many people viewed this practice as leading to a substantial undervaluation of the RMB relative to the USD and other major currencies, providing China with a competitive advantage in international trade. China now allows the RMB to float to a limited degree against a basket of major international currencies, including the USD, the euro and the Japanese yen. The official exchange rate has historically remained stable; however, there are no assurances that this currency exchange rate will continue to be as stable in the future due to the Chinese government's adoption of a floating rate with respect to the value of the RMB against foreign currencies. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on China to adopt an even more flexible and more market-oriented currency policy that allows a greater fluctuation in the exchange rate between the RMB and the USD. This floating exchange rate, and any appreciation of the RMB that may result from such rate, could have various effects on our business, which include making our purchases of Chinese products more expensive. If we are unable to negotiate commensurate price decreases from our Chinese suppliers, these higher prices would eventually translate into higher costs of sales, which could have a material adverse effect on our results of operations.

The results of operations of foreign subsidiaries, when translated into U.S. dollars, reflect the average rates of exchange for the months that comprise the periods presented. As a result, similar results in local currency can vary significantly upon translation into U.S. dollars if exchange rates fluctuate significantly from one period to the next. Accordingly, fluctuations in foreign currency rates, most notably the strengthening of the dollar against the euro, could have a material impact on our revenue growth in future periods.

### *General Market Risk*

Our competitors include department stores, specialty stores, mass merchandisers, discount stores and other retail and internet channels. Our operations are impacted by consumer spending levels, which are affected by general economic conditions, consumer confidence, employment levels, availability of consumer credit and interest rates on credit, consumer debt levels, consumption of consumer staples including food and energy, consumption of other goods, adverse weather conditions and other factors over which the Company has little or no control. The increase in costs of such staple items has reduced the amount of discretionary funds that consumers are willing and able to spend for other goods, including our merchandise. Should there be continued volatility in food and energy costs, sustained recession in the U.S. and Europe, rising unemployment and continued declines in discretionary income, our revenue and margins could be significantly affected in the future. We can not predict whether, when or the manner in which the economic conditions described above will change.

---

**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**

<u>Report of Independent Registered Public Accounting Firm</u>	<b>Page No.</b> 48
<u>Consolidated Balance Sheets as of January 28, 2012 and January 29, 2011</u>	49
<u>Consolidated Statements of Operations and Comprehensive Income for the fiscal years ended January 28, 2012, January 29, 2011 and January 30, 2010</u>	50
<u>Consolidated Statements of Changes in Stockholder's Deficit for the fiscal years ended January 28, 2012, January 29, 2011 and January 30, 2010</u>	51
<u>Consolidated Statements of Cash Flows for the fiscal years ended January 28, 2012, January 29, 2011 and January 30, 2010</u>	52
<u>Notes to Consolidated Financial Statements</u>	53

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholder

Claire's Stores, Inc.:

We have audited the accompanying consolidated balance sheets of Claire's Stores, Inc. and subsidiaries (the Company) as of January 28, 2012 and January 29, 2011, and the related consolidated statements of operations and comprehensive income, changes in stockholder's deficit, and cash flows for each of the fiscal years in the three-year period ended January 28, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Claire's Stores, Inc. and subsidiaries as of January 28, 2012 and January 29, 2011, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended January 28, 2012 in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

April 4, 2012

Miami, Florida

Certified Public Accountants

**Table of Contents****CLAIRE S STORES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	January 28, 2012	January 29, 2011
	(In thousands, except share and per share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents and restricted cash of \$4,350 and \$23,864, respectively	\$ 174,374	\$ 279,766
Inventories	142,104	136,148
Prepaid expenses	20,010	21,449
Other current assets	25,423	24,658
Total current assets	361,911	462,021
Property and equipment:		
Furniture, fixtures and equipment	207,620	186,514
Leasehold improvements	281,774	248,030
	489,394	434,544
Less accumulated depreciation and amortization	(281,874)	(233,511)
	207,520	201,033
Leased property under capital lease:		
Land and building	18,055	18,055
Less accumulated depreciation and amortization	(1,805)	(903)
	16,250	17,152
Goodwill	1,550,056	1,550,056
Intangible assets, net of accumulated amortization of \$49,270 and \$38,747, respectively	549,768	557,466
Deferred financing costs, net of accumulated amortization of \$55,818 and \$41,659, respectively	33,025	36,434
Other assets	44,495	42,287
	2,177,344	2,186,243
Total assets	\$ 2,763,025	\$ 2,866,449
<b>LIABILITIES AND STOCKHOLDER S DEFICIT</b>		
Current liabilities:		
Short-term debt and current portion of long-term debt	\$	\$ 76,154
Trade accounts payable	60,704	54,355
Income taxes payable	10,228	11,744
Accrued interest payable	31,859	16,783
Accrued expenses and other current liabilities	104,525	107,115
Total current liabilities	207,316	266,151
Long-term debt	2,386,382	2,236,842
Revolving credit facility		194,000
Obligation under capital lease	17,290	17,290

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Deferred tax liability	120,452	121,776
Deferred rent expense	28,861	26,637
Unfavorable lease obligations and other long-term liabilities	25,020	30,268
	2,578,005	2,626,813
Commitments and contingencies		
Stockholder's deficit:		
Common stock par value \$0.001 per share; authorized 1,000 shares; issued and outstanding 100 shares		
Additional paid-in capital	619,453	621,099
Accumulated other comprehensive income (loss), net of tax	(4,351)	1,416
Accumulated deficit	(637,398)	(649,030)
	(22,296)	(26,515)
Total liabilities and stockholder's deficit	\$ 2,763,025	\$ 2,866,449

See accompanying notes to consolidated financial statements.



**Table of Contents****CLAIRE S STORES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**

(in thousands)

	<b>Fiscal Year Ended January 28, 2012</b>	<b>Fiscal Year Ended January 29, 2011</b>	<b>Fiscal Year Ended January 30, 2010</b>
Net sales	\$ 1,495,900	\$ 1,426,397	\$ 1,342,389
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	724,775	685,111	663,269
Gross profit	771,125	741,286	679,120
Other expenses:			
Selling, general and administrative	504,360	493,081	466,965
Depreciation and amortization	68,753	65,198	71,471
Impairment of assets		12,262	3,142
Severance and transaction-related costs	6,928	741	921
Other (income) expense, net	(1,254)	5,542	(5,493)
	578,787	576,824	537,006
Operating income	192,338	164,462	142,114
Gain on early debt extinguishment	6,405	13,388	36,412
Impairment of equity investment		6,030	
Interest expense, net	176,475	157,706	177,418
Income before income tax expense	22,268	14,114	1,108
Income tax expense	10,636	9,791	11,510
Net income (loss)	\$ 11,632	\$ 4,323	\$ (10,402)
Net income (loss)	\$ 11,632	\$ 4,323	\$ (10,402)
Foreign currency translation and interest rate swap adjustments, net of tax	(5,767)	8,363	24,944
Reclassification of foreign currency translation adjustments into net income		(9,572)	
Comprehensive income	\$ 5,865	\$ 3,114	\$ 14,542

See accompanying notes to consolidated financial statements.

**Table of Contents**

**CLAIRE S STORES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN**  
**STOCKHOLDER S DEFICIT**

(In thousands, except per share amounts)

	Number of shares of common stock	Common stock	Additional paid-in capital	Accumulated other comprehensive income (loss), net	Accumulated deficit	Total
Balance: January 31, 2009	100		609,427	(22,319)	(642,951)	(55,843)
Net loss					(10,402)	(10,402)
Stock option expense			6,518			6,518
Restricted stock expense, net of unearned compensation			141			141
Foreign currency translation adjustment and unrealized gain on interest rate swaps, net of tax				24,944		24,944
Balance: January 30, 2010	100		616,086	2,625	(653,353)	(34,642)
Net income					4,323	4,323
Stock option expense			4,946			4,946
Restricted stock expense, net of unearned compensation			67			67
Foreign currency translation adjustment and unrealized gain on interest rate swaps, net of tax				8,363		8,363
Reclassification of foreign currency translation adjustments into net income				(9,572)		(9,572)
Balance: January 29, 2011	100		621,099	1,416	(649,030)	(26,515)
Net income					11,632	11,632
Stock option benefit			(1,661)			(1,661)
Restricted stock expense, net of unearned compensation			15			15
Foreign currency translation adjustment and unrealized loss on interest rate swaps, net of tax				(5,767)		(5,767)
Balance: January 28, 2012	100	\$	\$ 619,453	\$ (4,351)	\$ (637,398)	\$ (22,296)

See accompanying notes to consolidated financial statements.

**Table of Contents**

**CLAIRE S STORES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Fiscal Year Ended January 28, 2012	Fiscal Year Ended January 29, 2011	Fiscal Year Ended January 30, 2010
Cash flows from operating activities:			
Net income (loss)	\$ 11,632	\$ 4,323	\$ (10,402)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	68,753	65,198	71,471
Impairment		18,292	3,142
Amortization of lease rights and other assets	3,189	3,204	2,199
Amortization of debt issuance costs	13,106	10,005	10,398
Payment of in kind interest expense	11,831	36,872	39,013
Foreign currency exchange net gain on Euro Loan	(1,953)		
Net unfavorable accretion of lease obligations	(657)	(1,490)	(2,151)
Loss (gain) on sale/retirement of property and equipment, net	42	672	(1,389)
Gain on early debt extinguishment	(6,405)	(13,388)	(36,412)
Gain on sale of intangible assets/lease rights	(90)		(506)
Stock compensation (benefit) expense	(1,646)	5,013	6,659
(Increase) decrease in:			
Inventories	(8,394)	(25,374)	(4,081)
Prepaid expenses	1,376	12,658	1,797
Other assets	(5,852)	751	(5,519)
Increase (decrease) in:			
Trade accounts payable	7,311	10,314	(12,744)
Income taxes payable	(1,991)	3,667	5,510
Accrued interest payable	15,081	2,139	1,328
Accrued expenses and other liabilities	(3,071)	14,575	(129)
Deferred income taxes	(2,022)	(595)	4,114
Deferred rent expense	2,320	4,423	3,178
Net cash provided by operating activities	102,560	151,259	75,476
Cash flows from investing activities:			
Acquisition of property and equipment, net	(70,908)	(48,711)	(24,952)
Proceeds from sale of property and equipment		16,765	1,830
Acquisition of intangible assets/lease rights	(5,709)	(1,104)	(546)
Proceeds from sale of intangible assets/lease rights	816		2,409
Changes in restricted cash	18,417	(23,902)	
Net cash used in investing activities	(57,384)	(56,952)	(21,259)
Cash flows from financing activities:			
Payments of Credit facility	(438,940)	(14,500)	(14,500)
Proceeds from note	450,000		
Proceeds from short-term debt		57,494	
Payment of short-term debt	(54,653)		
Repurchases of notes	(78,343)	(79,865)	(46,091)
Payment of debt issuance costs	(10,751)	(503)	
Principal payments of capital lease		(765)	

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Net cash used in financing activities:	(132,687)	(38,139)	(60,591)
Effect of foreign currency exchange rate changes on cash and cash equivalents	1,633	1,026	508
Net (decrease) increase in cash and cash equivalents	(85,878)	57,194	(5,866)
Cash and cash equivalents, at beginning of period	255,902	198,708	204,574
Cash and cash equivalents, at end of period	170,024	255,902	198,708
Restricted cash, at end of period	4,350	23,864	
Cash and cash equivalents and restricted cash, at end of period	\$ 174,374	\$ 279,766	\$ 198,708
Supplemental disclosure of cash flow information:			
Income taxes paid	\$ 14,283	\$ 6,332	\$ 3,159
Interest paid	136,533	108,923	126,733
Non-cash investing and financing activities:			
Property acquired under capital lease		18,055	
See accompanying notes to consolidated financial statements.			

---

**Table of Contents**

**CLAIRE S STORES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. NATURE OF OPERATIONS AND ACQUISITION OF CLAIRE S STORES, INC.**

**Nature of Operations** - Claire s Stores, Inc., a Florida corporation, and subsidiaries (collectively the Company ), is a leading retailer of value-priced fashion accessories targeted towards pre-teens, teenagers, and young adults. The Company is organized into two segments: North America and Europe. The Company operates owned stores throughout the United States, Puerto Rico, Canada, and the U.S. Virgin Islands (North America segment) and the United Kingdom, Switzerland, Austria, Germany, France, Ireland, Spain, Portugal, Netherlands, Belgium, Poland, Czech Republic and Hungary (Europe segment). Until September 2, 2010, the Company operated stores in Japan through a former 50:50 joint venture. Beginning September 2, 2010, these stores began to operate as licensed stores.

**Acquisition of Claire s Stores, Inc.** - In May 2007, the Company was acquired by Apollo Management VI, L.P. ( Apollo Management ), together with certain affiliated co-investment partnerships (collectively the Sponsors ), through a merger (the Merger ) and Claire s Stores, Inc. became a wholly-owned subsidiary of Claire s Inc.

The purchase of the Company and the related fees and expenses were financed through the issuance of the Merger Notes, borrowings under the Credit Facility, an equity investment by the Sponsors, and cash on hand at the Company.

The closing of the Merger occurred simultaneously with:

the closing of the Company s senior secured term loan facility and revolving credit facility, (the Revolver ), (collectively the Credit Facility ) of \$1.65 billion;

the closing of the Company s senior notes offering (the Merger Notes ) in the aggregate principal amount of \$935.0 million; and

the equity investment by the Sponsors, collectively, of approximately \$595.7 million.

The aforementioned transactions, including the Merger and payment of costs related to these transactions, are collectively referred to as the Transactions.

Claire s Inc. is an entity that was formed in connection with the Transactions and prior to the Merger had no assets or liabilities other than the shares of Bauble Acquisition Sub, Inc. and its rights and obligations under and in connection with the merger agreement. As a result of the Merger, all of the Company s issued and outstanding capital stock is owned by Claire s Inc.

The acquisition of Claire s Stores, Inc. was accounted for as a business combination using the purchase method of accounting, whereby the purchase price was allocated to the assets and liabilities based on the estimated fair market values at the date of acquisition.

See Note 5 Debt for a summary of the terms of the Merger Notes and the Credit Facility.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of Consolidation** - The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. Until September 2, 2010, the Company accounted for the results of operations of its former 50% ownership interest in Claire s Nippon under the equity method and included the results within Other (income) expense, net in its Consolidated Statements of Operations and Comprehensive Income. On September 2, 2010, the Company no longer had an ownership interest in Claire s Nippon. All significant intercompany balances and transactions have been eliminated in consolidation.



**Table of Contents**

**Fiscal Year** - The Company's fiscal year ends on the Saturday closest to January 31. The fiscal year ended January 28, 2012 (Fiscal 2011), January 29, 2011 (Fiscal 2010) and January 30, 2010 (Fiscal 2009) consisted of 52 weeks, respectively.

**Use of Estimates** - The Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make certain estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures regarding contingent assets and liabilities and reported amounts of revenues and expenses. Such estimates include, but are not limited to, the value of inventories, goodwill, intangible assets and other long-lived assets, legal contingencies and assumptions used in the calculation of income taxes, retirement and other post-retirement benefits, stock-based compensation, derivative and hedging activities, residual values and other items. These estimates and assumptions are based on management's best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. Management adjusts such estimates and assumptions when facts and circumstances dictate. Illiquidity in credit markets, volatility in each of the equity, foreign currency, and energy markets and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates will be reflected in the financial statements in those future periods when the changes occur.

**Reclassifications** - The Consolidated Financial Statements include certain reclassifications of prior period amounts in order to conform to current year presentation.

**Cash and Cash Equivalents and Restricted Cash** - The Company considers all highly liquid instruments purchased with an original maturity of 90 days or less to be cash equivalents. As of January 28, 2012, all cash equivalents were maintained in one money market fund that was invested exclusively in U.S. Treasury securities. Restricted cash is not available to the Company for general corporate purposes. As of January 28, 2012, restricted cash consisted of collateral in the amount of \$4.4 million for the interest rate swap. As of January 29, 2011, restricted cash consists of a security deposit in the amount of 15.0 million Euros (€) (\$20.4 million) for the outstanding short-term note payable and collateral in the amount of \$3.5 million for the interest rate swap. The restricted cash amount is classified as a current asset in the accompanying Consolidated Balance Sheets since the items it secures are classified as current liabilities. See Note 5 Debt and Note 6 Derivatives and Hedging Activities, respectively, for further details.

**Inventories** - Merchandise inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out basis using the retail method in North America and average cost method, at an individual item level for Europe.

**Prepaid Expenses** - Prepaid expenses as of January 28, 2012 and January 29, 2011 included the following components (in thousands):

	January 28, 2012	January 29, 2011
Prepaid rent and occupancy	\$ 16,739	\$ 19,532
Prepaid insurance	1,002	577
Other	2,269	1,340
Total prepaid expenses	\$ 20,010	\$ 21,449

**Table of Contents**

Other Current Assets - Other current assets as of January 28, 2012 and January 29, 2011 included the following components (in thousands):

	January 28, 2012	January 29, 2011
Credit card receivables	\$ 6,141	\$ 5,209
Franchise receivables	2,528	4,139
Store supplies	6,862	6,567
Deferred tax assets, net of valuation allowance	5,852	4,064
Income taxes receivable	393	69
Other	3,647	4,610
<b>Total other current assets</b>	<b>\$ 25,423</b>	<b>\$ 24,658</b>

Property and Equipment - Property and equipment are recorded at historical cost. Depreciation is computed on the straight-line method over the estimated useful lives of the furniture, fixtures, and equipment, which range from five to ten years. Amortization of leasehold improvements is computed on the straight-line method based upon the shorter of the estimated useful lives of the assets or the terms of the respective leases. Maintenance and repair costs are charged to earnings while expenditures for major improvements are capitalized. Upon the disposition of property and equipment, the accumulated depreciation is deducted from the original cost and any gain or loss is reflected in current earnings.

Capital Leases - Leased property meeting certain capital lease criteria is capitalized as an asset and the present value of the related lease payments is recorded as a liability. Amortization of capitalized leased assets is recorded using the straight-line method over the shorter of the estimated useful life of the leased asset or the initial lease term and is included in Depreciation and amortization in the Company's Consolidated Statements of Operations and Comprehensive Income. Interest expense is recognized on the outstanding capital lease obligation using the effective interest method and is recorded in Interest expense, net in the Company's Consolidated Statements of Operations and Comprehensive Income. On February 19, 2010, the Company sold its North America distribution center/office building (the Property) to a third party. The Company received net proceeds of \$16.8 million from the sale of the Property. Contemporaneously with the sale of the Property, the Company entered into a lease agreement, dated February 19, 2010. The lease agreement provides for (1) an initial expiration date of February 28, 2030 with two (2) five (5) year renewal periods, each at the option of the Company and (2) basic rent of \$2.1 million per annum (subject to annual increases). This transaction is accounted for as a capital lease. The Company has a \$1.1 million letter of credit to secure lease payments for the Property.

Goodwill - As discussed in Note 1 Nature of Operations and Acquisition of Claire's Stores, Inc. above, the Company accounted for the acquisition of Claire's Stores, Inc. as a business combination using the purchase method of accounting. The purchase price was allocated to assets and liabilities based on estimated fair market values at the date of acquisition. The remaining \$1.8 billion excess of cost over amounts assigned to assets acquired and liabilities assumed was recognized as goodwill. The goodwill is not deductible for tax purposes.

The Company performs a goodwill impairment test on an annual basis or more frequently when events or circumstances indicate that the carrying value of a reporting unit more likely than not exceeds its fair value. Recoverability of goodwill is evaluated using a two-step process. The first step involves a comparison of the fair value of each of our reporting units with its carrying value. If a reporting unit's carrying value exceeds its fair value, the second step is performed to measure the amount of impairment loss, if any. The second step involves a comparison of the implied fair value and carrying value of that reporting unit's goodwill. To the extent that a reporting unit's carrying value exceeds the implied fair value of its goodwill, an impairment loss is recognized. See Note 3 Impairment Charges for results of impairment testing and Note 4 Goodwill and Other Intangible Assets, respectively, for more details.



**Table of Contents**

**Intangible Assets** - Intangible assets include tradenames, franchise agreements, lease rights, territory rights and leases that existed at the date of acquisition with terms that were favorable to market at that date. The Company makes investments through its Europe subsidiaries in intangible assets upon the opening and acquisition of many of our store locations in Europe. These intangible assets are amortized to residual value on a straight-line basis over the useful lives of the respective leases, not to exceed 25 years. The Company evaluates the residual value of its intangible assets periodically and adjusts the amortization period and/or residual value when the Company believes the residual value of the asset is not recoverable. Indefinite-lived intangible assets are tested for impairment annually or more frequently when events or circumstances indicate that the carrying value more likely than not exceeds its fair value. Definite-lived intangible assets are tested for impairment when events or circumstances indicate that the carrying value may not be recoverable. Any impairment charges resulting from the application of these tests are immediately recorded as a charge to earnings in the Company's Consolidated Statements of Operations and Comprehensive Income. See Note 3 Impairment Charges for results of impairment testing and Note 4 Goodwill and Other Intangible Assets, respectively, for more details.

**Deferred Financing Costs** - Costs incurred to issue debt are deferred and amortized as a component of interest expense over the estimated term of the related debt using the effective interest rate method. Amortization expense, recognized as a component of Interest expense, net in the Company's Consolidated Statements of Operations and Comprehensive Income, were \$13.1 million, \$10.0 million and \$10.4 million for Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively.

**Other Assets** - Other assets as of January 28, 2012 and January 29, 2011 included the following components (in thousands):

	January 28, 2012	January 29, 2011
Initial direct costs of leases	\$ 16,257	\$ 16,358
Prepaid lease payments	7,366	6,856
Deferred tax assets, non-current	1,424	2,726
Other	19,448	16,347
<b>Total other assets</b>	<b>\$ 44,495</b>	<b>\$ 42,287</b>

On September 2, 2010, the Company converted its former 50% ownership interest in the Claire's Nippon joint venture into the full and exclusive rights to operate Claire's stores in all of Asia excluding Japan. The former joint venture partner acquired the right to operate Claire's stores exclusively in Japan. The Company and the former joint venture partner also agreed to operate Claire's Nippon under a new license agreement, to replace the existing merchandising agreement and to amend the buying agency agreement. In accordance with Accounting Standards Codification (ASC) Subtopic 845-10, *Nonmonetary Transactions*, the Company measured the conversion based on the fair value of the asset surrendered. The Company recorded the exclusive territory rights as an indefinite-lived intangible asset in the amount of \$0.6 million. See Note 4 Goodwill and Other Intangibles.

The Company recorded its 50% ownership interest of Claire's Nippon's net loss in the amounts of \$2.5 million and \$1.0 million for Fiscal 2010 and Fiscal 2009, respectively, in Other (income) expense, net in the Consolidated Statements of Operations and Comprehensive Income.

The initial direct costs of leases and prepaid lease payments are amortized on a straight-line basis over the respective lease terms, typically ranging from four to 15 years.

**Impairment of Long-Lived Assets** - The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the net book value of an asset may not be recoverable. Recoverability of long-lived assets to be held and used is measured by a comparison of the net book value of an asset or asset group to the future net undiscounted cash flows expected to be generated by the asset or asset group. If these comparisons indicate that the asset or asset group is not recoverable, an impairment loss is recognized for the excess of the carrying amount over the fair value of the asset or asset group. The fair value is estimated based on discounted future cash flows expected to result from the

**Table of Contents**

use and eventual disposition of the asset or asset group using a rate that reflects the operating segment's average cost of capital. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell and are no longer depreciated. See Note 3 Impairment Charges for results of impairment testing.

**Accrued Expenses and Other Current Liabilities** Accrued expenses and other current liabilities as of January 28, 2012 and January 29, 2011 included the following components (in thousands):

	January 28, 2012	January 29, 2011
Compensation and benefits	\$ 40,532	\$ 46,121
Gift cards and certificates	22,270	21,917
Sales and local taxes	16,493	14,321
Store rent	3,776	3,753
Interest rate swaps	2,159	1,165
Other	19,295	19,838
<b>Total accrued expenses and other current liabilities</b>	<b>\$ 104,525</b>	<b>\$ 107,115</b>

**Revenue Recognition** - The Company recognizes sales as the customer takes possession of the merchandise. The estimated liability for sales returns is based on the historical return levels, which is included in Accrued expenses and other current liabilities. The Company excludes sales taxes collected from customers from Net sales in its Consolidated Statements of Operations and Comprehensive Income.

The Company accounts for the goods it sells to third parties under franchising and licensing agreements within Net sales and Cost of sales, occupancy and buying expenses in the Company's Consolidated Statements of Operations and Comprehensive Income. The franchise fees the Company charges under the franchising agreements are reported in Other (income) expense, net in the Company's Consolidated Statements of Operations and Comprehensive Income.

Upon purchase of a gift card or gift certificate, a liability is established for the cash value. The liability is included in Accrued expenses and other current liabilities. Revenue from gift card and gift certificate sales is recognized at the time of redemption.

**Cost of Sales** - Included within the Company's Consolidated Statements of Operations and Comprehensive Income line item Cost of sales, occupancy and buying expenses is the cost of merchandise sold to our customers, inbound and outbound freight charges, purchasing costs, and inspection costs. Also included in this line item are the occupancy costs of the Company's stores and the Company's internal costs of facilitating the merchandise procurement process, both of which are treated as period costs. All merchandise purchased by the Company is shipped to one of its two distribution centers. As a result, the Company has no internal transfer costs. The cost of the Company's distribution centers are included within the financial statement line item Selling, general and administrative expenses, and not in Cost of sales, occupancy and buying expenses. These distribution center costs were approximately \$12.4 million, \$10.0 million and \$8.5 million, for Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively. All depreciation and amortization expense is reported on a separate line on the Company's consolidated statement of operations.

**Advertising Expenses** - The Company expenses advertising costs as incurred and include in-store marketing, mall association dues and digital interactive media. Advertising expenses were \$15.9 million, \$12.8 million and \$11.3 million for Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively.

**Rent Expense** - The Company recognizes rent expense for operating leases with periods of free rent (including construction periods), step rent provisions, and escalation clauses on a straight-line basis over the applicable lease term. From time to time, the Company may receive capital improvement funding from its lessors. These amounts are recorded as a Deferred rent expense and amortized over the

## **Table of Contents**

remaining lease term as a reduction of rent expense. The Company considers lease renewals in the determination of the applicable lease term when such renewals are reasonably assured. The Company takes this factor into account when calculating minimum aggregate rental commitments under non-cancelable operating leases set forth in Note 7 Commitments and Contingencies.

**Stock-Based Compensation** - The Company issues stock options and other stock-based awards to executive management, key employees, and directors under its stock-based compensation plans.

Time-vested stock awards, including stock options and restricted stock, are accounted for at fair value at date of grant. The stock-based compensation expense is recorded on a straight-line basis over the requisite service period using the graded-vesting method for the entire award. Performance-based stock awards are accounted for at fair value at date of grant. The stock-based expense was based upon the number of shares expected to be issued when it became probable that performance targets required to receive the awards would be achieved. The stock-based compensation expense is recognized over the requisite service period.

Buy-one-get-one (the BOGO ) options, which are immediately vested and exercisable upon issuance, are accounted for at fair value at date of grant. The compensation expense is recognized on a straight-line basis over a four year period due to the terms of the option requiring forfeiture in certain cases including the grantee's voluntary resignation from the Company's employ prior to May 2011.

**Income Taxes** - The Company accounts for income taxes under the provisions of ASC Topic 740, *Income Taxes*, which generally requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax laws or rates is recognized in income in the period the new legislation is enacted. Valuation allowances are recognized to reduce deferred tax assets to the amount that is more likely than not to be realized. In assessing the likelihood of realization, the Company considers estimates of future taxable income.

The Company is subject to tax audits in numerous jurisdictions, including the United States, individual states and localities, and internationally. Tax audits by their very nature are often complex and can require several years to complete. In the normal course of business, the Company is subject to challenges from the Internal Revenue Service ( IRS ) and other tax authorities regarding amounts of taxes due. These challenges may alter the timing or amount of taxable income or deductions, or the allocation of income among tax jurisdictions. In July 2006, the Financial Accounting Standards Board ( FASB ) issued guidance which clarifies the accounting for income taxes in the financial statements by prescribing a minimum probability recognition threshold and measurement process for recording uncertain tax positions taken or expected to be taken in a tax return. This guidance requires that the Company determine whether a tax position is more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are at least more likely than not of being sustained upon audit, the Company recognizes the largest amount of the benefit that is more likely than not of being sustained. See Note 11 Income Taxes for further information.

**Foreign Currency Translation** - The financial statements of the Company's foreign operations are translated into U.S. Dollars. Assets and liabilities are translated at fiscal year-end exchange rates while income and expense accounts are translated at the average rates in effect during the year. Equity accounts are translated at historical exchange rates. Resulting translation adjustments are accumulated as a component of Accumulated other comprehensive income (loss), net of tax in the Company's Consolidated Balance Sheets. Foreign currency gains and losses resulting from transactions denominated in foreign currencies, including intercompany transactions, except for intercompany loans of a long-term investment nature, are included in results of operations. These foreign currency transaction losses (gains) were approximately \$0.9 million, \$5.1 million and \$(1.3) million, for Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively.

## Table of Contents

**Comprehensive Income** - Comprehensive income represents a measure of all changes in shareholder's deficit except for changes resulting from transactions with shareholders in their capacity as shareholders. The Company's total comprehensive income consists of net income (loss), foreign currency translation adjustments, reclassification of foreign currency translation adjustments into net income and adjustments for derivative instruments accounted for as cash flow hedges. Amounts included in Comprehensive income are recorded net of income taxes.

**Derivative Financial Instruments** The Company recognizes the fair value of derivative financial instruments in the Consolidated Balance Sheets. Gain and losses related to a hedge that result from changes in the fair value of the hedge are either recognized in income to offset the gain or loss on the hedged item, or deferred and reported as a component of Accumulated other comprehensive income (loss), net of tax in the Consolidated Balance Sheets and subsequently recognized in income when the hedged item affects net income. The ineffective portion of the change in fair value of a hedge is recognized in income immediately.

**Fair Value Measurements** ASC 820, *Fair Value Measurement Disclosures* defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Disclosures of the fair value of certain financial instruments are required, whether or not recognized in the Consolidated Balance Sheets. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. There is a three-level valuation hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs are inputs market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors market participants would use in valuing the asset or liability.

### *Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis*

The following table summarizes the Company's assets (liabilities) measured at fair value on a recurring basis segregated among the appropriate levels within the fair value hierarchy (in thousands):

Fair Value Measurements at January 28, 2012 Using Quoted Prices in Active Markets for Identical Assets (Liabilities) (Level 1)				
	Carrying Value		Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap	\$ (2,159)	\$	\$ (2,159)	\$

Fair Value Measurements at January 29, 2011 Using Quoted Prices in Active Markets for Identical Assets (Liabilities) (Level 1)				
	Carrying Value		Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap	\$ (1,165)	\$	\$ (1,165)	\$

The fair value of the Company's interest rate swaps represents the estimated amounts the Company would receive or pay to terminate those contracts at the reporting date based upon pricing or valuation models applied to current market information. The interest rate swaps are valued using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates derived from observed market interest rate curves. The Swap entered into on July 28, 2010 is collateralized by cash and thus the Company does not make any credit-related valuation adjustments. The Company mitigates derivative credit risk by transacting with highly rated counterparties. The Company does not enter into derivative financial instruments for trading or speculative purposes. See Note 6 Derivatives and Hedging Activities for further information.



**Table of Contents***Non-Financial Assets Measured at Fair Value on a Non-Recurring Basis*

The Company's non-financial assets, which include goodwill, intangible assets, and long-lived tangible assets, are not adjusted to fair value on a recurring basis. Fair value measures of non-financial assets are primarily used in the impairment analysis of these assets. Any resulting asset impairment would require that the non-financial asset be recorded at its fair value. The Company reviews goodwill and indefinite-lived intangible assets for impairment annually, during the fourth quarter of each fiscal year, or as circumstances indicate the possibility of impairment. The Company monitors the carrying value of definite-lived intangible assets and long-lived tangible assets for impairment whenever events or changes in circumstances indicate its carrying amount may not be recoverable.

The following tables summarize the Company's assets measured at fair value on a nonrecurring basis segregated among the appropriate levels within the fair value hierarchy (in thousands):

		Fair Value Measurements at January 29, 2011			
		Using			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (1)	Impairment Charges Fiscal 2010
	Carrying Value				
Intangible assets	\$ 28,180	\$	\$	\$ 28,180	\$ 12,262

(1) See Note 3 *Impairment Charges* for discussion of the valuation techniques used to measure fair value, the description of the inputs and information used to develop those inputs.

During Fiscal 2010, franchise agreements with a carrying amount of \$40.5 million were written down to their fair value of \$28.2 million, resulting in an impairment charge of \$12.3 million, which was included in *Impairment of assets* on the Consolidated Statements of Operations and Comprehensive Income.

During Fiscal 2009, long-lived assets held and used with a carrying amount of \$20.1 million were written down to their fair value of \$17.0 million, resulting in an impairment charge of \$3.1 million, which was included in *Impairment of assets* on the Consolidated Statements of Operations and Comprehensive Income.

*Financial Instruments Not Measured at Fair Value*

The Company's financial instruments consist primarily of cash and cash equivalents, restricted cash, accounts receivable, current liabilities, short-term debt, long-term debt, and the revolving credit facility. Cash and cash equivalents, restricted cash, accounts receivable, short-term debt and current liabilities approximate fair market value due to the relatively short maturity of these financial instruments.

The Company considers all investments with a maturity of three months or less when acquired to be cash equivalents. The Company's cash equivalent instruments are valued using quoted market prices and are primarily U.S. Treasury securities. The estimated fair value of the Company's long-term debt, including the current portion, and the revolving credit facility was approximately \$2.03 billion at January 28, 2012, compared to a carrying value of \$2.39 billion at that date. The estimated fair value of the Company's debt was approximately \$2.36 billion at January 29, 2011, compared to a carrying value of \$2.45 billion at that date. For publicly-traded debt, the fair value (estimated market value) is based on market prices. For other debt, fair value is estimated based on quoted prices for similar instruments.

**Recent Accounting Pronouncements** In December 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, which defers the presentation on

**Table of Contents**

the face of the financial statements the effects of reclassification out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. The amendments in this ASU are effective for interim and annual fiscal periods beginning after December 15, 2011. The Company does not expect adoption of ASU 2011-12 will have a material impact on the Company's financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU 2011-08, *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, which permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the two-step goodwill impairment test. If an entity can support the conclusion that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it would not need to perform the two-step impairment test for that reporting unit. The amendments in this ASU are effective for interim and annual fiscal periods beginning after December 15, 2011 and early adoption is permitted. The Company does not expect adoption of ASU 2011-08 will have a material impact on the Company's financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income* which requires the presentation of components of other comprehensive income with the components of net income in either a continuous statement of comprehensive income that contains two sections, net income and other comprehensive income, or two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of equity. The amendments in this ASU are effective for interim and annual fiscal periods beginning after December 15, 2011 and are applied retrospectively. The Company does not expect adoption of ASU 2011-05 will have a material impact on the Company's financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs)* to provide a consistent definition of fair value and ensure that fair value measurements and disclosure requirements are similar between U.S. GAAP and IFRSs. This guidance changes certain fair value measurement principles and enhances the disclosure requirements for fair value measurements. The amendments in this ASU are effective for interim and annual fiscal periods beginning after December 15, 2011 and are applied prospectively. Early adoption by public entities is not permitted. The Company does not expect adoption of ASU 2011-04 will have a material impact on the Company's financial position, results of operations or cash flows.

There are no recently issued accounting standards that are expected to have a material effect on the Company's financial condition, results of operations or cash flows.

**3. IMPAIRMENT CHARGES**

The Company recorded non-cash impairment charges for the fiscal years ended January 28, 2012, January 29, 2011 and January 30, 2010 as follows (in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Franchise agreements	\$	\$ 12,262	\$
Investment in Claire's Nippon		6,030	
Long-lived assets			3,142
 Total impairment charges	 \$	 \$ 18,292	 \$ 3,142

The Company's principal indefinite-lived intangible assets, other than goodwill, include tradenames and lease rights which are not subject to amortization. Goodwill and other indefinite-lived intangible assets are tested for impairment annually or more frequently when events or circumstances indicate that the carrying value of a reporting unit more likely than not exceeds its fair value. The Company performs annual impairment tests during the fourth quarter of its fiscal year.

## Table of Contents

The Company's principal definite-lived intangible assets include franchise agreements and lease rights which are subject to amortization and leases that existed at date of acquisition with terms that were favorable to market at that date. Definite-lived intangible assets are tested for impairment when events or circumstances indicate that the carrying value of the asset may not be recoverable.

The deterioration in the financial and housing markets and resulting effect on consumer confidence and discretionary spending that occurred during Fiscal 2011, Fiscal 2010 and Fiscal 2009 had a significant impact on the retail industry. The Company tests assets for impairment annually as of the first day of the fourth quarter of its fiscal year. On the first day of the fourth quarter of Fiscal 2011, Fiscal 2010 and Fiscal 2009, the Company considered the impact the economic conditions had on its business as an indicator under ASC Topic 350, *Intangibles Goodwill and Other*, that a reduction in its goodwill fair value may have occurred. Accordingly, the Company performed its test for goodwill impairment following the two step process defined in ASC Topic 350. The first step in this process compares the fair value of the reporting unit to its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second step of the impairment test is performed to measure the impairment. In the second step, the fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit to determine an implied goodwill value. This allocation is similar to a purchase price allocation performed in purchase accounting. If the carrying amount of the reporting unit goodwill exceeds the implied goodwill value, an impairment loss should be recognized in an amount equal to that excess. The Company has two reporting units as defined under ASC Topic 350. These reporting units are its North America segment and its Europe segment.

The fair value of each reporting unit determined under step 1 of the goodwill impairment test was based on a three-fourths weighting of a discounted cash flow analysis using forward-looking projections of estimated future operating results and a one-fourth weighting of a guideline company methodology under the market approach using revenue and earnings before interest, taxes, depreciation and amortization (EBITDA) multiples. Management's determination of the fair value of each reporting unit incorporates multiple assumptions, including future business growth, earnings projections and the weighted average cost of capital used for purposes of discounting. Decreases in business growth, decreases in earnings projections and increases in the weighted average cost of capital will all cause the fair value of the reporting unit to decrease.

Based on this testing under step 1, no impairment charge was recognized during Fiscal 2011, Fiscal 2010 and Fiscal 2009.

The Company also performed similar impairment testing on its other indefinite lived intangible assets during the fourth quarter of Fiscal 2011, Fiscal 2010 and Fiscal 2009. The Company estimates the fair value of these intangible assets primarily utilizing a discounted cash flow model. The forecasted cash flows used in the model contain inherent uncertainties, including significant estimates and assumptions related to growth rates, margins and cost of capital. Changes in any of the assumptions utilized could affect the fair value of the intangible assets and result in an impairment triggering event. No impairment charge was recognized in Fiscal 2011, Fiscal 2010 and Fiscal 2009.

During the fourth quarter of Fiscal 2010, management performed a strategic review of its franchise business. The franchisees' continued inability to meet store development expectations prompted the Company to reevaluate its franchise development strategy and to perform a valuation of the franchise agreements, which are definite-lived intangible assets. The Company utilized a discounted cash flow model and determined the franchise agreements intangible assets were impaired. This resulted in the Company recording a non-cash impairment charge of \$12.3 million in Fiscal 2010, which was included in Impairment of assets on the Company's Consolidated Statements of Operations and Comprehensive Income. No impairment charge was recognized for Fiscal 2011 and Fiscal 2009.

In accordance with ASC Subtopic 323-10, *Investments - Equity Method and Joint Ventures*, the Company is required to perform an assessment of overall other than temporary decrease in investment value when events or circumstances indicate that the carrying value may not be recoverable. The fair value of Claire's Nippon is based on a discounted cash flow analysis of estimated future operating results.



**Table of Contents**

A decrease in business growth, decrease in earnings projections or increase in the discount factor will cause the fair value to decrease. The 2010 precipitous decline in sales, lower margin rates due to markdowns on slow-moving merchandise, and difficulty in cost reduction efforts, coupled with an inability to generate positive cash flow to pay royalties or dividends since inception, prompted the Company to perform a valuation of Claire's Nippon. Because the expected future cash flows were less than the net carrying value of the investment in Claire's Nippon, during Fiscal 2010, a non-cash impairment charge of \$6.0 million was recognized for the excess of the net carrying value of the investment over the estimated fair value of \$0.6 million.

The Company accounts for long-lived tangible assets under ASC Topic 360, *Property, Plant, and Equipment*. Assessment for possible impairment is based on the Company's ability to recover the carrying value of the long-lived asset from the expected undiscounted future operating cash flows or management's determination that the long-lived asset has limited future use. If the expected undiscounted future cash flows are less than the carrying value of such assets, an impairment loss is recognized for the difference between estimated fair value and carrying value. Fair value is measured based on a projected discounted cash flow model using a discount rate that is commensurate with the risk inherent in the business. During Fiscal 2011 and Fiscal 2010, no impairment charges were recognized with regards to long-lived assets. During Fiscal 2009, the Company recognized non-cash impairment charges related to long-lived assets of \$3.1 million recorded in Impairment of assets in the Company's Consolidated Statements of Operations and Comprehensive Income.

**4. GOODWILL AND OTHER INTANGIBLE ASSETS**

In connection with the Transactions, the Company recorded goodwill and other intangible assets at date of acquisition. The Company's indefinite-lived intangible assets include tradenames and territory rights which are not subject to amortization. The Company's principal definite-lived intangible assets include lease rights, franchise agreements and leases that existed at date of acquisition with terms that were favorable to market at that date.

The changes in the carrying amount of goodwill during Fiscal 2011 and Fiscal 2010 by reporting unit are as follows (in thousands):

	North America	Europe	Total
Balance as of January 28, 2012 and January 29, 2011:			
Goodwill	\$ 1,415,651	\$ 431,405	\$ 1,847,056
Accumulated impairment losses	(180,000)	(117,000)	(297,000)
	\$ 1,235,651	\$ 314,405	\$ 1,550,056

**Table of Contents**

The carrying amount and accumulated amortization of identifiable intangible assets at January 28, 2012 and January 29, 2011 were (in thousands):

	Estimated Life in Years	January 28, 2012 Gross Carrying Amount	Accumulated Amortization	January 29, 2011 Gross Carrying Amount	Accumulated Amortization
<b>Intangible assets subject to amortization:</b>					
Lease rights (1)	Lease terms ranging from 4.5 to 16.5	\$ 79,261	\$ (8,216)	\$ 76,409	\$ (5,996)
Franchise agreements	4 to 9	40,738	(16,678)	40,738	(12,558)
Favorable lease obligations	10	30,791	(24,079)	30,859	(20,000)
Other	5	545	(297)	499	(193)
Total intangible assets subject to amortization		151,335	(49,270)	148,505	(38,747)
<b>Indefinite-lived intangible assets:</b>					
Indefinite-lived tradenames		\$ 447,103	\$	\$ 447,108	\$
Indefinite-lived territory rights		600		600	
Total indefinite-lived intangible assets		447,703		447,708	
Total intangible assets		\$ 599,038	\$ (49,270)	\$ 596,213	\$ (38,747)

(1) Amounts include lease rights not currently subject to amortization of \$50,985 and \$51,652 as of January 28, 2012 and January 29, 2011, respectively.

For Fiscal 2011, Fiscal 2010 and Fiscal 2009, amortization expense of \$10.8 million, \$10.9 million and \$13.6 million, respectively, was recognized by the Company. As discussed in Note 3 Impairment Charges, the Company recognized impairment charges related to intangible assets of \$12.3 million in Fiscal 2010. There were no such impairment charges for intangible assets in Fiscal 2011 and Fiscal 2009.

Intangible Asset Acquisitions (in 000 \$)	Amortizable	Weighted Average Amortization Period for Amortizable Intangible Asset Acquisitions
<b>Lease rights:</b>		
Fiscal 2011	\$ 1,855	9.9
Fiscal 2010	978	9.9
Fiscal 2009	435	9.9
<b>Other:</b>		
Fiscal 2011	46	5.0
Fiscal 2010	126	5.0
Fiscal 2009	111	5.0

The weighted average amortization period of amortizable intangible assets acquired in Fiscal 2011 was 9.8 years.

**Table of Contents**

The remaining net amortization as of January 28, 2012 of identifiable intangible assets with finite lives by year is as follows (in thousands):

<b>Fiscal Year</b>	<b>Amortization</b>
2012	\$ 8,492
2013	7,552
2014	6,841
2015	5,845
2016	5,103
2017 and thereafter	17,247
<b>Total</b>	<b>\$ 51,080</b>

**5. DEBT**

Debt as of January 28, 2012 and January 29, 2011 included the following components (in thousands):

	<b>January 28, 2012</b>	<b>January 29, 2011</b>
Short-term debt and current portion of long-term debt:		
Note payable to bank due January 2012	\$	\$ 57,703
Current portion of long-term debt		18,451
<b>Total short-term debt and current portion of long-term debt</b>	<b>\$</b>	<b>\$ 76,154</b>
Long-term debt:		
Senior secured term loan facility due 2014	\$ 1,154,310	\$ 1,399,250
Senior fixed rate notes due 2015	220,270	236,000
Senior toggle notes due 2015	302,190	360,431
Senior subordinated notes due 2017	259,612	259,612
Senior secured second lien notes due 2019	450,000	
	2,386,382	2,255,293
Less: current portion of long-term debt		(18,451)
<b>Long-term debt</b>	<b>\$ 2,386,382</b>	<b>\$ 2,236,842</b>
Senior secured revolving credit facility due 2013		\$ 194,000
<b>Obligation under capital lease</b>	<b>\$ 17,290</b>	<b>\$ 17,290</b>

As of January 28, 2012, the Company's total debt maturities are as follows for each of the following fiscal years (in thousands):

	<b>Capital Leases</b>	<b>Debt</b>
2012	\$ 2,209	\$
2013	2,253	
2014	2,298	1,154,310
2015	2,344	522,460
2016	2,391	

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Thereafter	35,015	709,612
Total	46,510	\$ 2,386,382
Imputed interest	(29,220)	
Present value of minimum capital lease principal payments Current portion	17,290	
Long-term capital lease obligation	\$ 17,290	

**Table of Contents**

The Company's interest expense, net for Fiscal 2011, Fiscal 2010 and Fiscal 2009 included the following components (in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Term loan facility	\$ 38,226	\$ 53,255	\$ 66,348
Revolving credit facility	1,576	6,110	5,708
Senior fixed rate notes	20,663	22,605	23,154
Senior toggle notes	32,263	36,881	39,021
Senior subordinated notes	27,118	27,620	32,913
Senior secured second lien notes	36,120		
Note payable to bank	5,535	85	
Capital lease obligation	2,151	1,232	
Amortization of deferred debt issue costs	13,106	10,005	10,398
Other interest expense	98	57	82
Interest income	(381)	(144)	(206)
Interest expense, net	\$ 176,475	\$ 157,706	\$ 177,418

Accrued interest payable as of January 28, 2012 and January 29, 2011 consisted of the following components (in thousands):

	<b>January 28, 2012</b>	<b>January 29, 2011</b>
Term loan facility	\$ 4,409	\$ 8,239
Revolving credit facility	93	231
Senior fixed rate notes	3,303	3,658
Senior toggle notes	4,714	
Senior subordinated notes	4,418	4,568
Senior secured second lien notes	14,922	
Note payable to bank		87
Total accrued interest payable	\$ 31,859	\$ 16,783

**SHORT-TERM DEBT**

On January 24, 2011, the Company entered into a Euro denominated loan (the "Euro loan") in the amount of \$42.4 million that was due on January 24, 2012. The Euro loan bore interest at the three month Euro Interbank Offered Rate ("EURIBOR") rate plus 8.00% per year and was payable quarterly. As of January 29, 2011, there was \$42.4 million, or the equivalent of \$57.7 million, outstanding under the Euro loan, and the weighted-average interest rate for borrowings outstanding was 9.02%. The Company used the net proceeds of the borrowings for general corporate purposes.

The obligation under the Euro loan was secured by a cash deposit in the amount of \$15.0 million (\$20.4 million) at January 29, 2011, and a perfected first lien security interest in all of the issued and outstanding equity interest of one of the Company's international subsidiaries, Claire's Holdings S.a.r.l. The cash deposit was classified as "Cash and cash equivalents and restricted cash" in the Company's Consolidated Balance Sheet. See Note 2 - Summary of Significant Accounting Policies for further details.

On January 24, 2012, the Company paid \$54.7 million to retire the Euro loan and received the cash deposit of \$19.6 million that secured the Euro loan.

**LONG-TERM DEBT****Credit Facility**

## Edgar Filing: CLAIRE'S STORES INC - Form 10-K

The Credit Facility is with a syndication of lenders and consists of a \$1.45 billion senior secured term loan facility and a \$200.0 million senior secured revolving credit facility. The Credit Facility contains customary provisions relating to mandatory prepayments, voluntary prepayments, affirmative covenants, negative covenants, and events of default. At the consummation of the Merger, the Company drew the full amount of the senior secured term loan Credit Facility and was issued a \$4.5 million letter of credit. The letter of credit was subsequently increased to \$6.0 million and later reduced to \$4.8 million.

## **Table of Contents**

The Company drew down the remaining \$194.0 million available under the Revolver during Fiscal 2008. The Company was not required to repay any of the Revolver until the due date of May 29, 2013, therefore, the Revolver was classified as a long-term liability in the accompanying Consolidated Balance Sheet as of January 29, 2011. During Fiscal 2011, the Company paid down the entire \$194.0 million of the Revolver (without terminating the commitment) and \$241.0 million of indebtedness under the senior secured term loan Credit Facility with the net proceeds from the Senior Secured Second Lien Notes offering. Subsequent to January 28, 2012, the Company paid \$489.8 million of indebtedness under the senior secured term loan Credit Facility with the net proceeds from the Senior Secured First Lien Notes offering. As a result of the prepayment under the senior secured term loan Credit Facility, the Company is no longer required to make any quarterly payments and has a final payment of \$664.6 million due on May 29, 2014. See Senior Secured First Lien Notes below and Note 16 Subsequent Events to our Consolidated Financial Statements.

All obligations under the Credit Facility are unconditionally guaranteed by (i) Claire's Inc., our parent, prior to an initial public offering of Claire's Stores, Inc. stock, and (ii) certain of our existing and future wholly-owned domestic subsidiaries, subject to certain exceptions.

All obligations under the Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by (i) all of Claire's Stores, Inc. capital stock, prior to an initial public offering of Claire's Stores, Inc. stock, and (ii) substantially all of our material owned assets and the material owned assets of subsidiary guarantors, including:

a perfected pledge of all the equity interests held by us or any subsidiary guarantor, which pledge, in the case of any foreign subsidiary, is limited to 100% of the non-voting equity interests and 65% of the voting equity interests of such foreign subsidiary held directly by us and the subsidiary guarantors; and

perfected security interests in, and mortgages on, substantially all material tangible and intangible assets owned by us and each subsidiary guarantor, subject to certain exceptions.

Borrowings under the Credit Facility bear interest at a rate equal to, at the Company's option, either (a) an alternate base rate determined by reference to the higher of (1) prime rate in effect on such day and (2) the federal funds effective rate plus 0.50% or (b) LIBOR rate, with respect to any Eurodollar borrowing, determined by reference to the costs of funds for U.S. dollar deposits in the London Interbank Market for the interest period relevant to such borrowing, adjusted for certain additional costs, in each case plus an applicable margin. The initial applicable margin for borrowings under the Credit Facility was 1.75% with respect to alternate base rate borrowings and 2.75% with respect to LIBOR borrowings. The applicable margin for borrowings under the Credit Facility will be subject to one or more stepdowns, in each case based upon the ratio of our net senior secured debt to EBITDA for the period of four consecutive fiscal quarters most recently ended as of such date (the "Total Net Secured Leverage Ratio"). In addition to paying interest on outstanding principal under the Credit Facility, the Company is required to pay a commitment fee, initially 0.50% per annum, in respect of the revolving credit commitments thereunder. The commitment fee will be subject to one stepdown, based upon our Total Net Secured Leverage Ratio. The Company must also pay customary letter of credit fees and agency fees. At January 28, 2012 and January 29, 2011, the weighted average interest rate for borrowings outstanding under the Credit Facility was 3.07% and 2.98%, respectively.

The Credit Facility does not contain any covenants that require the Company to maintain any particular financial ratio or other measure of financial performance; however, it does contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit our, our parent's and our restricted subsidiaries' ability to, among other things:

incur additional indebtedness or issue certain preferred shares;

## **Table of Contents**

pay dividends on, repurchase or make distributions in respect of our capital stock or make other restricted payments;

make certain investments;

sell certain assets;

create liens;

consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; and

enter into certain transactions with our affiliates.

A breach of any of these covenants could result in an event of default. Upon the occurrence of an event of default, the lenders could elect to declare all amounts outstanding under the Credit Facility to be immediately due and payable and terminate all commitments to extend further credit. Such actions by those lenders could cause cross defaults under our other indebtedness. If we were unable to repay those amounts, the lenders under the Credit Facility could proceed against the collateral granted to them to secure that indebtedness.

## **Senior Notes**

In connection with the Transactions, the Company issued \$600 million of senior notes in two series:

- 1) \$250.0 million of 9.25% Senior Notes due 2015 (the "Senior Fixed Rate Notes"), and
- 2) \$350.0 million of 9.625%/10.375% Senior Toggle Notes due 2015 (the "Senior Toggle Notes" and together with the Senior Fixed Rate Notes, the "Senior Notes").

The Senior Fixed Rate Notes are unsecured obligations of the Company and mature on June 1, 2015. Interest is payable semi-annually at 9.25% per annum, which commenced on December 1, 2007.

The Senior Toggle Notes are unsecured obligations of the Company and mature on June 1, 2015. Interest is payable semi-annually commencing on December 1, 2007. For any interest period through June 1, 2011, the Company may, at its option, elect to pay interest on the Senior Toggle Notes (i) entirely in cash ("Cash Interest"), (ii) entirely by increasing the principal amount of the outstanding Senior Toggle Notes or by issuing PIK Notes ("PIK Interest") or (iii) 50% as Cash Interest and 50% of PIK Interest.

Cash Interest on the Senior Toggle Notes accrues at 9.625% per annum and is payable in cash. PIK Interest on the Senior Toggle Notes accrues at the Cash Interest Rate per annum plus 0.75% and increases the amount outstanding of the Senior Toggle Notes.

The Company elected to pay interest in kind on its Senior Toggle Notes for the interest periods beginning June 2, 2008 through June 1, 2011. This election, net of reductions for note repurchases, increased the principal amount on the Senior Toggle Notes by \$109.5 million and \$98.1 million as of January 28, 2012 and January 29, 2011, respectively. The accrued payment in kind interest is included in "Long-term debt" in the Consolidated Balance Sheets. Effective June 2, 2011, the Company began accruing cash interest.

Each of the Company's wholly-owned domestic subsidiaries that guarantee indebtedness under the Credit Facility jointly and severally irrevocably and unconditionally guarantee on a senior basis the performance and punctual payment when due, whether at stated maturity, by acceleration or otherwise, of all obligations of the Company under the Senior Notes, expenses, indemnification or otherwise.





**Table of Contents**

On or after June 1, 2011, the Company may redeem the Senior Notes at its option, subject to certain notice provisions at the following redemption prices (expressed as percentage of principal amount), plus accrued and unpaid interest to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), if redeemed during the twelve-month period commencing on June 1 of the years set forth below:

<b>Period</b>	<b>Senior Fixed Rate Notes</b>	<b>Senior Toggle Notes</b>
2011	104.625%	104.813%
2012	102.313%	102.406%
2013 and thereafter	100.000%	100.000%

In addition, prior to June 1, 2011, the Company may redeem the Senior Notes, subject to certain notice periods, at a price equal to 100% of the principal amount of the Senior Notes redeemed plus an applicable premium and accrued and unpaid interest, if any.

Upon the occurrence of a change of control, each holder of the Senior Notes has the right to require the Company to repurchase all or any part of such holder's Senior Notes, at a price in cash equal to 101% of the principal amount of the Senior Notes redeemed plus accrued and unpaid interest, if any.

**Senior Subordinated Notes**

In connection with the Transactions, the Company issued \$335.0 million of Senior Subordinated Notes. The Senior Subordinated Notes are senior subordinated obligations of the Company and will mature on June 1, 2017. Interest is payable semi-annually at 10.50% per annum, which commenced on December 1, 2007.

Each of the Company's wholly-owned domestic subsidiaries that guarantee indebtedness under the Credit Facility jointly and severally irrevocably and unconditionally guarantee on a senior subordinated basis the performance and punctual payment when due, whether at stated maturity, by acceleration or otherwise, of all obligations of the Company under the Senior Subordinated Notes, expenses, indemnification or otherwise.

On or after June 1, 2012, the Company may redeem the Senior Subordinated Notes at its option, subject to certain notice provisions, at the following redemption prices (expressed as a percentage of principal amount), plus accrued and unpaid interest to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), if redeemed during the twelve-month period commencing on June 1 of the years set forth below:

<b>Period</b>	<b>Redemption Price</b>
2012	105.25%
2013	103.50%
2014	101.75%
2015 and thereafter	100.00%

In addition, prior to June 1, 2012, the Company may redeem the Senior Subordinated Notes, subject to certain notice periods, at a price equal to 100% of the principal amount of the Senior Subordinated Notes redeemed plus an applicable premium and accrued and unpaid interest, if any.

Upon the occurrence of a change of control, each holder of the Senior Subordinated Notes has the right to require the Company to repurchase all or any part of such holder's Senior Subordinated Notes, at a price in cash equal to 101% of the principal amount of the Senior Subordinated Notes redeemed plus accrued and unpaid interest, if any.

**Table of Contents****Senior Secured Second Lien Notes**

On March 4, 2011, the Company issued \$450.0 million aggregate principal amount of 8.875% senior secured second lien notes that mature on March 15, 2019 (the "Senior Secured Second Lien Notes"). Interest on the Senior Secured Second Lien Notes is payable semi-annually to holders of record at the close of business on March 1 or September 1 immediately preceding the interest payment date on March 15 and September 15 of each year, commencing on September 15, 2011.

The Senior Secured Second Lien Notes are guaranteed on a second-priority senior secured basis by all of the Company's existing and future direct or indirect wholly-owned domestic subsidiaries that guarantee the Company's senior secured credit facility. The Senior Secured Second Lien Notes and related guarantees are secured by a second-priority lien on substantially all of the assets that secure the Company's and its subsidiary guarantors' obligations under the Company's senior secured credit facility. The Company used the net proceeds of the offering of the Senior Secured Second Lien Notes to reduce the entire \$194.0 million outstanding under the Revolver (without terminating the commitment) and \$241.0 million indebtedness under the Company's senior secured term loan Credit Facility.

On or after March 15, 2015, the Company may redeem the Senior Secured Second Lien Notes at its option, subject to certain notice provisions, at the following redemption prices (expressed as a percentage of principal amount), plus accrued and unpaid interest to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), if redeemed during the twelve-month period commencing on March 15 of the years set forth below:

<b>Period</b>	<b>Redemption Price</b>
2015	104.438%
2016	102.219%
2017 and thereafter	100.000%

The Merger Notes and Senior Secured Second Lien Notes (collectively, the "Notes") contain certain covenants that, among other things, and subject to certain exceptions and other basket amounts, restrict the Company's ability and the ability of its subsidiaries to:

incur additional indebtedness;

pay dividends or distributions on capital stock, repurchase or retire capital stock and redeem, repurchase or defease any subordinated indebtedness;

make certain investments;

create or incur certain liens;

create restrictions on the payment of dividends or other distributions to the Company from its subsidiaries;

transfer or sell assets;

engage in certain transactions with its affiliates; and

## Edgar Filing: CLAIRE'S STORES INC - Form 10-K

merge or consolidate with other companies or transfer all or substantially all of its assets.

Certain of these covenants, such as limitations on the Company's ability to make certain payments such as dividends, or incur debt, will no longer apply if the Notes have investment grade ratings from both of the rating agencies of Moody's Investor Services, Inc. ( Moody's ) and Standard & Poor's Ratings Group ( S&P ) and no event of default has occurred. Since the date of issuance of the Notes, the Notes have not received investment grade ratings from Moody's or S&P. Accordingly, all of the covenants under the Notes currently apply to the Company. None of these covenants, however, require the Company to maintain any particular financial ratio or other measure of financial performance. As of January 28, 2012, the Company is in compliance with the covenants under its Notes.

**Table of Contents****Europe Credit Facilities**

The Company's non-U.S. subsidiaries have bank credit facilities totaling approximately \$2.2 million. The facilities are used for working capital requirements, letters of credit and various guarantees. These credit facilities have been arranged in accordance with customary lending practices in the respective country of operation. As of January 28, 2012, the entire amount of \$2.2 million was available for borrowing by the Company, subject to a reduction of \$2.2 million for outstanding bank guarantees.

**Note Repurchases**

The following is a summary of the Company's note repurchase activity during Fiscal 2011, Fiscal 2010 and Fiscal 2009 (in thousands):

Notes Repurchased	Principal Amount	Fiscal 2011 Repurchase Price	Recognized Gain (1)
Senior Fixed Rate Notes	\$ 15,730	\$ 15,213	\$ 260
Senior Toggle Notes	69,617	63,130	6,145
	\$ 85,347	\$ 78,343	\$ 6,405

- (1) Net of deferred issuance cost write-offs of \$257 for the Senior Fixed Rate Notes and \$796 for the Senior Toggle Notes, and accrued interest write-off of \$455 for the Senior Toggle Notes.

Notes Repurchased	Principal Amount	Fiscal 2010 Repurchase Price	Recognized Gain (1)
Senior Fixed Rate Notes	\$ 14,000	\$ 12,268	\$ 1,467
Senior Toggle Notes	57,173	49,798	7,612
Senior Subordinated Notes	22,625	17,799	4,309
	\$ 93,798	\$ 79,865	\$ 13,388

- (1) Net of deferred issuance cost write-offs of \$265 for the Senior Fixed Rate Notes, \$922 for the Senior Toggle Notes and \$517 for the Senior Subordinated Notes, and accrued interest write-off of \$1,159 for the Senior Toggle Notes

Notes Repurchased	Principal Amount	Fiscal 2009 Repurchase Price	Recognized Gain (1)
Senior Toggle Notes	\$ 30,500	\$ 19,744	\$ 11,297
Senior Subordinated Notes	52,763	26,347	25,115
	\$ 83,263	\$ 46,091	\$ 36,412

- (1) Net of deferred issuance cost write-offs of \$603 and \$1,301 for the Senior Toggle Notes and Senior Subordinated Notes, respectively, and accrued interest write-off of \$1,144 for the Senior Toggle Notes.

**6. DERIVATIVES AND HEDGING ACTIVITIES**

The Company formally designates and documents the financial instrument as a hedge of a specific underlying exposure, as well as the risk management objectives and strategies for undertaking the hedge transaction. The Company formally assesses both at inception and at least quarterly thereafter, whether the financial instruments that are used in hedging transactions are effective at offsetting changes in cash flows of the related underlying exposure. The Company measures the effectiveness of its cash flow hedges by evaluating the following criteria: (i) the re-pricing dates of the derivative instrument match those of the debt obligation; (ii) the interest rates of the derivative instrument and the debt obligation are

## **Table of Contents**

based on the same interest rate index and tenor; (iii) the variable interest rate of the derivative instrument does not contain a floor or cap, or other provisions that cause a basis difference with the debt obligation; and (iv) the likelihood of the counterparty not defaulting is assessed as being probable.

The Company primarily employs derivative financial instruments to manage its exposure to interest rate changes and to limit the volatility and impact of interest rate changes on earnings and cash flows. The Company does not enter into derivative financial instruments for trading or speculative purposes. The Company faces credit risk if the counterparties to the financial instruments are unable to perform their obligations. However, the Company seeks to mitigate derivative credit risk by entering into transactions with counterparties that are significant and creditworthy financial institutions. The Company monitors the credit ratings of the counterparties.

For derivatives that qualify as cash flow hedges, the Company reports the effective portion of the change in fair value as a component of Accumulated other comprehensive income (loss), net of tax in the Consolidated Balance Sheets and reclassifies it into earnings in the same periods in which the hedged item affects earnings, and within the same income statement line item as the impact of the hedged item. The ineffective portion of the change in fair value of a cash flow hedge is recognized in income immediately. No ineffective portion was recorded to earnings during Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively, and all components of the derivative gain or loss were included in the assessment of hedge effectiveness. For derivative financial instruments which do not qualify as cash flow hedges, any changes in fair value would be recorded in the Consolidated Statements of Operations and Comprehensive Income.

The Company may at its discretion change the designation of any such hedging instrument agreements prior to maturity. At that time, any gains or losses previously reported in accumulated other comprehensive income (loss) on termination would amortize into interest expense or interest income to correspond to the recognition of interest expense or interest income on the hedged debt. If such debt instrument was also terminated, the gain or loss associated with the terminated derivative included in accumulated other comprehensive income (loss) at the time of termination of the debt would be recognized in the Consolidated Statements of Operations and Comprehensive Income at that time.

On July 28, 2010, the Company entered into an interest rate swap agreement (the Swap) to manage exposure to fluctuations in interest rate changes related to the senior secured term loan facility. The Swap has been designated and accounted for as a cash flow hedge and expires on July 30, 2013. The Swap represents a contract to exchange floating rate for fixed interest payments periodically over the life of the Swap without exchange of the underlying notional amount. The Swap covers an aggregate notional amount of \$200.0 million of the outstanding principal balance of the senior secured term loan facility and has a fixed rate of 1.2235%. The interest rate Swap results in the Company paying a fixed rate plus the applicable margin then in effect for LIBOR borrowings resulting in an interest rate of 3.97% at January 28, 2012, on a notional amount of \$200.0 million of the senior secured term loan facility.

The Company entered into three interest rate swap agreements in July 2007 (the Swaps) to manage exposure to interest rate changes related to the senior secured term loan facility. The Swaps were designated and accounted for as cash flow hedges. Those Swaps expired on June 30, 2010. The Swaps covered an aggregate notional amount of \$435.0 million of the outstanding principal balance of the senior secured term loan facility. The fixed rates of the Swaps ranged from 4.96% to 5.25%. The Swaps were designated and accounted for as cash flow hedges.

The Company does not make any credit-related valuation adjustments to the Swap entered into on July 28, 2010 because it is collateralized by cash, the balance of which is \$4.4 million at January 28, 2012. The collateral requirement increases for declines in the three year LIBOR rate below 1.2235%. As of January 28, 2012, the three year LIBOR rate was 0.50% and each further 10 basis point decline in rate would result in an additional collateral requirement of \$0.3 million. Any subsequent increases in the three year LIBOR rate will result in a release of the collateral.

**Table of Contents**

At January 28, 2012 and January 29, 2011, the estimated fair values of the Company's derivative financial instruments designated as interest rate cash flow hedges were liabilities of approximately \$2.2 million and \$1.2 million, respectively, which were recorded in Accrued expenses and other current liabilities in the Consolidated Balance Sheets. Both of these amounts were also recorded, net of tax of approximately \$5.7 million as a component in Accumulated other comprehensive income (loss), net of tax in the Consolidated Balance Sheets. See Note 2 Summary of Significant Accounting Policies for fair value measurement of interest rate swaps.

The following tables provide a summary of the financial statement effect of the Company's derivative financial instruments designated as interest rate cash flow hedges during Fiscal 2011, Fiscal 2010 and Fiscal 2009 (in thousands):

<b>Derivatives in Cash Flow Hedging Relationships</b>	<b>Amount of Gain or (Loss) Recognized in OCI on</b>		
	<b>Derivative</b>		
	<b>(Effective Portion)</b>		
	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Interest Rate Swaps	\$ (993)	\$ 7,587	\$ 9,437

**Location of Gain or (Loss) Reclassified from**

<b>Accumulated OCI into Income</b>	<b>Amount of Gain or (Loss) Reclassified from</b>		
	<b>Accumulated OCI into Income</b>		
	<b>(Effective Portion) <sup>(1)</sup></b>		
	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Interest expense, net	\$ (1,839)	\$ (9,630)	\$ (19,011)

(1) Represents reclassification of amounts from accumulated other comprehensive income (loss) into earnings as interest expense is recognized on the senior secured term loan facility. No ineffectiveness is associated with these interest rate cash flow hedges.

Over the next twelve months, the Company expects to reclassify net losses on the Company's interest rate swaps recognized within Accumulated other comprehensive income (loss), net of tax of \$1.3 million into interest expense.

**7. COMMITMENTS AND CONTINGENCIES**

**Leases** - The Company leases its retail stores, certain offices and warehouse space, and certain equipment under operating leases which expire at various dates through the year 2031 with options to renew certain of such leases for additional periods. Most lease agreements contain construction allowances and/or rent holidays. For purposes of recognizing landlord incentives and minimum rental expense on a straight-line basis over the terms of the leases, the Company uses the date of initial possession to begin amortization, which is generally when the Company enters the space and begins to make improvements in preparation of intended use. The lease agreements covering retail store space provide for minimum rentals and/or rentals based on a percentage of net sales. Rental expense for Fiscal 2011, Fiscal 2010 and Fiscal 2009 is set forth below (in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Minimum store rentals	\$ 212,519	\$ 199,304	\$ 199,908
Store rentals based on net sales	3,152	2,990	1,454
Other rental expense	11,352	11,751	13,181
Total rental expense	\$ 227,023	\$ 214,045	\$ 214,543



**Table of Contents**

Minimum aggregate rental commitments as of January 28, 2012 under non-cancelable operating leases are summarized by fiscal year as follows (in thousands):

2012	\$ 205,279
2013	182,542
2014	160,035
2015	137,278
2016	108,614
Thereafter	266,470
<b>Total</b>	<b>\$ 1,060,218</b>

Certain leases provide for payment of real estate taxes, insurance, and other operating expenses of the properties. In other leases, some of these costs are included in the basic contractual rental payments. In addition, certain leases contain escalation clauses resulting from the pass-through of increases in operating costs, property taxes, and the effect on costs from changes in price indexes.

ASC Topic 410, *Asset Retirement and Environmental Obligations*, requires the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made and that the associated asset retirement costs be capitalized as part of the carrying amount of the long-lived asset. The retirement obligation relates to costs associated with the retirement of leasehold improvements under store and warehouse leases, within the Europe segment. The Company had retirement obligations of \$4.1 million and \$3.6 million as of January 28, 2012 and January 29, 2011, respectively. These retirement obligations are classified as Deferred rent expense in the Company's Consolidated Balance Sheets.

**Legal** The Company is, from time to time, involved in litigation incidental to the conduct of its business, including personal injury litigation, litigation regarding merchandise sold, including product and safety concerns regarding heavy metal and chemical content in merchandise, litigation with respect to various employment matters, including litigation with present and former employees, wage and hour litigation and litigation regarding intellectual property rights.

The Company believes that current pending litigation will not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

**Employment Agreements** The Company has employment agreements with several members of senior management. The agreements, with terms ranging from approximately two to three years, provide for minimum salary levels, performance bonuses, and severance payments.

**Other** Approximately 69% of the merchandise purchased by the Company in Fiscal 2011 was manufactured in China. Any event causing a sudden disruption of imports from China, or other foreign countries, could have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

**Table of Contents****8. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

The following summary sets forth the components of accumulated other comprehensive income (loss), net of tax for Fiscal 2011, Fiscal 2010 and Fiscal 2009 (in thousands, net of tax):

	Foreign Currency Translation	Derivative Instruments	Total
Balance as of January 31, 2009	\$ (9,861)	\$ (12,458)	\$ (22,319)
Foreign currency translation adjustment, net of tax of \$833	15,507		15,507
Unrealized gain on interest rate swaps, net of tax of \$1,546		9,437	9,437
Balance as of January 30, 2010	5,646	(3,021)	2,625
Foreign currency translation adjustment, net of tax of \$(149)	776		776
Unrealized gain on interest rate swaps, net of tax of \$0		7,587	7,587
Reclassification of foreign currency translation adjustments into net income, net of tax of \$0	(9,572)		(9,572)
Balance as of January 29, 2011	(3,150)	4,566	1,416
Foreign currency translation adjustment, net of tax of \$(171)	(4,774)		(4,774)
Unrealized loss on interest rate swaps, net of tax of \$0		(993)	(993)
Balance as of January 28, 2012	\$ (7,924)	\$ 3,573	\$ (4,351)

Other comprehensive income (loss) for unrealized foreign currency translation adjustments of certain long-term intercompany loans within the Company's foreign subsidiaries includes income tax expense (benefit) of \$(0.2) million, \$(0.1) million and \$0.8 million for Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively. There were no income tax effects on other comprehensive income (loss) related to unrealized losses on foreign currency translation adjustments, excluding the certain long-term intercompany loans, in Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively.

**9. STOCK OPTIONS AND STOCK-BASED COMPENSATION**

On June 29, 2007, the Board of Directors and stockholders of Claire's Inc. adopted the Claire's Inc. Stock Incentive Plan (the "Plan"). The Plan provides employees and directors of Claire's Inc., the Company and its subsidiaries, who are in a position to contribute to the long-term success of these entities, with shares or options to acquire shares in Claire's Inc. to aid in attracting, retaining, and motivating individuals of outstanding ability.

The Plan was amended on July 23, 2007 and September 9, 2008 to increase the number of shares available for issuance to 6,860,000 and 8,200,000, respectively, and to provide for equity investments by employees and directors of the Company through the voluntary stock purchase program. As of January 28, 2012, 1,856,247 shares were available for future grants. The Board of Directors of Claire's Inc. awarded certain employees and directors the opportunity to purchase common stock at a price of \$10.00 per share, the estimated fair market value of the Company's common stock. With each share purchased, the employee or director was granted a buy-one-get-one option, (the "BOGO Option") to purchase an additional share at an exercise price of \$10.00 per share.

The total stock-based compensation (benefit) expense recognized by the Company in Fiscal 2011, Fiscal 2010 and Fiscal 2009 was \$(1.6) million, \$5.0 million and \$6.7 million, respectively. During Fiscal 2011, the Company recorded a reversal of stock compensation expense of \$5.1 million associated with forfeitures of stock options, including \$3.8 million for our former Chief Executive Officer. Related income tax expense (benefit) of approximately \$0.6 million, \$(1.7) million and \$(2.3) million were recognized in Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively. Stock-based compensation is recorded in Selling, general and administrative expenses in the Company's Consolidated Statements of Operations and Comprehensive Income.

## **Table of Contents**

### **Incentive Plan Modifications**

On May 20, 2011, the Compensation Committee of the Company approved amendments to the Company's Stock Incentive Plan (the "Incentive Plan"), the form of option grant letter and certain outstanding options (the "Outstanding Options") held by various employees (collectively, the "Plan Amendments").

The Plan Amendments (which apply to Outstanding Options and, unless otherwise specified at the time of grant, any future option grants under the Amended Incentive Plan, and, where applicable, any shares held by employees) generally provide for the following:

Eliminated the holding period after vesting for Performance and Stretch Performance options;

Changed the definition of "Qualified IPO";

Eliminated certain restrictions on transfer of shares in the event of a Qualified IPO;

Provided each optionee the right to satisfy the exercise price and any withholding tax obligation triggered by such exercise by any combination of cash and/or shares (including both previously owned shares and shares otherwise to be delivered upon exercise of the option); and

Added two additional vesting events applicable to Performance Options and to certain Stretch Performance Options if they occur prior to or concurrent with the end of the Company's fiscal 2012 year.

The incremental compensation cost associated with the modifications to the Company's Incentive Plan totaled \$2.2 million, of which \$0.2 million was initially recognized in the second fiscal quarter 2011 and \$0.3 million in the third fiscal quarter 2011. The plan modification affected approximately 155 employees. During the fourth quarter of Fiscal 2011, the Company determined that the achievement of vesting events for the Performance Stock Options was not probable, and therefore, reversed the stock option expense that was previously recognized for these stock options.

### **Buy-One-Get-One ("BOGO") Option Offer**

On May 20, 2011, the Compensation Committee of the Company also approved an offer pursuant to the amended Incentive Plan to certain employees to purchase a specified number of shares of the common stock of the parent of the Company at a price per share of \$10.00 (the "Offer"). For each share purchased, the employee received an option to purchase an additional share at \$10.00 (a "BOGO Option"). The Offer was made available to employees who had not previously accepted similar offers from the parent of the Company. The Company granted 179,000 BOGO Options and recognized stock-based compensation expense of approximately \$0.3 million in Fiscal 2011 related to these options.

During the period from May 29, 2007 through February 2, 2008, the Board of Directors of Claire's Inc. approved the grant of a total of approximately 3,265,000 stock options under the Plan to certain employees of the Company. In addition, the Board approved approximately 1,850,000 stock options to certain senior executives. The stock options consist of a "Time Option" and "Performance Option" as those terms are defined in the standard form of the option grant letter. The stock options have an exercise price of \$10.00 per share, the estimated fair market value of the underlying shares at the date of grant, and expire seven years after the date of grant. Time Options vest and become exercisable based on continued service to the Company. The Time Options vest in four equal annual installments, commencing one year from date of grant. Performance Options vest based on growth in the stock price between May 29, 2007 and specific quarterly measurement dates commencing with the last day of the eighth full fiscal quarter after May 29, 2007. Upon achievement of the performance target, the Performance Options vest and become exercisable in two equal annual installments on the first two anniversaries of the measurement date. During Fiscal 2011, Fiscal 2010 and Fiscal 2009, the Board of Directors approved the grant of approximately 713,800, 995,000 and 828,000, respectively, of similar stock options. The Company recognized stock-based compensation (benefit) expense of \$(2.2) million, \$4.2 million and \$5.5 million in Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively, related to Time and Performance Options.



**Table of Contents**

During the period from May 29, 2007 through February 2, 2008, the Board of Directors also granted approximately 970,000 BOGO options which are immediately exercisable and expire in seven years. The period from May 29, 2007 through February 2, 2008 included options to purchase an aggregate of 312,500 BOGO options granted outside of the Plan to certain senior executive officers and directors. During Fiscal 2011 and Fiscal 2010, the Board of Directors granted 186,000 and 6,000, respectively, BOGO options with similar terms. No BOGO options were granted during Fiscal 2009. The Company recognized stock-based compensation expense of \$497,000, \$702,000 and \$1,039,000 in Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively, related to these options.

The following is a summary of activity in the Company's stock option plan from January 29, 2011 through January 28, 2012:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)
Outstanding as of January 29, 2011	6,860,014	\$ 10.00	
Options granted	899,800	\$ 10.00	
Options exercised			
Options forfeited	(1,310,932)	\$ 10.00	
Options expired	(105,126)	\$ 10.00	
Outstanding as of January 28, 2012	6,343,756	\$ 10.00	3.6
Options vested and expected to vest at January 28, 2012	6,157,479	\$ 10.00	3.6
Exercisable at end of period	2,738,386	\$ 10.00	2.4

The weighted average grant date fair value of options granted in Fiscal 2011, Fiscal 2010 and Fiscal 2009 was \$2.63, \$3.35 and \$2.98, respectively.

As of January 28, 2012, there was \$3.1 million of unrecognized stock-based compensation expense, net of estimated forfeitures, related to non-vested stock options that is expected to be recognized over a weighted-average period of approximately 2.0 years.

**Table of Contents**

For options granted during Fiscal 2011, Fiscal 2010 and Fiscal 2009, the fair value of each option was estimated on the date of grant using the Black-Scholes and Monte Carlo option pricing models with the following assumptions:

<b>Time Options and BOGO Options (Black-Scholes)</b>	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Expected dividend yield	0.00%	0.00%	0.00%
Weighted average expected stock price volatility	58.79%	59.25%	55.53%
Weighted average risk-free interest rate	1.23%	2.04%	2.15%
Range of risk-free interest rate	0.69% - 2.20%	1.05% - 2.54%	1.38% - 2.98%
Weighted average expected term (years)	4.57	4.74	4.39

<b>Performance Options (Monte Carlo)</b>	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Expected dividend yield	0.00%	0.00%	0.00%
Weighted average expected stock price volatility	55.61%	58.66%	53.50%
Weighted average risk-free interest rate	1.63%	2.45%	2.05%
Range of risk-free interest rate	1.24% - 2.59%	1.42% - 2.93%	0.18% - 4.25%
Weighted average expected term (years)	N/A	N/A	N/A

The expected term of Time Options and BOGO Options has been based on the simplified method in accordance with SEC Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment*, as amended by SEC SAB No. 110, because the Company has no readily available relevant historical data on option-hold-periods by employees. The Company's historical option exercise data does not provide a reasonable basis upon which to estimate an expected term of an option due to new ownership of the Company establishing new equity-based compensation arrangements and different classifications of employees receiving grants. The risk-free interest rate for periods within the contractual life of the options is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected stock price volatility was based on peer company data as of the date of each option grant.

Claire's Inc. will issue new shares to satisfy exercise of stock options. During Fiscal 2011, Fiscal 2010 and Fiscal 2009, no options were exercised and no cash was used to settle equity instruments granted under share-based payment arrangements.

*Time-Vested Restricted Stock Awards*

On May 29, 2007, Claire's Inc. issued 125,000 shares of restricted common stock to certain members of executive management of the Company. The shares are subject to certain transfer restrictions and the shares are forfeited if a recipient leaves the Company. The shares vest at the rate of 25% on each of May 29, 2008, May 29, 2009, May 29, 2010, and May 29, 2011. Vesting is based on continued service to the Company. The weighted average grant date fair value was \$10.00 per share and the shares had an aggregate fair value at date of grant of \$1.25 million. Stock-based compensation expense relating to these shares recorded in Fiscal 2011, Fiscal 2010 and Fiscal 2009 approximated \$15,000, \$67,000 and \$141,000, respectively. At January 28, 2012 and January 29, 2011, unearned stock-based compensation related to these shares approximated \$0 and \$15,000, respectively.

A summary of the activity from January 29, 2011 through January 28, 2012 in the Company's restricted common stock is presented below:

	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Nonvested as of January 29, 2011	25,000	\$ 10.00
Granted		
Vested	(25,000)	\$ 10.00
Forfeited		
Nonvested as of January 28, 2012		



**Table of Contents****10. EMPLOYEE BENEFIT PLANS**

The Company maintains a defined contribution plan under 401(k) of the Internal Revenue Code that covers substantially all United States employees meeting certain service requirements. The Company, at its sole discretion, may make matching cash contributions up to specified percentages of employees' contributions. In March 2009, the Company changed to an annual election of discretionary matching contributions. The Company elected not to make any matching contributions during Fiscal 2011 and Fiscal 2010. During Fiscal 2009, the cost of Company matching contributions was \$152,000.

**11. INCOME TAXES**

The components of income (loss) before income taxes for Fiscal 2011, Fiscal 2010 and Fiscal 2009 were as follows (in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
U.S.	\$ (24,910)	\$ (34,663)	\$ (76,154)
Foreign	47,178	48,777	77,262
<b>Total income before income taxes</b>	<b>\$ 22,268</b>	<b>\$ 14,114</b>	<b>\$ 1,108</b>

The components of income tax expense (benefit) for Fiscal 2011, Fiscal 2010 and Fiscal 2009 were as follows (in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
<b>Federal:</b>			
Current	\$ 107	\$ 22	\$ 378
Deferred	109	1,098	3,541
	216	1,120	3,919
<b>State</b>			
Current	1,477	1,622	437
Deferred	(84)	(779)	63
	1,393	843	500
<b>Foreign</b>			
Current	10,608	8,737	5,552
Deferred	(1,581)	(909)	1,539
	9,027	7,828	7,091
<b>Total income tax expense</b>	<b>\$ 10,636</b>	<b>\$ 9,791</b>	<b>\$ 11,510</b>

The provision for income taxes for Fiscal 2011, Fiscal 2010 and Fiscal 2009 differs from an amount computed at the statutory federal rate as follows:

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
U.S. income taxes at statutory federal rate	35.0%	35.0%	35.0%
Valuation allowance	16.1	90.1	1,577.1
Foreign rate differential	(41.4)	(82.5)	(1,927.8)



## Edgar Filing: CLAIRE'S STORES INC - Form 10-K

State and local income taxes, net of federal tax benefit	5.9	(2.5)	(92.1)
Earnings of foreign subsidiaries	27.3	3.0	1,674.7
Change in accrual for estimated tax contingencies	0.5	7.9	199.6
Other, net	4.4	18.4	(427.7)
	47.8%	69.4%	1,038.8%

In Fiscal 2011, the Company's income tax expense was \$10.6 million and its effective income tax rate was 47.8%, including income tax expense of \$3.6 million related to the effect of changes to its valuation allowance on deferred tax assets. In Fiscal 2010, the Company's income tax expense was \$9.8 million and its effective income tax rate was 69.4%, including income tax expense of \$12.7 million related to the effect of changes to its valuation allowance on deferred tax assets. In Fiscal 2009, the Company's income tax expense was \$11.5 million and its effective income tax rate was 1,038.8%, including income tax expense of \$17.5 million related to the effect of changes to its valuation allowance on deferred tax assets.

**Table of Contents**

The effective income tax rates for Fiscal 2011, Fiscal 2010 and Fiscal 2009 also differ from the statutory federal income tax rate of 35% due to the overall geographic mix of losses in jurisdictions with higher income tax rates and income in jurisdictions with lower income tax rates, the impact of earnings of foreign subsidiaries, including repatriation to fund transaction related interest, and other permanent book to tax return adjustments.

The tax effects on the significant components of the Company's net deferred tax asset (liability) as of January 28, 2012 and January 29, 2011 are as follows (in thousands):

	<b>Jan. 28, 2012</b>	<b>Jan. 29, 2011</b>
Deferred tax assets:		
Tax carryforwards	\$ 79,509	\$ 69,306
Debt related	24,145	19,708
Compensation & benefits	11,650	15,009
Deferred rent	7,365	7,415
Depreciation	5,734	6,053
Accrued expenses	5,070	4,802
Gift cards	2,751	2,726
Other	1,567	2,198
Inventory	849	1,376
<b>Total gross deferred tax assets</b>	<b>138,640</b>	<b>128,593</b>
Valuation allowance	(124,250)	(120,286)
<b>Total deferred tax assets, net</b>	<b>14,390</b>	<b>8,307</b>
Deferred tax liabilities:		
Tradename intangibles	110,569	110,569
Lease rights	7,940	8,555
Earnings from foreign subsidiaries	8,495	3,187
Other	562	982
<b>Total deferred tax liabilities</b>	<b>127,566</b>	<b>123,293</b>
<b>Net deferred tax liability</b>	<b>\$ (113,176)</b>	<b>\$ (114,986)</b>

The deferred tax assets and deferred tax liabilities as of January 28, 2012 and January 29, 2011 are as follows (in thousands):

	<b>Jan. 28, 2012</b>	<b>Jan. 29, 2011</b>
Current deferred tax assets, net of valuation allowance	\$ 5,852	\$ 4,064
Current deferred tax liabilities		
Non-current deferred tax assets	1,424	2,726
Non-current deferred tax liabilities, net of valuation allowance	(120,452)	(121,776)
<b>Net deferred tax liability</b>	<b>\$ (113,176)</b>	<b>\$ (114,986)</b>

The amount and expiration dates of operating loss and tax credit carryforwards as of January 28, 2012 are as follows (in thousands):

	<b>Amount</b>	<b>Expiration Date</b>
U.S. federal net operating loss carryforwards	\$ 35,672	2028 2032

## Edgar Filing: CLAIRES STORES INC - Form 10-K

Non-U.S. net operating loss carryforwards	8,502	Indefinite	
Non-U.S. net operating loss carryforwards	8,773	2015	2027
State net operating loss carryforwards	2,934	2013	2032
U.S. foreign tax credits	23,628	2019	2022
 Total	 \$ 79,509		

In assessing the need for a valuation allowance recorded against deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Ultimately, the realization of deferred tax assets will depend on the existence of future taxable income. In making this assessment, management considers the scheduled reversal of deferred tax liabilities, past operating results, estimates of future taxable income and tax planning opportunities.

**Table of Contents**

In Fiscal 2011, the Company recorded an increase of \$4.0 million in valuation allowance against deferred tax assets in the U.S. In Fiscal 2010, the Company recorded a decrease of \$11.8 million in valuation allowance against deferred tax assets in the U.S. In Fiscal 2009, the Company recorded an increase of \$18.3 million in valuation allowance against deferred tax assets in the U.S. In Fiscal 2008, the Company concluded that a valuation allowance was appropriate in light of the significant negative evidence, which was objective and verifiable, such as cumulative losses in recent fiscal years in our U.S. operations. While the Company's long-term financial outlook in the U.S. remains positive, the Company concluded that its ability to rely on its long-term outlook as to future taxable income was limited due to the relative weight of the negative evidence from its recent U.S. cumulative losses. The Company's conclusion regarding the need for a valuation allowance against U.S. deferred tax assets could change in the future based on improvements in operating performance, which may result in the full or partial reversal of the valuation allowance. The foreign valuation allowances relate to net operating loss carryforwards that, in the opinion of management, are more likely than not to expire unutilized.

The net change in the total valuation allowances in Fiscal 2011, Fiscal 2010 and Fiscal 2009 was an increase of \$4.0 million, a decrease of \$10.3 million and an increase of \$20.4 million, respectively.

U.S. income taxes have not been recognized on the balance of accumulated unremitted earnings from the Company's foreign subsidiaries at January 28, 2012 of \$213.5 million, as these accumulated undistributed earnings are considered reinvested indefinitely. For Europe subsidiaries, this amount is based on the balance maintained in local currency of the Company's accumulated unremitted earnings at February 2, 2008 converted into U.S. dollars at foreign exchange rates in effect on January 28, 2012. Quantification of the deferred tax liability, if any, associated with indefinitely reinvested earnings is not practicable. The Company recognized U.S. income tax expense of \$6.1 million and \$0.4 million on Fiscal 2011 and Fiscal 2010 earnings, respectively, of its foreign subsidiaries. The Company expects that future earnings from its foreign subsidiaries will be repatriated.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Beginning balance	\$ 12,670	\$ 12,243	\$ 11,043
Additions based on tax positions related to the current year	1,163	1,694	1,987
Additions for tax positions of prior years	77		58
Reductions for tax positions of prior years	(370)	(1,133)	
Statute expirations	(815)	(134)	(351)
Settlements	(290)		(494)
Ending balance	\$ 12,435	\$ 12,670	\$ 12,243

The amount of unrecognized tax benefits at January 28, 2012 of \$12.4 million, if recognized, would favorably affect the Company's effective tax rate. These unrecognized tax benefits are classified as Unfavorable lease obligations and other long-term liabilities in the Company's Consolidated Balance Sheets.

Interest and penalties related to unrecognized tax benefits are included in income tax expense. The Company had \$3.4 million and \$3.1 million for the payment of interest and penalties accrued at January 28, 2012 and January 29, 2011, respectively, and are classified as Unfavorable lease obligations and other long-term liabilities in the Company's Consolidated Balance Sheets. For Fiscal 2011, Fiscal 2010 and Fiscal 2009, the Company recognized \$0.3 million, \$0.7 million and \$0.3 million, respectively, in interest and penalties.

On March 9, 2011, the Company was notified by the Canada Revenue Agency that it will proceed with a withholding tax assessment for 2003 through 2007 of approximately \$5.5 million, including penalties and interest. In conjunction with this assessment, a security deposit will be required in the amount of

## **Table of Contents**

approximately \$5.5 million until such time a final decision is made by the tax authority. The Company is objecting to this assessment and believes it will prevail at the appeals level; therefore, an accrual has not been recorded for this item. On February 11, 2011, the Internal Revenue Service concluded its tax examination of our U.S. Federal income tax return for Fiscal 2007 and did not assess any additional tax liability. The Company is currently under examination by the Internal Revenue Service for Fiscal 2008 and 2009.

The Company files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, and local, or non-U.S. income tax examinations for years before Fiscal 2005. We have also concluded tax examinations in our significant foreign tax jurisdictions including the United Kingdom through Fiscal 2005, France through Fiscal 2004, and Canada through Fiscal 2003.

Within the next 12 months, the Company estimates that the unrecognized tax benefits at January 28, 2012, could be reduced by approximately \$0.4 million related to the settlement of various state and local tax examinations for prior periods. Other than the expected settlement for state and local tax positions, the Company does not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

## **12. RELATED PARTY TRANSACTIONS**

Upon consummation of the Merger, the Company entered into a management services agreement with Apollo Management and the Sponsors. Under this management services agreement, Apollo Management and the Sponsors agreed to provide to the Company certain investment banking, management, consulting, and financial planning services on an ongoing basis for a fee of \$3.0 million per year. Under this management services agreement, Apollo Management and the Sponsors also agreed to provide to the Company certain financial advisory and investment banking services from time to time in connection with major financial transactions that may be undertaken by it or its subsidiaries in exchange for fees customary for such services after taking into account expertise and relationships within the business and financial community of Apollo Management and the Sponsors. Under this management services agreement, the Company also agreed to provide customary indemnification. The Company paid Apollo Management and Sponsors \$3.0 million for fees in each of Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively. These amounts are included in Selling, general and administrative expenses in the Company's Consolidated Statements of Operations and Comprehensive Income.

The Company paid store planning and retail design fees to a company owned by a member of one of the Company's executive officers. These fees are included in Furniture, fixtures and equipment in the Company's Consolidated Balance Sheets and Selling, general and administrative expenses in the Company's Consolidated Statements of Operations and Comprehensive Income. For Fiscal 2011, Fiscal 2010 and Fiscal 2009, the Company paid fees of approximately \$1.5 million, \$1.2 million and \$0.9 million, respectively. This arrangement was approved by the Audit Committee of the Board of Directors.

The initial purchasers of the Senior Secured Second Lien Notes were Credit Suisse Securities (USA) LLC, J.P. Morgan Securities LLC, Goldman Sachs & Co., and Morgan Joseph TriArtisan LLC. Apollo Management, LLC, an affiliate of Apollo Management VI, L.P., has a non-controlling interest in Morgan Joseph TriArtisan LLC and its affiliates. Additionally, a member of the Company's Board of Directors is an executive of Morgan Joseph TriArtisan Inc., an affiliate of Morgan Joseph TriArtisan LLC. In connection with the issuance of the Senior Secured Second Lien Notes, the Company paid a fee of approximately \$0.3 million to Morgan Joseph TriArtisan LLC.

See Note 16 Subsequent Events for related party transactions.

**Table of Contents****13. SELECTED QUARTERLY FINANCIAL DATA**

(Unaudited, in thousands)

	1st Qtr	2nd Qtr	Fiscal 2011 3rd Qtr	4th Qtr	Total Year
Net sales	\$ 346,446	\$ 358,547	\$ 356,000	\$ 434,907	\$ 1,495,900
Gross profit	175,087	183,165	183,495	229,378	771,125
Severance and transaction related costs	343	426	180	5,979	6,928
Gain on early debt extinguishment	249	233	3,986	1,937	6,405
Interest expense, net	46,235	44,335	43,543	42,362	176,475
Income tax (benefit) expense (a)	(732)	3,400	3,193	4,775	10,636
Net income (loss)	(19,597)	(10,143)	1,898	39,474	11,632

(a) Includes a \$3.6 million charge for an increase in the valuation allowance related to deferred tax assets.

	1st Qtr	2nd Qtr	Fiscal 2010 3rd Qtr	4th Qtr	Total Year
Net sales	\$ 322,077	\$ 334,233	\$ 348,175	\$ 421,912	\$ 1,426,397
Gross profit	163,326	175,013	180,602	222,345	741,286
Impairment of assets (b)				12,262	12,262
Severance and transaction related costs	102	212	121	306	741
Gain on early debt extinguishment	4,487	6,249	2,652		13,388
Impairment of equity investment (c)		6,030			6,030
Interest expense, net	42,763	40,573	37,132	37,238	157,706
Income tax expense (d)	1,633	1,607	3,369	3,182	9,791
Net income (loss)	(12,300)	(8,345)	3,647	21,321	4,323

(b) Represents impairment charge related to franchise agreements. See Note 3 Impairment Charges for detail of impairment charges.

(c) Represents impairment charge related to equity investment in Claire's Nippon. See Note 3 Impairment Charges for detail of impairment charges.

(d) Includes a \$12.7 million charge for an increase in the valuation allowance related to deferred tax assets.

**Table of Contents****14. SEGMENT REPORTING**

The Company is organized based on the geographic markets in which it operates. Under this structure, the Company currently has two reportable segments: North America and Europe. The Company accounts for the goods it sells to third parties under franchising and licensing agreements within Net sales and Cost of sales, occupancy and buying expenses in the Company's Consolidated Statements of Operations and Comprehensive Income within its North America division. The franchise fees the Company charges under the franchising agreements are reported in Other (income) expense, net in the Company's Consolidated Statements of Operations and Comprehensive Income within its Europe division. Until September 2, 2010, the Company accounted for the results of operations of Claire's Nippon under the equity method and included the results within Other (income) expense, net in the Company's Consolidated Statements of Operations and Comprehensive Income within the Company's North America division. After September 2, 2010, these former joint venture stores began to operate as licensed stores. Substantially all of the interest expense on the Company's outstanding debt is recorded in the Company's North America division.

Information about the Company's operations by segment is as follows (in thousands):

	Fiscal 2011	Fiscal 2010	Fiscal 2009
Net sales:			
North America	\$ 942,278	\$ 914,149	\$ 850,313
Europe	553,622	512,248	492,076
Total net sales	\$ 1,495,900	\$ 1,426,397	\$ 1,342,389
Depreciation and amortization:			
North America	\$ 41,650	\$ 42,169	\$ 47,574
Europe	27,103	23,029	23,897
Total depreciation and amortization	\$ 68,753	\$ 65,198	\$ 71,471
Segment operating income:			
North America	\$ 153,121	\$ 124,606	\$ 88,890
Europe	46,145	52,859	57,287
Total segment operating income	\$ 199,266	\$ 177,465	\$ 146,177
Impairment of assets:			
North America	\$	\$	\$ 3,142
Europe		12,262	
Total impairment charges	\$	\$ 12,262	\$ 3,142
Impairment of equity investment:			
North America	\$	\$ 6,030	\$
Europe			
Total impairment of equity investment	\$	\$ 6,030	\$
Interest expense (income), net:			
North America	\$ 171,211	\$ 157,595	\$ 177,496
Europe	5,264	111	(78)
Total interest expense, net	\$ 176,475	\$ 157,706	\$ 177,418
Income (loss) before income taxes:			
North America	\$ (15,637)	\$ (26,003)	\$ (56,257)
Europe	37,905	40,117	57,365

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Total income before income taxes	\$ 22,268	\$ 14,114	\$ 1,108
Income tax expense:			
North America	\$ 1,883	\$ 2,694	\$ 4,559
Europe	8,753	7,097	6,951
Total income tax expense	\$ 10,636	\$ 9,791	\$ 11,510
Net income (loss):			
North America	\$ (17,520)	\$ (28,697)	\$ (60,816)
Europe	29,152	33,020	50,414
Net income (loss)	\$ 11,632	\$ 4,323	\$ (10,402)



**Table of Contents**

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
<b>Goodwill:</b>			
North America	\$ 1,235,651	\$ 1,235,651	\$ 1,235,651
Europe	314,405	314,405	314,405
 Total goodwill	 \$ 1,550,056	 \$ 1,550,056	 \$ 1,550,056
<b>Long-lived assets:</b>			
North America	\$ 135,555	\$ 142,090	\$ 161,648
Europe	88,215	76,095	66,336
 Total long lived assets	 \$ 223,770	 \$ 218,185	 \$ 227,984
<b>Total assets:</b>			
North America	\$ 1,402,946	\$ 1,493,210	\$ 1,505,727
Europe	1,360,079	1,373,239	1,328,378
 Total assets	 \$ 2,763,025	 \$ 2,866,449	 \$ 2,834,105
<b>Capital Expenditures</b>			
North America	\$ 33,784	\$ 20,353	\$ 13,731
Europe	37,124	28,358	11,221
 Total capital expenditures	 \$ 70,908	 \$ 48,711	 \$ 24,952

The Company measures segment operating income as gross profit less selling, general and administrative expenses and depreciation and amortization expense, including other operating income and expense, but excluding impairment of assets and severance and transaction-related costs. A reconciliation of total segment operating income to consolidated operating income is as follows (in thousands).

	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Fiscal 2009</b>
Total segment operating income	\$ 199,266	\$ 177,465	\$ 146,177
Impairment of assets		12,262	3,142
Severance and transaction-related costs	6,928	741	921
 Consolidated operating income	 \$ 192,338	 \$ 164,462	 \$ 142,114

Excluded from operating income are impairment charges of \$0, \$12.3 million and \$3.1 million for Fiscal 2011, Fiscal 2010 and Fiscal 2009, respectively. For Fiscal 2011, Fiscal 2010 and Fiscal 2009, segment operating income also excludes severance and transaction-related costs for North America of \$3.9 million, \$0.4 million and \$0.9 million, respectively, and Europe of \$3.0 million, \$0.3 million and \$0, respectively. See Note 3 Impairment Charges.

Identifiable assets are those assets that are identified with the operations of each segment. Corporate assets consist mainly of cash and cash equivalents, investments in affiliated companies and other assets. These assets are included within North America.

The following table compares the Company's sales of each product category by segment for the last three fiscal years:

<b>Product Category</b>	<b>Fiscal 2011</b>	<b>Percentage of Total Fiscal 2010</b>	<b>Fiscal 2009</b>
<b>Accessories:</b>			
North America	30.7	31.8	30.5
Europe	23.2	22.7	23.1

Edgar Filing: CLAIRE'S STORES INC - Form 10-K

	53.9	54.5	53.6
Jewelry:			
North America	31.8	32.0	32.3
Europe	14.3	13.5	14.1
	46.1	45.5	46.4
	100.0	100.0	100.0

**Table of Contents**

The following table provides data for selected geographical areas.

Net Sales:	Percentage of Total Net Sales		
	Fiscal 2011	Fiscal 2010	Fiscal 2009
United Kingdom	13.7	15.0	16.9
France	9.6	9.1	8.7

Long-lived Assets:	Percentage of Total Long-lived Assets	
	January 28, 2012	January 29, 2011
United Kingdom	8.6	10.4
France	4.4	5.7

**15. SUPPLEMENTAL FINANCIAL INFORMATION**

On May 29, 2007, Claire's Stores, Inc. (the "Issuer"), issued \$935.0 million in Senior Fixed Rate Notes, Senior Toggle Notes and Senior Subordinated Notes, and on March 4, 2011, issued \$450.0 million aggregate principal amount of Senior Secured Second Lien Notes. These Notes are irrevocably and unconditionally guaranteed, jointly and severally, by all wholly-owned domestic current and future subsidiaries of Claire's Stores, Inc. that guarantee the Company's Credit Facility (the "Guarantors"). The Company's other subsidiaries, principally its international subsidiaries including its Europe, Canadian and Asian subsidiaries (the "Non-Guarantors"), are not guarantors of these Notes.

The tables in the following pages present the condensed consolidating financial information for the Issuer, the Guarantors and the Non-Guarantors, together with eliminations, as of and for the periods indicated. The consolidating financial information may not necessarily be indicative of the financial position, results of operations or cash flows had the Issuer, Guarantors and Non-Guarantors operated as independent entities.

**Table of Contents****Condensed Consolidating Balance Sheet****January 28, 2012****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents and restricted cash (1)	\$ 107,265	\$ 4,908	\$ 62,201	\$	\$ 174,374
Inventories		84,608	57,496		142,104
Prepaid expenses	676	1,530	17,804		20,010
Other current assets		15,967	9,456		25,423
Total current assets	107,941	107,013	146,957		361,911
Property and equipment:					
Furniture, fixtures and equipment	4,540	128,650	74,430		207,620
Leasehold improvements	1,071	151,891	128,812		281,774
	5,611	280,541	203,242		489,394
Less accumulated depreciation and amortization	(2,761)	(175,999)	(103,114)		(281,874)
	2,850	104,542	100,128		207,520
Leased property under capital lease:					
Land and building		18,055			18,055
Less accumulated depreciation and amortization		(1,805)			(1,805)
		16,250			16,250
Intercompany receivables		234,828		(234,828)	
Investment in subsidiaries	2,138,159	(58,841)		(2,079,318)	
Goodwill		1,235,651	314,405		1,550,056
Intangible assets, net	286,000	6,176	257,592		549,768
Deferred financing costs, net	32,432		593		33,025
Other assets	130	3,788	40,577		44,495
	2,456,721	1,421,602	613,167	(2,314,146)	2,177,344
Total assets	\$ 2,567,512	\$ 1,649,407	\$ 860,252	\$ (2,314,146)	\$ 2,763,025
<b>LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)</b>					
Current liabilities:					
Trade accounts payable	\$ 1,468	\$ 23,845	\$ 35,391	\$	\$ 60,704
Income taxes payable		766	9,462		10,228
Accrued interest payable	31,859				31,859
Accrued expenses and other current liabilities	14,890	39,744	49,891		104,525
Total current liabilities	48,217	64,355	94,744		207,316

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Intercompany payables	155,209		79,619	(234,828)	
Long-term debt	2,386,382				2,386,382
Revolving credit facility					
Obligation under capital lease		17,290			17,290
Deferred tax liability		106,825	13,627		120,452
Deferred rent expense		17,680	11,181		28,861
Unfavorable lease obligations and other long-term liabilities		24,217	803		25,020
	2,541,591	166,012	105,230	(234,828)	2,578,005
Stockholder's equity (deficit):					
Common stock		367	2	(369)	
Additional paid in capital	619,453	1,435,909	815,866	(2,251,775)	619,453
Accumulated other comprehensive income (loss), net of tax	(4,351)	3,675	(11,780)	8,105	(4,351)
Accumulated deficit	(637,398)	(20,911)	(143,810)	164,721	(637,398)
	(22,296)	1,419,040	660,278	(2,079,318)	(22,296)
Total liabilities and stockholder's equity (deficit)	\$ 2,567,512	\$ 1,649,407	\$ 860,252	\$ (2,314,146)	\$ 2,763,025

(1) Cash and cash equivalents includes restricted cash of \$4,350 for Issuer

**Table of Contents****Condensed Consolidating Balance Sheet****January 29, 2011****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents and restricted cash (1)	\$ 179,529	\$ 3,587	\$ 96,650	\$	\$ 279,766
Inventories		84,868	51,280		136,148
Prepaid expenses	851	1,680	18,918		21,449
Other current assets		16,547	8,111		24,658
Total current assets	180,380	106,682	174,959		462,021
Property and equipment:					
Furniture, fixtures and equipment	3,276	119,228	64,010		186,514
Leasehold improvements	1,052	143,072	103,906		248,030
	4,328	262,300	167,916		434,544
Less accumulated depreciation and amortization	(2,205)	(147,857)	(83,449)		(233,511)
	2,123	114,443	84,467		201,033
Leased property under capital lease:					
Land and building		18,055			18,055
Less accumulated depreciation and amortization		(903)			(903)
		17,152			17,152
Intercompany receivables		366,929		(366,929)	
Investment in subsidiaries	2,303,333	(63,535)		(2,239,798)	
Goodwill		1,235,651	314,405		1,550,056
Intangible assets, net	286,000	9,294	262,172		557,466
Deferred financing costs, net	35,973		461		36,434
Other assets	130	3,842	38,315		42,287
	2,625,436	1,552,181	615,353	(2,606,727)	2,186,243
Total assets	\$ 2,807,939	\$ 1,790,458	\$ 874,779	\$ (2,606,727)	\$ 2,866,449
<b>LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)</b>					
Current liabilities:					
Short-term debt and current portion of long-term debt	\$ 18,451	\$	\$ 57,703	\$	\$ 76,154
Trade accounts payable	1,199	24,545	28,611		54,355
Income taxes payable		644	11,100		11,744
Accrued interest payable	16,696		87		16,783
Accrued expenses and other current liabilities	20,630	37,910	48,575		107,115
Total current liabilities	56,976	63,099	146,076		266,151

# Edgar Filing: CLAIRES STORES INC - Form 10-K

Intercompany payables	346,636		20,293	(366,929)	
Long-term debt	2,236,842				2,236,842
Revolving credit facility	194,000				194,000
Obligation under capital lease		17,290			17,290
Deferred tax liability		106,797	14,979		121,776
Deferred rent expense		17,230	9,407		26,637
Unfavorable lease obligations and other long-term liabilities		28,889	1,379		30,268
	2,777,478	170,206	46,058	(366,929)	2,626,813
Stockholder's equity (deficit):					
Common stock		367	2	(369)	
Additional paid in capital	621,099	1,435,909	815,866	(2,251,775)	621,099
Accumulated other comprehensive income (loss), net of tax	1,416	3,663	(7,080)	3,417	1,416
Retained earnings (accumulated deficit)	(649,030)	117,214	(126,143)	8,929	(649,030)
	(26,515)	1,557,153	682,645	(2,239,798)	(26,515)
Total liabilities and stockholder's equity (deficit)	\$ 2,807,939	\$ 1,790,458	\$ 874,779	\$ (2,606,727)	\$ 2,866,449

(1) Cash and cash equivalents includes restricted cash of \$3,450 for Issuer and \$20,414 for Non-Guarantors

**Table of Contents****Condensed Consolidating Statement of Operations and Comprehensive Income****Fiscal 2011****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$	\$ 869,873	\$ 626,027	\$	\$ 1,495,900
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	5,920	412,439	306,416		724,775
Gross (deficit) profit	(5,920)	457,434	319,611		771,125
Other expenses:					
Selling, general and administrative	23,116	256,816	224,428		504,360
Depreciation and amortization	738	38,001	30,014		68,753
Severance and transaction-related costs	2,851	1,100	2,977		6,928
Other (income) expense, net	(11,030)	(25)	9,801		(1,254)
	15,675	295,892	267,220		578,787
Operating (loss) income	(21,595)	161,542	52,391		192,338
Gain on early debt extinguishment	6,405				6,405
Interest expense, net	169,107	2,155	5,213		176,475
Income (loss) before income taxes	(184,297)	159,387	47,178		22,268
Income tax expense		1,609	9,027		10,636
Income (loss) from continuing operations	(184,297)	157,778	38,151		11,632
Equity in earnings of subsidiaries	195,929	4,609		(200,538)	
Net income	11,632	162,387	38,151	(200,538)	11,632
Foreign currency translation and interest rate swap adjustments, net of tax	(5,767)	12	(4,700)	4,688	(5,767)
Comprehensive income	\$ 5,865	\$ 162,399	\$ 33,451	\$ (195,850)	\$ 5,865

**Condensed Consolidating Statement of Operations and Comprehensive Income****Fiscal 2010****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$	\$ 847,048	\$ 579,349	\$	\$ 1,426,397
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	5,222	408,851	271,038		685,111



Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Gross (deficit) profit	(5,222)	438,197	308,311		741,286
Other expenses:					
Selling, general and administrative	35,132	252,522	205,427		493,081
Depreciation and amortization	631	38,700	25,867		65,198
Impairment of assets			12,262		12,262
Severance and transaction-related costs	372		369		741
Other (income) expense, net	(20,304)	10,325	15,521		5,542
	15,831	301,547	259,446		576,824
Operating income (loss)	(21,053)	136,650	48,865		164,462
Gain on early debt extinguishment	13,388				13,388
Impairment of equity investment		6,030			6,030
Interest expense, net	156,427	1,190	89		157,706
Income (loss) before income taxes	(164,092)	129,430	48,776		14,114
Income tax expense	23	1,939	7,829		9,791
Income (loss) from continuing operations	(164,115)	127,491	40,947		4,323
Equity in earnings of subsidiaries	168,438	4,847		(173,285)	
Net income	4,323	132,338	40,947	(173,285)	4,323
Foreign currency translation and interest rate swap adjustments, net of tax	8,363	1,562	(2,946)	1,384	8,363
Reclassification of foreign currency translation adjustments into net income	(9,572)	(9,572)		9,572	(9,572)
Comprehensive income	\$ 3,114	\$ 124,328	\$ 38,001	\$ (162,329)	\$ 3,114

**Table of Contents****Condensed Consolidating Statement of Operations and Comprehensive Income****Fiscal 2009****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated Combined</b>
Net sales	\$	\$ 792,190	\$ 550,199	\$	\$ 1,342,389
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)		402,594	260,675		663,269
Gross profit		389,596	289,524		679,120
Other expenses:					
Selling, general and administrative	31,798	240,657	194,510		466,965
Depreciation and amortization	1,439	43,182	26,850		71,471
Impairment of assets		3,142			3,142
Severance and transaction-related costs	921				921
Other (income) expense, net	(16,768)	20,283	(9,008)		(5,493)
	17,390	307,264	212,352		537,006
Operating income (loss)	(17,390)	82,332	77,172		142,114
Gain on early debt extinguishment	36,412				36,412
Interest expense (income), net	177,518	(11)	(89)		177,418
Income (loss) before income taxes	(158,496)	82,343	77,261		1,108
Income tax expense	2,503	1,916	7,091		11,510
Income (loss) from continuing operations	(160,999)	80,427	70,170		(10,402)
Equity in earnings of subsidiaries	150,597	7,101		(157,698)	
Net income (loss)	(10,402)	87,528	70,170	(157,698)	(10,402)
Foreign currency translation and interest rate swap adjustments, net of tax	24,944	4,426	16,457	(20,883)	24,944
Comprehensive income	\$ 14,542	\$ 91,954	\$ 86,627	\$ (178,581)	\$ 14,542

**Table of Contents****Condensed Consolidating Statement of Cash Flows****Fiscal 2011****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Cash flows from operating activities:</b>					
Net income	\$ 11,632	\$ 162,387	\$ 38,151	\$ (200,538)	\$ 11,632
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries	(195,929)	(4,609)		200,538	
Depreciation and amortization	738	38,001	30,014		68,753
Amortization of lease rights and other assets			3,189		3,189
Amortization of debt issuance costs	13,148		(42)		13,106
Payment of in kind interest expense	11,831				11,831
Foreign currency exchange net gain on Euro Loan			(1,953)		(1,953)
Net accretion of favorable (unfavorable) lease obligations		(1,174)	517		(657)
Loss on sale/retirement of property and equipment, net		29	13		42
Gain on early debt extinguishment	(6,405)				(6,405)
Gain on sale of intangible assets/lease rights			(90)		(90)
Stock compensation benefit	(1,452)		(194)		(1,646)
<b>(Increase) decrease in:</b>					
Inventories		260	(8,654)		(8,394)
Prepaid expenses	175	150	1,051		1,376
Other assets		746	(6,598)		(5,852)
<b>Increase (decrease) in:</b>					
Trade accounts payable	269	(1,169)	8,211		7,311
Income taxes payable		124	(2,115)		(1,991)
Accrued interest payable	15,163		(82)		15,081
Accrued expenses and other liabilities	(7,073)	2,174	1,828		(3,071)
Deferred income taxes		(540)	(1,482)		(2,022)
Deferred rent expense		450	1,870		2,320
Net cash (used in) provided by operating activities	(157,903)	196,829	63,634		102,560
<b>Cash flows from investing activities:</b>					
Acquisition of property and equipment, net	(1,466)	(26,652)	(42,790)		(70,908)
Acquisition of intangible assets/lease rights		(46)	(5,663)		(5,709)
Proceeds from sale of intangible assets/lease rights			816		816
Changes in restricted cash	(900)		19,317		18,417
Net cash used in investing activities	(2,366)	(26,698)	(28,320)		(57,384)
<b>Cash flows from financing activities:</b>					
Payments of Credit facility	(438,940)				(438,940)
Proceeds from note	450,000				450,000
Payment of short-term debt			(54,653)		(54,653)
Repurchase of notes	(78,343)				(78,343)
Payment of debt issuance costs	(10,661)		(90)		(10,751)
Intercompany activity, net	165,049	(168,751)	3,702		
Net cash provided by (used in) financing activities	87,105	(168,751)	(51,041)		(132,687)

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Effect of foreign currency exchange rate changes on cash and cash equivalents		(59)	1,692		1,633
Net (decrease) increase in cash and cash equivalents	(73,164)	1,321	(14,035)		(85,878)
Cash and cash equivalents at beginning of period	176,079	3,587	76,236		255,902
Cash and cash equivalents at end of period	102,915	4,908	62,201		170,024
Restricted cash at end of period	4,350				4,350
Cash and cash equivalents and restricted cash at end of period	\$ 107,265	\$ 4,908	\$ 62,201	\$	\$ 174,374

**Table of Contents****Condensed Consolidating Statement of Cash Flows****Fiscal 2010****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Cash flows from operating activities:</b>					
Net income	\$ 4,323	\$ 132,338	\$ 40,947	\$ (173,285)	\$ 4,323
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries	(168,438)	(4,847)		173,285	
Depreciation and amortization	631	38,700	25,867		65,198
Impairment		6,030	12,262		18,292
Amortization of lease rights and other assets		29	3,175		3,204
Amortization of debt issuance costs	9,963		42		10,005
Payment of in kind interest expense	36,872				36,872
Net accretion of favorable (unfavorable) lease obligations		(2,054)	564		(1,490)
Loss on sale/retirement of property and equipment, net		668	4		672
Gain on early debt extinguishment	(13,388)				(13,388)
Stock compensation expense	3,863		1,150		5,013
(Increase) decrease in:					
Inventories		(10,966)	(14,408)		(25,374)
Prepaid expenses	(342)	12,536	464		12,658
Other assets	1,243	4,335	(4,827)		751
Increase (decrease) in:					
Trade accounts payable	(128)	6,682	3,760		10,314
Income taxes payable		2,320	1,347		3,667
Accrued interest payable	2,053		86		2,139
Accrued expenses and other liabilities	4,828	1,800	7,947		14,575
Deferred income taxes		318	(913)		(595)
Deferred rent expense	(107)	2,273	2,257		4,423
<b>Net cash provided by (used in) operating activities</b>	<b>(118,627)</b>	<b>190,162</b>	<b>79,724</b>		<b>151,259</b>
<b>Cash flows from investing activities:</b>					
Acquisition of property and equipment, net	(1,248)	(18,310)	(29,153)		(48,711)
Proceeds from sale of property and equipment		16,765			16,765
Acquisition of intangible assets/lease rights		(126)	(978)		(1,104)
Changes in restricted cash	(3,450)		(20,452)		(23,902)
<b>Net cash provided by (used in) investing activities</b>	<b>(4,698)</b>	<b>(1,671)</b>	<b>(50,583)</b>		<b>(56,952)</b>
<b>Cash flows from financing activities:</b>					
Payments of Credit facility	(14,500)				(14,500)
Proceeds from short-term debt			57,494		57,494
Repurchase of notes	(79,865)				(79,865)
Payment of debt issuance costs			(503)		(503)
Principal payments of capital leases		(765)			(765)
Intercompany activity, net	284,631	(176,753)	(107,878)		
<b>Net cash provided by (used in) financing activities</b>	<b>190,266</b>	<b>(177,518)</b>	<b>(50,887)</b>		<b>(38,139)</b>

## Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Effect of foreign currency exchange rate changes on cash and cash equivalents		3,218	(2,192)	1,026
Net increase (decrease) in cash and cash equivalents	66,941	14,191	(23,938)	57,194
Cash and cash equivalents at beginning of period	109,138	(10,604)	100,174	198,708
Cash and cash equivalents at end of period	176,079	3,587	76,236	255,902
Restricted cash at end of period	3,450		20,414	23,864
Cash and cash equivalents and restricted cash at end of period	\$ 179,529	\$ 3,587	\$ 96,650	\$ 279,766

**Table of Contents****Condensed Consolidating Statement of Cash Flows****Fiscal 2009****(in thousands)**

	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Cash flows from operating activities:</b>					
Net income (loss)	\$ (10,402)	\$ 87,528	\$ 70,170	\$ (157,698)	\$ (10,402)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity in (earnings) loss of subsidiaries	(150,597)	(7,101)		157,698	
Depreciation and amortization	1,439	43,182	26,850		71,471
Impairment of assets		3,142			3,142
Amortization of lease rights and other assets		49	2,150		2,199
Amortization of debt issuance costs	10,398				10,398
Payment of in kind interest expense	39,013				39,013
Net accretion of favorable (unfavorable) lease obligations		(2,550)	399		(2,151)
(Gain) loss on sale/retirement of property and equipment, net	(1,430)	20	21		(1,389)
Gain on early debt extinguishment	(36,412)				(36,412)
Gain on sale of intangible assets/lease rights			(506)		(506)
Stock compensation expense	4,942		1,717		6,659
<b>(Increase) decrease in:</b>					
Inventories		(457)	(3,624)		(4,081)
Prepaid expenses	(76)	425	1,448		1,797
Other assets	134	(4,926)	(727)		(5,519)
<b>Increase (decrease) in:</b>					
Trade accounts payable	(1,016)	(3,389)	(8,339)		(12,744)
Income taxes payable		248	5,262		5,510
Accrued interest payable	1,331		(3)		1,328
Accrued expenses and other current liabilities	(1,424)	229	1,066		(129)
Deferred income taxes	2,483	13	1,618		4,114
Deferred rent expense	(591)	2,425	1,344		3,178
<b>Net cash provided by (used in) operating activities</b>	<b>(142,208)</b>	<b>118,838</b>	<b>98,846</b>		<b>75,476</b>
<b>Cash flows from investing activities:</b>					
Acquisition of property and equipment, net	(120)	(12,209)	(12,623)		(24,952)
Proceeds from sale of property and equipment	1,830				1,830
Acquisition of intangible assets/lease rights		(111)	(435)		(546)
Proceeds from sale of intangible assets/lease rights			2,409		2,409
<b>Net cash provided by (used in) investing activities</b>	<b>1,710</b>	<b>(12,320)</b>	<b>(10,649)</b>		<b>(21,259)</b>
<b>Cash flows from financing activities:</b>					
Payments of Credit facility	(14,500)				(14,500)
Repurchase of notes	(46,091)				(46,091)
Intercompany activity, net	155,813	(117,125)	(38,688)		
<b>Net cash provided by (used in) financing activities</b>	<b>95,222</b>	<b>(117,125)</b>	<b>(38,688)</b>		<b>(60,591)</b>
Effect of foreign currency exchange rate changes on cash and cash equivalents		(208)	716		508

# Edgar Filing: CLAIRE'S STORES INC - Form 10-K

Net increase (decrease) in cash and cash equivalents	(45,276)	(10,815)	50,225	(5,866)
Cash and cash equivalents at beginning of period	154,414	211	49,949	204,574
Cash and cash equivalents at end of period	\$ 109,138	\$ (10,604)	\$ 100,174	\$ 198,708



## **Table of Contents**

### **16. SUBSEQUENT EVENTS**

On February 28, 2012, the Company issued \$400.0 million aggregate principal amount of 9.00% senior secured first lien notes that mature on March 15, 2019 (the "Senior Secured First Lien Notes"). The notes were issued at a price equal to 100.00% of the principal amount. On March 12, 2012, the Company issued an additional \$100.0 million aggregate principal amount of the same series of Senior Secured First Lien Notes at a price equal to 101.50% of the principal amount of the same series as the \$400.0 million aggregate principal amount for an aggregate of \$500.0 million. Interest on the Senior Secured First Lien Notes is payable semi-annually to holders of record at the close of business on March 1 or September 1 immediately preceding the interest payment date on March 15 and September 15 of each year, commencing on September 15, 2012. The Senior Secured First Lien Notes are guaranteed on a first-priority senior secured basis by all of the Company's existing and future direct or indirect wholly-owned domestic subsidiaries that guarantee the Company's senior secured credit facility. The Senior Secured First Lien Notes and related guarantees are secured by a first-priority lien on substantially all of the assets that secure the Company's and its subsidiary guarantors' obligations under the Company's senior secured credit facility. The Company used the net proceeds of the offering of the Senior Secured First Lien Notes to reduce \$489.8 million of indebtedness under the Company's senior secured term loan.

The initial purchasers of the Senior Secured First Lien Notes were J.P. Morgan Securities LLC, Credit Suisse Securities (USA) LLC, Goldman Sachs & Co., Apollo Global Securities, LLC and Morgan Joseph TriArtisan LLC. Apollo Global Securities, LLC is an affiliate of Apollo Management VI, L.P., which is the Company's controlling stockholder. Apollo Management, LLC, an affiliate of Apollo Management VI, L.P., has a non-controlling interest in Morgan Joseph TriArtisan LLC and its affiliates. Additionally, a member of the Company's Board of Directors is an executive of Morgan Joseph TriArtisan Inc., an affiliate of Morgan Joseph TriArtisan LLC. In connection with the issuance of the Senior Secured First Lien Notes, the Company paid fees of approximately \$0.7 million to Apollo Global Securities, LLC and \$0.1 million to Morgan Joseph TriArtisan LLC.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

### **Item 9A. Controls and Procedures**

#### ***Disclosure Controls and Procedures***

The Company's management, including its Interim Co-Chief Executive Officers and its Chief Financial Officer, performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of January 28, 2012. Disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act has been appropriately recorded, processed, summarized, and reported on a timely basis and are effective in ensuring that such information is accumulated and communicated to the Company's management, including the Company's Interim Co-Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Based upon that evaluation, the Company's management, including the Interim Co-Chief Executive Officers and the Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of January 28, 2012.

#### ***Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f), and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our Interim Co-Chief Executive Officers and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal

## **Table of Contents**

controls over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control – Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of January 28, 2012.

This Annual Report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. The Company's internal control over financial reporting was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permits the Company, as a non-accelerated filer, to provide only management's report in this Annual Report.

### ***Changes in Internal Controls over Financial Reporting***

There were no changes in the Company's internal control over financial reporting during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Item 9B. Other Information**

None.

## **PART III.**

An amendment to this Annual Report on Form 10-K to include Part III of the Form 10-K will be filed with the Securities and Exchange Commission no later than 120 days after the end of Fiscal 2011.

**Table of Contents**

**PART IV.**

**Item 15. Exhibits, Financial Statement Schedules**

(a) List of documents filed as part of this report.

**1. Financial Statements**

<u>Report of Independent Registered Public Accounting Firm</u>	<b>Page No.</b> 48
<u>Consolidated Balance Sheets as of January 28, 2012 and January 29, 2011</u>	49
<u>Consolidated Statements of Operations and Comprehensive Income for the fiscal years ended January 28, 2012, January 29, 2011 and January 30, 2010</u>	50
<u>Consolidated Statements of Changes in Stockholder's Deficit for the fiscal years ending January 28, 2012, January 29, 2011 and January 30, 2010</u>	51
<u>Consolidated Statements of Cash Flows for the fiscal years ending January 28, 2012, January 29, 2011 and January 30, 2010</u>	52
<u>Notes to Consolidated Financial Statements</u>	53

**2. Financial Statement Schedules**

All schedules have been omitted because the required information is included in the Consolidated Financial Statements or the notes thereto, or the omitted schedules are not applicable.

**3. Exhibits**

- 3.1 Articles of Incorporation of Claire's Stores, Inc. (1)
- 3.2 By-laws of Claire's Stores, Inc. (1)
- 3.3 Certificate of Incorporation of BMS Distributing Corp. (1)
- 3.4 By-laws of BMS Distributing Corp. (1)
- 3.5 Certificate of Incorporation of CBI Distributing Corp. (1)
- 3.6 By-laws of CBI Distributing Corp. (1)
- 3.7 Articles of Incorporation of Claire's Boutiques, Inc. (1)
- 3.8 By-laws of Claire's Boutiques, Inc. (1)
- 3.9 Certificate of Incorporation of Claire's Canada Corp. (1)
- 3.10 By-laws of Claire's Canada Corp. (1)
- 3.11 Certificate of Incorporation of Claire's Puerto Rico Corp. (1)
- 3.12 By-laws of Claire's Puerto Rico Corp. (1)
- 4.1 Senior Notes Indenture, dated as of May 29, 2007, between Bauble Acquisition Sub, Inc. and The Bank of New York, as Trustee (1)



## **Table of Contents**

4.2	Senior Toggle Notes Indenture, dated as of May 29, 2007, between Bauble Acquisition Sub, Inc. and The Bank of New York, as Trustee (1)
4.3	Senior Subordinated Notes Indenture, dated as of May 29, 2007, between Bauble Acquisition Sub, Inc. and The Bank of New York, as Trustee (1)
4.4	Senior Notes Supplemental Indenture, dated as of May 29, 2007, by and among Claire's Stores, Inc., the guarantors listed on Exhibit A thereto and The Bank of New York, as Trustee, to the Senior Notes Indenture, dated as of May 29, 2007, between Bauble Acquisition Sub, Inc. and The Bank of New York, as Trustee (1)
4.5	Senior Toggle Notes Supplemental Indenture, dated as of May 29, 2007, by and among Claire's Stores, Inc., the guarantors listed on Exhibit A thereto and The Bank of New York, as Trustee, to the Senior Toggle Notes Indenture, dated as of May 29, 2007, between Bauble Acquisition Sub, Inc. and The Bank of New York, as Trustee (1)
4.6	Senior Subordinated Notes Supplemental Indenture, dated as of May 29, 2007, by and among Claire's Stores, Inc., the guarantors listed on Exhibit A thereto and The Bank of New York, as Trustee, to the Senior Subordinated Notes Indenture, dated as of May 29, 2007, between Bauble Acquisition Sub, Inc. and The Bank of New York, as Trustee (1)
4.7	Form of 9.25% Senior Notes due 2015 (1)
4.8	Form of 9.625%/10.375% Senior Toggle Notes due 2015 (1)
4.9	Form of 10.50% Senior Subordinated Notes due 2017 (1)
4.10	Indenture, dated as of March 4, 2011, by and between Claire's Escrow Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent (8)
4.11	Supplemental Indenture, dated as of March 4, 2011, by and between Claire's Stores, Inc., the Guarantors and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent (8)
4.12	Form of 8.875% Senior Secured Second Lien Notes due 2019 (included in the Indenture filed as Exhibit 4.10 hereto) (8)
4.13	Registration Rights Agreement, dated as of March 4, 2011, by and between Claire's Stores, Inc., Claire's Escrow Corporation, the Guarantors and the Representatives (8)
4.14	Indenture, dated as of February 28, 2012, by and between Claire's Escrow II Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent (12)
4.15	Supplemental Indenture, dated as of March 2, 2012, by and among Claire's Stores, Inc., the Guarantors and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent (12)
4.16	Form of 9.00% Senior Secured First Lien Notes due 2019 (included in the Indenture filed as Exhibit 4.14 hereto) (12)
10.1	Credit Agreement, dated as of May 29, 2007, among Bauble Holdings Corp., Bauble Acquisition Sub, Inc. (to be merged with and into Claire's Stores, Inc.), as Borrower, the Lenders party thereto, Credit Suisse, as Administrative Agent, Bear Stearns Corporate Lending Inc. and Mizuho Corporate Bank, Ltd., as Co-Syndication Agents, Lehman Commercial Paper Inc. and LaSalle Bank National Association, as Co-Documentation Agents, and Bear, Stearns & Co. Inc., Credit Suisse Securities (USA) LLC, and Lehman Brothers Inc., as Joint Bookrunners and Joint Lead Arrangers (1)

---

**Table of Contents**

10.2	Management Services Agreement, dated as of May 29, 2007, among Claire's Stores, Inc., Bauble Holdings Corp. and Apollo Management VI, L.P. and Tri-Artisan Capital Partners, LLC and TACP Investments - Claire's LLC (1)
10.3	Claire's Inc. Amended and Restated Stock Incentive Plan, dated June 29, 2007 (1)
10.4	1 <sup>st</sup> Amendment to Claire's Inc. Amended and Restated Stock Incentive Plan (2)
10.5	Standard Form of Option Grant Letter (Target Performance Option and Stretch Performance Option) (1)
10.6	Standard Form of Option Grant Letter (Target Performance Option) (1)
10.7	Standard Form of Director Option Grant Letter (1)
10.8	Standard Form of Co-Investment Letter (9)
10.9	Employment Agreement with Eugene S. Kahn (1)
10.10	Employment Agreement with James Conroy (1)
10.11	Amendment to Employment Agreement with James Conroy (3)
10.12	2nd Amendment to Employment Agreement with James Conroy (7)
10.13	Employment Agreement with Kenny Wilson (4)
10.14	Lease Agreement, dated as of February 19, 2010, by and between AGNL Bling, L.L.C. and Claire's Boutiques, Inc. (6)
10.15	Guarantee and Collateral Agreement, dated and effective as of May 29, 2007, among Bauble Holdings Corp., Bauble Acquisition Sub, Inc., and Credit Suisse, dated as of May 29, 2007 (5)
10.16	Mortgage, Assignment of Leases and Rents, Security Agreement and Fixture Filing, dated as of May 29, 2007 (5)
10.17	Employment Agreement with Jay Friedman (9)
10.18	Collateral Agreement, dated March 4, 2011, by and among Claire's Stores, Inc., Claire's Inc., the Guarantors and The Bank of New York Mellon Trust Company, N.A. as Collateral Agent (8)
10.19	Intercreditor Agreement, dated as of March 4, 2011, by and among Claire's Stores, Inc., Claire's Inc., the Guarantors, The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent and Credit Suisse AG, Cayman Islands Branch (f/k/a Credit Suisse, Cayman Island Branch), as Credit Agreement Agent (8)
10.20	Second Lien Trademark Security Agreement, dated as of March 4, 2011, by and between CBI Distributing Corp. and The Bank of New York Mellon Trust Company, N.A., as Collateral Agent (8)

## **Table of Contents**

10.21	Claire's Inc. Amended and Restated Stock Incentive Plan, dated May 20, 2011 (10)
10.22	Form of Option Grant Letter under Claire's Inc. Amended and Restated Stock Incentive Plan (10)
10.23	Contract of Employment with Beatrice Lafon (11)
10.24	Collateral Agreement, dated as of March 2, 2012, by and among Claire's Stores, Inc., the Guarantors and The Bank of New York Mellon Trust Company, N.A., as Collateral Agent (12)
10.25	Intercreditor Agreement, dated as of March 2, 2012, by and among Claire's Stores, Inc., Claire's, Inc., the Guarantors, The Bank of New York Mellon Trust Company, N.A. and Credit Suisse AG, Cayman Islands Branch (f/k/a Credit Suisse, Cayman Islands Branch), as Bank Collateral Agent (12)
10.26	Trademark Security Agreement, dated as of March 2, 2012, by and between CBI Distributing Corp. and The Bank of New York Mellon Trust Company, as Collateral Agent (12)
10.27	Joinder Agreement to the Second Lien Intercreditor Agreement, dated as of March 2, 2012 by and among Claire's Stores, Inc., Claire's Inc., the Guarantors, The Bank of New York Mellon Trust Company, N.A., as Trustee under the Company's outstanding 8.875% Senior Secured Second Lien Notes and Credit Suisse AG, Cayman Islands Branch (f/k/a Credit Suisse, Cayman Islands Branch), as Credit Agreement Agent (12)
10.28	Amendment, dated as of March 2, 2012, to the Collateral Agreement, dated as of March 4, 2011, by and among Claire's Stores, Inc., Claire's Inc., the Guarantors and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent (12)
10.29	Second Supplemental Indenture, dated as of March 12, 2012, by and among Claire's Stores, Inc., the Guarantors and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent (13)
21.1	Subsidiaries of Claire's Stores, Inc. (14)
24	Power of Attorney (included on signature page) (14)
31.1	Certification of Interim Co-Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) (14)
31.2	Certification of Interim Co-Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) (14)
31.3	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) (14)
32.1	Certification of Interim Co-Chief Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (15)
32.2	Certification of Interim Co-Chief Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (15)
32.3	Certification of Chief Financial Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (15)

<sup>(1)</sup> Filed previously as exhibit to the Registration Statement on Form S-4 (File No. 333-148108) by the Company on December 17, 2007.

**Table of Contents**

- (2) Filed previously as exhibit to Form 8-K by the Company on September 12, 2008.
- (3) Filed previously as exhibit to Form 8-K by the Company on April 22, 2009.
- (4) Filed previously as exhibit to Form 10-K/A by the Company on May 27, 2009.
- (5) Filed previously as exhibit to Form 10-Q on December 8, 2009.
- (6) Filed previously as exhibit to Form 8-K on February 25, 2010.
- (7) Filed previously as exhibit to Form 10 K/A on June 1, 2010.
- (8) Filed previously as exhibit to Form 8-K by the Company on March 9, 2011.
- (9) Filed previously as exhibit to Form 10-K on April 21, 2011.
- (10) Filed previously as exhibit to Form 8-K by the Company on May 20, 2011.
- (11) Filed previously as exhibit to Form 10-Q on December 2, 2011.
- (12) Filed previously as exhibit to Form 8-K on March 5, 2012.
- (13) Filed previously as exhibit to Form 8-K on March 14, 2012.
- (14) Filed herewith.
- (15) Furnished herewith.



**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 of 15(d) 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.

CLAIRE S STORES, INC.

April 4, 2012

By: /s/ JAMES G. CONROY  
**James G. Conroy, Interim Co-Chief Executive Officer**  
**(principal executive officer)**

April 4, 2012

By: /s/ JAY FRIEDMAN  
**Jay Friedman, Interim Co-Chief Executive Officer**  
**(principal executive officer)**

April 4, 2012

By: /s/ J. PER BRODIN  
**J. Per Brodin, Executive Vice President and Chief Financial Officer**  
**(principal financial and accounting officer)**

**POWER OF ATTORNEY**

We, the undersigned, hereby constitute J. Per Brodin and Greg Hackman, or either of them, our true and lawful attorneys-in-fact with full power to sign for us in our name and in the capacity indicated below any and all amendments and supplements to this report, and to file the same, with exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorneys-in-fact or their substitutes, each acting alone, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

April 4, 2012

/s/ PETER COPSES  
**Peter Copses, Chairman of the Board of Directors**

April 4, 2012

/s/ JAMES G. CONROY  
**James G. Conroy, Interim Co-Chief Executive Officer**

April 4, 2012

/s/ JAY FRIEDMAN  
**Jay Friedman, Interim Co-Chief Executive Officer**

April 4, 2012

/s/ LANCE MILKEN  
**Lance Milken, Director**

April 4, 2012

/s/ GEORGE GOLLEHER  
**George Golleher, Director**

April 4, 2012

/s/ ROBERT J. DiNICOLA  
**Robert J. DiNicola, Director**

April 4, 2012

/s/ ROHIT MANOCHA  
**Rohit Manocha, Director**

April 4, 2012

/s/ RON MARSHALL  
**Ron Marshall, Director**

**Table of Contents**

**INDEX TO EXHIBITS**

<b>EXHIBIT NO.</b>	<b>DESCRIPTION</b>
21.1	Claire's Stores, Inc. Subsidiaries.
31.1	Certification of Interim Co-Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a).
31.2	Certification of Interim Co-Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a).
31.3	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a).
32.1	Certification of Interim Co-Chief Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Interim Co-Chief Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.3	Certification of Chief Financial Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document