
**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 February 1, 2014

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
incorporation or organization)

59-0940416
(I.R.S. Employer
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 Explanatory Note: While Claire's Stores, Inc. is not subject to the filing requirement of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, it filed all reports pursuant thereto during the preceding twelve months.

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, 2014, 100 shares of the Registrant's common stock, \$.001 par value were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

TABLE OF CONTENTS

<u>Item</u>		<u>Page No.</u>
PART I.		3
Item 1.	Business	4
Item 1A.	Risk Factors	12
Item 1B.	Unresolved Staff Comments	23
Item 2.	Properties	23
Item 3.	Legal Proceedings	24
Item 4.	Mine Safety Disclosures	24
PART II		25
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters an Issuer Purchases of Equity Securities	25
Item 6.	Selected Financial Data	26
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	27
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	48
Item 8.	Financial Statements and Supplementary Data	50
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	93
Item 9A.	Controls and Procedures	93
Item 9B.	Other Information	93
PART III		94
Item 10.	Directors, Executive Officers and Corporate Governance	94
Item 11.	Executive Compensation	94
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	94
Item 13.	Certain Relationships and Related Transactions and Director Independence	94
Item 14.	Principal Accountant Fees and Services	94
PART IV.		95
Item 15.	Exhibits, Financial Statement Schedules	95
Signatures		100

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.

History

We are controlled by investment funds affiliated with, and co-investment vehicles managed by, Apollo Management VI, L.P. ("Apollo Management," and such funds and co-investment vehicles, the "Apollo Funds"). The Apollo Funds are affiliates of Apollo Global Management, LLC (together with its subsidiaries, "Apollo"). The Apollo Funds acquired us in May 2007 in a merger transaction (the "Acquisition") that was financed by equity contributions from the Apollo Funds and through the incurrence by the Company of a significant amount of indebtedness under a bank credit facility (the "Former Credit Facility") and the issuance of senior and senior subordinated notes (the "Merger Notes"). At the time of the Acquisition, the Company did not have any material indebtedness.

Since Fiscal 2011, we have refinanced the Former Credit Facility and a significant amount of the Merger Notes with the proceeds of additional note issuances. The following table summarizes the amounts and maturities of the remaining outstanding Merger Notes and additional note issuance (collectively, the "Notes") as of February 1, 2014.

<u>Note Series</u>	<u>Maturity</u>	<u>Amount (in millions)</u>
9.0 % Senior Secured First Lien Notes	2019	\$1,139.2*
6.125% Senior Secured First Lien Notes	2020	210.0
8.875% Senior Secured Second Lien Notes	2019	450.0
7.75% Senior Notes	2020	320.0
10.5% Senior Subordinated Notes	2017	259.6

* Includes unamortized premium of approximately \$14.2 million.

In addition, we have a \$115.0 million senior secured revolving credit facility that terminates in Fiscal 2017 (the "Credit Facility"), which was undrawn as of February 1, 2014, and a capital lease obligation of approximately \$17.2 million as of February 1, 2014. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources" for further information regarding our Credit Facility and Notes.

Fiscal Year

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. As a result, our fiscal year ended February 1, 2014 ("Fiscal 2013") and January 28, 2012 ("Fiscal 2011") consisted of 52 weeks, while our fiscal year ended February 2, 2013 ("Fiscal 2012") consisted of 53 weeks.

Part III Information

An amendment to this Annual Report on Form 10-K to include the items required by Part III of Form 10-K will be filed with the Securities and Exchange Commission no later than 120 days after the end of Fiscal 2013.

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

[Table of Contents](#)

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; unwillingness of vendors and service providers to supply goods or services pursuant to historical customary credit arrangements; competition; general political and social conditions such as war, political unrest and terrorism; natural disasters or severe weather events; currency fluctuations and exchange rate adjustments; failure to maintain our favorable brand recognition; failure to successfully market our products through other channels, such as e-commerce; uncertainties generally associated with the specialty retailing business, such as decreases in mall traffic; 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; increase in our cost of merchandise; significant increases in our merchandise markdowns; inability to grow our company-operated store base or expand our international store base through franchise or similar licensing arrangements; inability to design and implement new information systems; data security breaches of confidential information or other cyber attacks; delays in anticipated store openings or renovations; results from any future asset impairment analysis, changes in applicable laws, rules and regulations, including laws and regulations governing the sale of our products, particularly regulations relating to heavy metal and chemical content in our products; changes in anti-bribery laws; changes in employment laws, including law relating to overtime pay, tax laws and import laws; product recalls; loss of key members of management; increases in the costs of healthcare for our employees; increases in the cost of labor; labor disputes; 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.

Trademarks and Tradenames

Certain of the titles and logos referenced in this Form 10-K are our trademarks and service marks. All other trademarks, service marks and trade names referred to in this Form 10-K are the property of their respective owners.

Item 1. Business

The Company

We are one of the world's leading specialty retailers of fashionable jewelry and accessories for young women, teens, tweens and kids. Our vision is to inspire girls and women around the world to become their best selves by providing products and experiences that empower them to express their own unique individual styles. Our broad and dynamic selection of merchandise is unique, and over 90% of our products are proprietary. *Claire's*[®] is our primary global brand that we operate in 45 countries through company-operated or franchise stores. *Claire's*[®] offers a differentiated and fun store experience with a "treasure hunt" setting that encourages our customer to visit often to explore and find merchandise that appeals to her. We believe by maintaining a highly relevant merchandise assortment and offering a compelling value proposition, *Claire's*[®] has universal appeal to teens, pre-teens and kids. *Icing*[®] is our other brand which we currently operate in North America through company-operated stores. *Icing*[®] offers an inspiring merchandise assortment of fashionable products that helps a young woman to say something about herself, whatever the occasion. We believe *Icing*[®] provides us with significant potential to reach young women in age groups beyond our *Claire's*[®] core demographic.

[Table of Contents](#)

We believe *Claire's*[®] represents a “Girl’s Best Friend” and a favorite shopping destination for teens, tweens, and kids. *Claire's*[®] target customer is a girl between 3-18 years old with a particular focus on a core demographic of girls between 10-14 years old, representing a total addressable market of approximately 900 million female customers across the globe. According to our estimates, we have over 95% brand awareness within this target demographic in our largest markets. As of February 1, 2014, *Claire's*[®] had a presence in 45 countries through the 2,719 company-operated *Claire's*[®] stores in North America, Europe and China, and 421 franchised stores in numerous other geographies.

Our *Icing*[®] brand targets a young woman in the 18-35 year age group with a focus on our core 21-25 year olds who have recently entered the workforce. This customer is independent, fashion-conscious, and has enhanced spending ability. We believe that expansion of our *Icing*[®] store base both in existing and new markets over time presents a significant opportunity to leverage our core merchandising, sourcing and marketing expertise to cater to a wider demographic. Furthermore, the differentiation of our *Claire's*[®] and *Icing*[®] brands allow us to operate multiple stores within a single mall or in close proximity. As of February 1, 2014, we operated 395 *Icing*[®] stores across the United States, Canada, and Puerto Rico.

We are organized by geography through our North America division and our Europe division. In North America, our stores are located primarily in shopping malls and average approximately 1,000 square feet of selling space. In Europe, our stores are located primarily on high streets, in shopping malls and in high traffic urban areas and average approximately 664 square feet of selling space. Despite smaller average selling square feet, our European stores average similar sales per store as our North American stores.

For Fiscal 2013, we had net sales of \$1,513.2 million, compared to \$1,557.0 million in Fiscal 2012. We reported a net loss for Fiscal 2013 of \$(65.3) million, compared to net income of \$1.3 million for Fiscal 2012. Fiscal 2012 included 53 weeks of operations compared to 52 weeks in Fiscal 2013.

Our Competitive Strengths

We have various competitive strengths that we believe have allowed us to operate successfully in many different global markets, as demonstrated by our ability over the past nine years to double the number of countries in which we operate to 45 countries as of February 1, 2014. We compete primarily on price, shopping experience, and merchandise assortment. Although we believe we have many competitive strengths, we recognize that we face competitive challenges, including the fact that large value retailers, department stores and some teen retail stores may have substantially greater financial, marketing, and other resources, and devote greater resources to the marketing and sale of their merchandise than we do.

We believe our competitive strengths include the following:

Category Defining Claire's[®] Brand

According to our estimates, over 95% of our target demographic in our largest markets recognizes the *Claire's*[®] brand. A *Claire's*[®] store is located in approximately 89% of all major United States shopping malls across all 50 states and in 44 countries outside of the United States, including markets where we franchise. We are a “Girl’s Best Friend” and believe we serve as an authority in jewelry and accessories for 3 – 18 years olds. We believe that our reputation for providing age-appropriate merchandise and shopping experience allows parents to trust the *Claire's*[®] brand for their daughters. Our *Claire's*[®] brand is regularly featured in editorial coverage and relevant fashion periodicals. Additionally, we leverage our e-commerce platform and social media to enhance our brand awareness and strengthen our customer relationships.

Preferred Shopping Destination

We are recognized as a favorite shopping destination for young women, teens, tweens, and kids. We believe our customer finds our store an engaging and stimulating experience that allows her to explore and

[Table of Contents](#)

share discoveries, thereby encouraging frequency of visits. Our employees are trained to provide friendly and effective service which we believe creates a memorable shopping experience. Besides jewelry and accessories, we also offer an exciting assortment of beauty products, lifestyle accessories and seasonal items to keep our customer engaged. As part of our jewelry offering, our stores have pierced the ears of over 87 million customers over the years, including 3.8 million in Fiscal 2013. We believe this seminal point of contact helps our stores establish an important relationship with our core customer. We believe our store environment, product assortment and low average dollar ticket differentiate us from other retail concepts as well as pure play online platforms.

Attractive Unit Economics with Strong Cash Flow

Our stores have relatively low build out costs and moderate inventory requirements. For a new store investment, we target a payback period of three years or less. We achieved for Fiscal 2011 and Fiscal 2012 openings and forecast for 2013 openings a better than three-year payback rate for aggregate new stores opened during these periods. We manage our store portfolio on a store-by-store basis to optimize overall returns and minimize risk. When we choose to close a store it is generally because the store has negative or marginally positive cash flow or the store's anticipated future performance or lease renewal terms do not meet our criteria. As a result, for Fiscal 2013, approximately 92% of our stores were cash flow positive.

Our cash flow is driven by our strong gross margins, efficient operating structure, low annual maintenance capital expenditures and flexible growth capital expenditure initiatives. Our moderate working capital requirements result from high merchandise margins, low unit cost of merchandise, relatively lower seasonality of our business and relatively strong inventory turnover. However, we are significantly leveraged, with total debt, including our capital lease obligation of approximately \$2.40 billion as of February 1, 2014. As a result, a large portion of our cash flow is devoted to our debt service obligations. In addition, as of February 1, 2014, we had a total accumulated deficit of \$701.4 million, primarily as a result of non-cash goodwill impairment charges in Fiscal 2008.

Although our capital growth expenditure initiatives are flexible, we must make decisions regarding fair market rent of real estate properties within the countries in which we operate in advance of entering into a new five to ten year lease or renewing an existing lease. Also, although we have relatively low seasonality, our business fluctuates according to changes in consumer preferences. Approximately 30% of our net sales typically occur in the fourth quarter, with the remaining 70% spread relatively evenly over the remaining three quarters. We have several peak selling periods in addition to Christmas, such as back-to-school, and a significant number of other holidays across the globe not necessarily applicable to other retailers, which we believe contribute to our relatively lower seasonality. If we are unable to anticipate, identify and react to changing styles and trends, we may need to rely on markdowns or promotional sales to dispose of excess or slow moving inventory from time-to-time.

Globally Diversified with Proven Ability to Enter New Countries

The *Claire's*[®] concept has a global scale and geographic portability. As of February 1, 2014, we operated or franchised a total of 3,140 *Claire's*[®] stores across all 50 states of the United States and in 44 additional countries across the world. We also operated 395 *Icing*[®] stores as of February 1, 2014. During Fiscal 2013, we entered four new markets through franchising relationships. During Fiscal 2012, we entered Italy through company-operated stores and also entered the Latin American and Southeast Asian markets through our franchising program. During Fiscal 2011, we entered the strategically significant countries of Mexico and India through franchising relationships. Over the past 9 years, we have doubled the number of countries in which we operate or franchise.

Cost-Efficient Global Sourcing Capabilities

Our merchandising strategy is supported by efficient, low-cost global sourcing capabilities diversified across approximately 580 suppliers located primarily outside the United States. Our vertically integrated Hong Kong buying office was established over 20 years ago and now sources a majority of our purchases. Our strategy of offering proprietary merchandise coupled with vertically-integrated local buying capabilities is designed to enable us to source rapidly and cost effectively. We believe our vertically integrated sourcing capabilities enable us to respond to quickly changing consumer trends.

Business Strategy

Our business strategy is designed to maximize our sales opportunities, earnings growth and cash flow:

Generate Organic Growth

Continue To Enhance Merchandise and In-Store Experience

We are focused on enhancing the fashion-orientation and quality of our product offerings to deliver a unique, proprietary assortment that is highly relevant to our target customers. We believe we can drive growth through intensifying key merchandise categories, especially in higher margin products such as jewelry. Jewelry as a percentage of sales has increased from 45.5% to 49.4% from Fiscal 2010 to Fiscal 2013.

We believe we can drive increased frequency of visits through our unique and compelling in-store environment. We aim to provide a consistent, engaging and brand-right customer experience across all of our company-operated and franchised stores worldwide. Additionally, we focus on improving ease of shopping and increasing sales productivity by enhancing store layout and merchandise displays. We will continue to develop our store management teams and sales associates emphasizing in-store operational excellence.

Deepen Customer Relationship & Loyalty

We will continue to drive brand awareness and deepen customer relationships with our branding efforts conducted through in-store marketing collateral and ongoing social media, email, and text campaigns. Maintaining and improving our leadership in ear piercing also allows us to solidify the customer's experience with *Claire's*® and establish brand loyalty early. We believe we can leverage our online community and proprietary customer database to drive increased customer engagement for *Claire's*® and *Icing*®.

Expand and Upgrade Company-Operated Store Base

We have demonstrated a consistent track record of expanding our company-operated store base, opening 157, 110 and 127 new company-operated stores in Fiscal 2011, Fiscal 2012 and Fiscal 2013, respectively. Of our 127 new stores opened in Fiscal 2013, 66 were in Europe, 47 were in North America and 14 were in China. In January 2014, we made a decision to close our China stores, and are currently in the process of closing our 17 company-operated stores in that country. We plan to open a total of approximately 40 new stores in Fiscal 2014 across all of our markets in Europe and North America. We recently entered the country of Italy and believe it presents significant growth opportunities. In North America, the *Claire's*® brand has significant penetration but we continue to opportunistically pursue additional locations. We also believe there is a compelling opportunity to remodel key locations in both North America and Europe in order to create a more contemporary ambience and a visually appealing display of our innovative product offerings, and to further enhance our customer's in-store experience. Historically, our remodel capital expenditures have produced increased sales returns similar to our new store expenditures. We typically target our most productive stores for remodel as they tend to deliver the best return on capital. We also evaluate stores whose leases are up for renewal and are likely to undergo a remodel. We plan to remodel approximately 120 additional *Claire's*® and *Icing*® stores in Fiscal 2014.

In recent years, we have taken steps to reposition our *Icing*® brand. This repositioning further differentiated our *Claire's*® and *Icing*® brands by moving from dual-tasked buying teams to dedicated buyers for *Claire's*® and *Icing*®. We believe our product offering at *Icing*® is now more appropriate for its core demographic. Furthermore, the product offering at *Icing*® is now unique to the brand and no longer has any overlap with *Claire's*®. We have also redesigned the store environment to offer a more mature atmosphere and shopping environment. We believe these changes will allow *Icing*® to offer a similar value proposition to *Claire's*® while becoming more relevant for its target customer and has positioned the concept for growth both domestically and abroad. We believe the *Icing*® brand has long-term growth potential in North America, and during Fiscal 2013, we opened 31 new *Icing*® stores and plan up to a total of 14 new store openings in Fiscal 2014. Over time, we plan to launch *Icing*® internationally to countries where we can leverage the existing *Claire's*® expertise and infrastructure.

[Table of Contents](#)

Franchise in New International Countries

Developing a robust franchising model has allowed us to gain a foothold in multiple international geographies and we believe that significant high potential “white space” opportunities remain. In 2013, we entered four new markets: Philippines, Costa Rica, Colombia and Serbia. In 2012, we entered Latin America and Southeast Asia. Within Latin America, we have partnered with a single franchisee to develop stores in sixteen new countries and, in 2012, opened franchise stores in four of these countries. Within Southeast Asia, we have partnered with another single franchisee to develop stores in five new countries and, in 2012, opened a franchise store in one of these countries. In 2011, under our franchise model, we entered into the countries of Mexico and India. We are currently studying our brand introduction strategy for Brazil, Russia, and Australia via our franchise model and we will continue to evaluate new countries for franchised stores. In addition, we believe the *Icing*[®] brand represents an additional opportunity for franchise growth.

Grow Our E-Commerce Sales

We believe that the increasing penetration of internet enabled devices within our customer base offers an opportunity to better connect with our customer and complement our in-store experience. We launched our e-commerce and mobile platforms in the United States during Fiscal 2011 and Fiscal 2012, respectively, to allow our target customer to shop with *Claire's*[®] at her convenience. In addition, our on-line channel allows us to expand product offerings to include complementary products not available in our stores. In early Fiscal 2013, we launched *Claire's*[®] e-commerce internationally starting in the United Kingdom, France, and Canada and also launched our e-commerce platform for *Icing*[®] in North America.

We believe that, over time, our digital platform represents a valuable tool for engaging with our customer, gathering feedback on her preferences and enhancing our product testing capabilities, all of which should drive higher sales productivity both in-store and online. We have also invested in developing new marketing capabilities in social media, such as our *Facebook*[®], *Instagram*[®], *Twitter*[®] and *Pinterest*[®] pages, and intend to further engage our customers through these channels.

Merchandising

The *Claire's*[®] mission is to be the “Girl’s Best Friend” brand for fun, fashionable, and value priced jewelry and accessories targeted at our core demographic of girls 3-18. Our merchandising team is keenly aware of the psychographics of our core customer and her ever-changing tastes and attitudes. We strive to connect with her as our “friend” with whom we share her most personal milestones – be it a first ear piercing, a first day at school, a first date, or a first job. We work to present a broad yet curated product assortment in an environment where girls and young women feel encouraged to express their personalities, creativity, and individuality. Our merchandising strategy leverages our authority as a jewelry destination and ear piercing specialist. Besides our core jewelry and accessories products, other important categories include hair accessories, our licensed product assortment, and our beauty businesses. Our other accessories categories allow us to reflect seasonal changes in the business and the customer mindset, and we develop strong event assortments to capitalize on key traffic periods, like Prom, Back-To-School, Halloween, and Holiday.

For Fiscal 2013, the company-wide average in-store unit selling price for our products was \$5.96 and the average transaction value was \$15.55. Each *Claire's*[®] store offers approximately 7,000 SKUs in the following major product categories:

- Jewelry: Includes earrings, necklaces, bracelets, body jewelry and rings, as well as our ear piercing service; and
- Accessories: Includes fashion and seasonal accessories, including headwear, legwear, hairgoods, handbags and small leather goods, attitude glasses, scarves, armwear and belts, sunglasses, hats, gloves, slippers and earmuffs; and our beauty product offerings.

[Table of Contents](#)

For Fiscal 2013, the company-wide average in-store unit selling price for our products was \$6.77 for jewelry and \$5.36 for accessories. The following table shows a comparison of sales by product category:

<u>Product Category</u>	<u>Percentage of Total</u>		
	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Jewelry	49.4	47.9	46.1
Accessories	50.6	52.1	53.9
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Icing's® mission is to be the “Say Something” brand focused on smart, trend right products that are appropriate for young women 18-35, with a particular focus on women in their mid 20’s. Jewelry is the dominant category for *Icing*®, but the Accessories business is highly penetrated as well. Key accessory categories include handbags, small leather goods, and tech accessories. Hair accessories are also important, and the beauty business is developing an excellent range of nail, eye, lip, and beauty tools products. The *Icing*® customer expresses her unique style and individuality through our products, and we enable the many dimensions of her personality and viewpoints to shine.

Over 90% of our merchandise consists of proprietary designs that carry the *Claire's*® or *Icing*® label. The remainder consists of licensed products featuring brands such as *Disney*, *Hello Kitty* or selected entertainment properties. Our wide range of products allows us to capitalize on a spectrum of trends, ideas and merchandise concepts, while not being dependent on any one of them.

Purchasing and Distribution

Our global sourcing group purchases merchandise from a diversified base of approximately 580 suppliers. Our vertically integrated buying office in Hong Kong has been in operation for over two decades and sources a majority of our products. In Fiscal 2013, we purchased 86% of our merchandise from vendors based outside the United States, including 69% purchased from China. We are not dependent on any single supplier for our products. In Fiscal 2013, we sourced at least 90% of our merchandise from approximately 100 suppliers, none of which represented more than five percent of total purchases.

Our distribution facility in Hoffman Estates, Illinois, a suburb of Chicago, ships merchandise to our North America stores. Our distribution facility in Birmingham, United Kingdom services all of our stores in Europe. We distribute merchandise to our franchisees from a third party operated distribution center in Hong Kong. Our distribution centers ship merchandise 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 per week.

Stores

As of February 1, 2014, we operated a total of 3,114 stores, including 395 *Icing*® stores, and also franchised 421 stores globally. Our stores, company-wide, average net sales of approximately \$488,000 and net sales per square foot of \$481 for Fiscal 2013.

Store Design and Environment

The in-store shopping experience is integral to the *Claire's*® and *Icing*® brands. Our *Claire's*® stores are designed and merchandised to allow our customer to discover appealing merchandise in a “treasure hunt” setting. We strive to maintain a consistent look and experience across all of our company-operated and franchised stores through a disciplined plan-o-gram process that coordinates floor plan changes 8-10 times per year.

Our stores in North America are located primarily in shopping malls and average approximately 1,000 square feet of selling space. Our stores in Europe are located on high streets, in shopping malls and in high traffic urban locations and average approximately 664 square feet of selling space. Our store hours are dictated by shopping mall operations which are typically 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. In Fiscal 2013, approximately 48% of our sales were made in cash, with the balance made by checks, debit cards, and credit cards.

[Table of Contents](#)

Each of our stores is typically led by a manager and a full-time assistant manager. In addition, each store has one or more part-time employees, depending on store volume. We utilize a labor scheduling model that optimizes the number of hours allocated to appropriately staff for varying sales volumes expected during each week.

New Stores and Store Economics

We have a standardized procedure for efficient opening of new stores and their integration into our information and distribution systems. The floor plan, merchandise layout and marketing efforts are developed specific to each new location. In addition, we maintain qualified store opening teams to provide training to new store employees. On average, we open a new store within two-to-three months from the commencement of construction.

We have experienced in-house real estate and development capabilities. During Fiscal 2013, we opened 127 new company-operated stores globally. Our capital investment, which includes build-out costs and cash preopening costs, amounted to \$86.1 million for new stores opened and remodels completed in Fiscal 2013. During the past three fiscal years, we have remodeled 678 stores and plan to remodel a total of approximately 120 stores in Fiscal 2014. Sales at our new stores ramp quickly and generate attractive returns. For a new store investment, we generally target a payback period of three years or less. The vast majority of our new stores have met or exceeded this target.

Store Openings, Closings and Future Growth

In Fiscal 2013, we opened 127 stores and closed 98 underperforming stores, for a net increase of 29 stores. When we choose to close a store it is generally because the store has negative or marginally positive cash flow or the store's anticipated future performance or lease renewal terms do not meet the Company's criteria. In Europe, we increased our store count by 24 stores, net, resulting in a total of 1,185 stores. In North America, we decreased our store count by 9 stores, net, to 1,912 stores. "Stores, net" refers to stores opened, net of closings. In China, we opened 14 stores, net, resulting in a total of 17. In January 2014, we made a decision to close our China stores, and are currently in the process of closing our 17 company-operated stores in that country.

<u>Store Openings (Closings):</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>
	<u>2013</u>	<u>2012</u>	<u>2011</u>
<u>North America</u>			
Openings	47	28	28
Closings	(56)	(60)	(47)
Net	<u>(9)</u>	<u>(32)</u>	<u>(19)</u>
<u>Europe</u>			
Openings	66	79	129
Closings	(42)	(36)	(20)
Net	<u>24</u>	<u>43</u>	<u>109</u>
<u>China</u>			
Openings	14	3	—
Closings	—	—	—
Net	<u>14</u>	<u>3</u>	<u>—</u>
<u>Consolidated</u>			
Openings	127	110	157
Closings	(98)	(96)	(67)
Total	<u>29</u>	<u>14</u>	<u>90</u>

We plan to open approximately 40 company-operated stores globally in Fiscal 2014. We also plan to continue opening stores when suitable locations are found and satisfactory lease negotiations are concluded. In addition to the investment in leasehold improvements and fixtures, we may also purchase

[Table of Contents](#)

intangible assets or incur initial direct costs for leases relating to certain store locations in our Europe operations. In Fiscal 2013, the average sales per store of our new stores were almost 1.5 times that of our average closed stores.

<u>Store Count as of:</u>	<u>February 1, 2014</u>	<u>February 2, 2013</u>	<u>January 28, 2012</u>
North America	1,912	1,921	1,953
Europe	1,185	1,161	1,118
China	17	3	—
Subtotal company-operated	3,114	3,085	3,071
Franchise	421	392	381
Total global stores	<u>3,535</u>	<u>3,477</u>	<u>3,452</u>

Financial Information About Segments

See Note 13 – Segment Reporting in the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K, which is incorporated herein by reference.

Marketing and Advertising

We rely on a multi-channel approach to marketing and advertising with a very limited reliance on traditional television, radio and print mediums. Given Claire's® focus as a shopping destination, we invest in locating our stores in prominent, high-traffic locations. Our stores feature colorful displays showcasing our merchandise and latest trends, thus adding to the fun and playful atmosphere of the store. Our brands are also featured on the tags attached to most of our products. We believe that our target customer develops an affinity for our stores through frequent visits and through word-of-mouth publicity from her peers.

Our digital marketing effort includes our United States e-commerce site launched in Fiscal 2011, which has a look and feel consistent with the in-store experience. We also drive brand awareness and relevance with social media, email and text campaigns which are complementary to in-store marketing. We leverage our facebook® presence by posting content such as celebrity looks and Claire's® promotions that are relevant to our target customer and have received over 1.5 million Likes on Facebook®. We use our email database to send weekly emails to over 1.9 million customers who have provided their email addresses through our website or in-store registration process, including when customers get their ears pierced.

Trademarks and Service Marks

We are the owner in the United States of various marks, including “Claire's®,” “Claire's Accessories®,” and “Icing®.” We have also registered these marks outside of the United States. We currently license certain of our marks under franchising arrangements in Japan, the Middle East, Turkey, Greece, Guatemala, Malta, Ukraine, Mexico, India, Dominican Republic, El Salvador, Venezuela, Panama, Honduras, Indonesia, Philippines, Costa Rica, Colombia and Serbia. We believe our rights in our marks are important to our business and intend to maintain our marks and the related registrations.

Franchise strategy

Claire's® has a strong global franchise platform with sophisticated franchise partners possessing strong retail experience, who also operate other leading retail brands. Claire's® utilizes relationships with its franchisees to increase penetration in existing franchise markets, and intends to develop new franchise partnerships for entry into new geographic markets. In the future, we also intend to bring Icing® to Claire's® franchise partners. Typically, franchise agreements range between 5–10 years, and provide the option for renewals. Claire's® earns license and merchandise fees on merchandise shipped to franchisees and a mark-up on merchandise sold. We generally expect, based on our historical experience, that 2 to 3 franchise stores will be equivalent to the operating income contribution of one company-operated store. In addition, there is no capital expenditure requirement for Claire's® when a franchise partner opens a store.

[Table of Contents](#)

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.

We compete primarily on price, shopping experience, and merchandise assortment. Although we believe we have many competitive strengths, we recognize that we face competitive challenges, including the fact that large value retailers, department stores and some junior retail stores have substantially greater financial, marketing, and other resources, and devote greater resources to the marketing and sale of their merchandise than we do.

We believe we do not have a direct competitor of scale that focuses purely on our product categories. As a result, we believe we are highly differentiated from other teen apparel players and benefit from meaningful margins, in addition to having a significant international presence.

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 2013 were 23%, 24%, 24% and 29%, respectively.

Employees

On February 1, 2014, we employed approximately 18,800 employees, 63% of whom were part-time. Part-time employees typically work up to 20 hours per week. 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 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.

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 Our Business

Economic conditions may adversely impact demand for our merchandise, 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.

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

Our retail fashion jewelry and accessories 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 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 jewelry and accessories especially affect the inventory we sell because we make decisions for the purchase and manufacture of merchandise with our suppliers 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. 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 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.

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.

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 580 suppliers in Fiscal 2013. Approximately 86% of our Fiscal 2013 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

[Table of Contents](#)

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. International pressure on China regarding revaluation of the Chinese yuan continues, which has included proposed United States Federal legislation to impose tariffs on imports from China unless the Chinese government revalues the Chinese yuan.

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 United States dollars. As a result, our sourcing operations may be adversely affected by significant fluctuation in the value of the United States 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 2013. During Fiscal 2013, the Chinese yuan strengthened against the United States dollar, and this trend may continue in Fiscal 2014. An increase in the Chinese yuan against the dollar means that we will have to pay more in United States 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.

A decline in number of people who go to shopping malls could reduce the number of our customers, reduce our net sales and leave us with unsold inventory.

Substantially all of our North America stores are located in shopping malls. Our North America sales are derived, in part, from traffic in those shopping malls. We depend on the ability of the shopping mall's "anchor" tenants, generally large department stores and other area attractions, to generate consumer traffic around our stores. We also depend on 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 and 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 and leave us with unsold inventory, which would have a material adverse affect on our business, financial condition and results of operations.

The failure to grow our store base outside of North America, expand our international franchising business or grow our e-commerce business 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. We have limited experience in operating in some of these locations outside of North America. In January 2014, we made a decision to close our China stores, and are currently in the process of closing our 17 company-operated stores in that country. 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. Customers in our new markets may not be as familiar with our brands, and we may need to build brand awareness in these markets through greater investments in promotional activities. As a result, our sales may not be at volumes we plan or not result in the margins we anticipate. In addition, in many of these markets, the real estate, employment and labor, transportation and logistics, regulatory, and other operating requirements differ dramatically from those in the places where we have experience. Also, the integration of our operations in foreign countries presents certain challenges not necessarily presented in the integration of our North America operations. If our expansion plans outside of North America are unsuccessful or do not deliver an appropriate return on our investments, our consolidated operations and financial results could be materially and adversely affected.

[Table of Contents](#)

We also 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.

We launched our United States e-commerce business in Fiscal 2011, and in Fiscal 2013, launched *Icing*[®] North America and *Claire's*[®] Europe e-commerce platforms. Failure to grow our current e-commerce business in the United States and Europe, or successfully launch and grow our e-commerce business in these new markets, could have a material adverse effect on our operating results and impede our growth strategy.

We experience fluctuations in our comparable sales and margins, which could impact our credit ratings and reduce the trading price of our Notes.

Our success depends in part on our ability to improve sales. Our net sales for Fiscal 2013 declined to \$1,513.2 million from \$1,557.0 million for Fiscal 2012, and our same stores sales decreased 3.9% in Fiscal 2013 compared to Fiscal 2012. Fiscal 2012 included 53 weeks of operations compared to 52 weeks in Fiscal 2013. A variety of factors affect comparable sales, including fashion trends, competition, current economic conditions, the timing of new merchandise releases, changes in our merchandise mix, and weather conditions. These factors may cause our comparable sales results to differ materially from prior periods and from expectations. Our comparable sales have fluctuated significantly in the past on an annual, quarterly, and monthly basis.

Our ability to deliver strong comparable sales results and margins depends in large part on accurately forecasting demand and fashion trends, providing an appropriate mix of merchandise for our customer base, managing inventory effectively, using effective pricing strategies, selecting effective marketing techniques, and optimizing store performance. Failure to meet the expectations of our investors or credit rating agencies in one or more future periods could cause our credit ratings to decline and reduce the trading price of our Notes.

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. 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, including the new initiatives labeled as “green chemistry,” 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 and China 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 European Union considers safer. Our failure to comply with this foreign legislation could result in significant fines or penalties and increase our cost of doing business.

[Table of Contents](#)

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 affected.

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 can reduce the number of underperforming 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.

Additionally, the economic environment may at times make it difficult to determine the fair market rent of retail real estate properties within the countries in which we operate. This could impact the quality of our decisions to exercise lease options at previously negotiated rents, renew expiring leases or enter into new leases, in each case at negotiated rents. These decisions could also impact our ability to retain real estate locations adequate to meet our financial targets or efficiently manage the profitability of our existing store portfolio and could have a material adverse effect on our results of operations.

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 in those markets. 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.

[Table of Contents](#)

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, and we may incur increasing costs in an effort to minimize these cybersecurity risks.

We are continuing to expand our digital reach through various channels, including e-commerce. As we continue to expand these channels, our risks regarding data privacy and possible cyber attacks increase. 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.

We may not have the resources or technical expertise to anticipate or prevent rapidly evolving types of cyber attacks. Attacks may be targeted at us, our customers, or others who have entrusted us with information. Actual or anticipated attacks may cause us to incur increasing costs, including costs to hire additional personnel, purchase additional protection technologies, train employees, and engage third-party experts and consultants. Advances in computer capabilities, new technological discoveries, or other developments may result in the technology used by us to protect data being breached or compromised. In addition, data and security breaches can also occur as a result of non-technical issues, including breach by us or by persons with whom we have commercial relationships that result in the unauthorized release of personal or confidential information. Any compromise or breach of our security could result in violation of applicable privacy and other laws, significant legal and financial exposure, and a loss of confidence in our security measures, which could have a material adverse effect on our results of operations and our reputation.

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.

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 Claire's[®] United States e-commerce site in Fiscal 2011, and, in Fiscal 2013, launched Icing[®] North America and Claire's[®] Europe e-commerce platforms, significant shifts in customer buying patterns to purchasing fashionable jewelry and accessories at affordable prices through channels other than traditional shopping malls, 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.

[Table of Contents](#)

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

Pursuant to the *U.S. Patient Protection and Affordable Care Act*, we will be 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. Many of these requirements 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.

We depend on our key personnel.

We cannot be sure that we will be able to attract and retain a sufficient number of qualified personnel in future periods. If we are unable to retain, attract, and motivate talented employees with appropriate skill sets, we may not achieve our objectives and our results of operations could be adversely impacted. In addition, the loss of services of 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.

[Table of Contents](#)

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 we or 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, the U.K. Bribery Act, and sanction laws administered by Office of Foreign Assets Control (OFAC) 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. In addition, we also conduct business directly in many countries and increased our international activities with the opening of company-operated stores in China in the latter part of Fiscal 2012. Accordingly, we are also subject to the Foreign Corrupt Practices Act, the U.K. Bribery Act, and OFAC sanction laws. Acts by our employees that violate these laws could subject us to criminal or civil sanctions and penalties. As a result, our results of operations could be adversely affected.

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. Timely receipt of merchandise by our stores and our customers may also be affected by factors such as inclement weather, natural disasters, accidents, system failures and acts of terrorism. 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.

[Table of Contents](#)

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 North America, Europe and China 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.

We are controlled by affiliates of Apollo, and its interests as an equity holder may conflict with the interests 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 entry into 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. In addition, because our equity securities are not registered under the Exchange Act and are not listed on any United States securities exchange, we are not subject to any of the corporate governance requirements of any United States 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 February 1, 2014, our total debt was approximately \$2.40 billion, consisting of borrowings under our Notes and a capital lease obligation. We cannot make assurances 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, if any, 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;
- 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 substantial high indebtedness, 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 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 February 1, 2014, we had undrawn availability under our Credit Facility of \$108.7 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 our Credit Facility will not prevent us from incurring obligations that do not constitute indebtedness under those agreements.

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

Our Credit Facility and the indentures governing the 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;

[Table of Contents](#)

- 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 the Credit Facility, permit the lenders to cease making loans to us. Upon the occurrence of an event of default under our indebtedness, the lenders and/or note holders could elect to declare all amounts outstanding to be immediately due and payable and, in the case of the Credit Facility, terminate all commitments to extend further credit. Such actions could cause cross defaults under our other indebtedness. If we were unable to repay such amounts, the lenders under our Credit Facility and the holders of our secured Notes could proceed against the collateral granted to them to secure that indebtedness.

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 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 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.

[Table of Contents](#)

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 United States federal income tax expense. We record United States 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.

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, Hungary, China, Italy and Luxembourg. We lease all of our company-operated 3,114 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, Europe and China 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 February 1, 2014. We believe our facilities are well maintained and are sufficient to meet our current and projected needs. The properties are leased with the leases expiring at various times through 2030, subject to renewal options.

<u>Location</u>	<u>Use</u>	<u>Approximate Square Footage</u>
Hoffman Estates, Illinois	Global and Division management and distribution center	538,000(1)
Birmingham, United Kingdom	Division management and distribution center	126,600(2)
Pembroke Pines, Florida	Accounting	28,300
Shanghai, China	Division management	11,000
Hong Kong	Sourcing and buying	12,400
Paris, France	Field support	6,300(3)
Madrid, Spain	Field support	2,200(3)

- (1) 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. On February 19, 2010, we sold this Property to a third party. Contemporaneously with the sale, 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. 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 102,600 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 company-operated stores in Europe.
- (3) We maintain our human resource and select operating functions for these countries at these facilities.

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.

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.

Holdings

As of April 1, 2014, there was one holder of record of our common stock, our parent, Claire's Inc.

Dividends

We have paid no cash dividends since the Acquisition. Our Credit Facility and the indentures governing the Notes restrict our ability to pay dividends.

[Table of Contents](#)

Item 6. Selected Financial Data

The balance sheet data as of February 1, 2014 and February 2, 2013 and statement of operations data for the fiscal years ended February 1, 2014, February 2, 2013 and January 28, 2012 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 28, 2012, January 29, 2011, and January 30, 2010 and the Consolidated Statement of Operations and Comprehensive Income (Loss) data for the fiscal years ended January 29, 2011 and January 30, 2010 are derived from our Consolidated Financial Statements which are not included herein.

	Fiscal Year Ended February 1, 2014	Fiscal Year Ended February 2, 2013 (1)	Fiscal Year Ended January 28, 2012	Fiscal Year Ended January 29, 2011	Fiscal Year Ended January 30, 2010
(In thousands, except for ratios and store data)					
Statement of Operations Data:					
Net sales	\$ 1,513,177	\$ 1,557,020	\$ 1,495,900	\$ 1,426,397	\$ 1,342,389
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	753,631	755,996	724,775	685,111	663,269
Gross profit	759,546	801,024	771,125	741,286	679,120
Other expenses:					
Selling, general and administrative	513,253	503,254	504,360	493,081	466,965
Depreciation and amortization	73,971	64,879	68,753	65,198	71,471
Impairment of assets	—	—	—	12,262	3,142
Severance and transaction-related costs	5,118	2,828	6,928	741	921
Other (income) expense, net	(4,568)	(6,105)	(1,254)	5,542	(5,493)
	587,774	564,856	578,787	576,824	537,006
Operating income	171,772	236,168	192,338	164,462	142,114
Gain (loss) on early debt extinguishment	(4,795)	(9,707)	6,405	13,388	36,412
Impairment of equity investment	—	—	—	6,030	—
Interest expense, net	223,361	210,797	176,475	157,706	177,418
Income (loss) from continuing operations before income taxes	(56,384)	15,664	22,268	14,114	1,108
Income tax expense	8,923	14,382	10,636	9,791	11,510
Income (loss) from continuing operations	\$ (65,307)	\$ 1,282	\$ 11,632	\$ 4,323	\$ (10,402)
Other Financial Data:					
Capital expenditures:					
New stores and remodels (2)	\$ 86,124	\$ 64,398	\$ 63,705	\$ 40,126	\$ 17,103
Other	12,870	9,455	12,912	9,689	8,395
Total capital expenditures	98,994	73,853	76,617	49,815	25,498
Cash interest expense (3)	217,081	165,495	136,533	108,923	126,733
Store Data:					
Number of stores (at period end)					
North America (4)	1,929	1,924	1,953	1,972	1,993
Europe	1,185	1,161	1,118	1,009	955
Total company-operated stores (at period end)	3,114	3,085	3,071	2,981	2,948
Joint venture	—	—	—	—	211
Franchise	421	392	381	395	195
Total global stores	3,535	3,477	3,452	3,376	3,354
Total gross square footage (000’s) (at period end)	3,170	3,117	3,092	3,012	2,982
Net sales per store (000’s) (5)	\$ 488	\$ 506	\$ 494	\$ 481	\$ 454
Net sales per square foot (6)	\$ 481	\$ 502	\$ 490	\$ 476	\$ 448
Balance Sheet Data (at period end)					
Cash and cash equivalents (7)	\$ 58,343	\$ 166,956	\$ 174,374	\$ 279,766	\$ 198,708
Total assets	2,731,632	2,799,272	2,763,025	2,866,449	2,834,105
Total debt (including capital lease)	2,396,018	2,390,652	2,403,672	2,524,286	2,521,878
Total stockholder’s deficit	(83,033)	(14,440)	(22,296)	(26,515)	(34,642)

(1) Consists of 53 weeks.

(2) For Fiscal 2013, Fiscal 2012, Fiscal 2011, Fiscal 2010, and Fiscal 2009 include expenditures for store related intangible assets in the amounts of \$2,756, \$5,049, \$5,709, \$1,104, and \$546. Fiscal 2013, Fiscal 2012, Fiscal 2011, Fiscal 2010 and Fiscal 2009 include expenditures for construction-in-process of \$4,115, \$570, \$393, \$471, and \$207.

(3) Cash interest expense does not include amortization of debt issuance costs, interest expense paid in kind or accretion of debt premium.

(4) Includes 17 and 3 China stores in Fiscal 2013 and Fiscal 2012, respectively.

(5) Net sales per store are calculated based on the average number of stores during the period.

- (6) Net sales per square foot are calculated based on the average gross square feet during the period.
- (7) As of February 1, 2014, February 2, 2013, and January 28, 2012, cash and cash equivalents included restricted cash of \$0 million, \$0 million, and \$4.4 million, respectively.

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. As a result, our fiscal years ended February 1, 2014 (“Fiscal 2013”) and January 28, 2012 (“Fiscal 2011”) consisted of 52 weeks, while our fiscal year ended February 2, 2013 (“Fiscal 2012”) consisted of 53 weeks.

We include a store in the calculation of same store sales once it has been in operation sixty weeks after its initial opening and, effective in the third quarter of Fiscal 2012, we include sales from e-commerce. A store which is temporarily closed, such as for remodeling, is removed from the same store sales computation if it is closed for one week or more. The removal is effective prospectively upon the completion of the first fiscal 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 exchange rates.

Results of Consolidated Operations

Management overview

We are one of the world’s leading specialty retailers of fashionable jewelry and accessories for young women, teens, tweens, and kids. Our vision is to inspire girls and women around the world to become their best selves by providing products and experience that empower them to express their own unique individual styles. 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. As of February 1, 2014, we operated a total of 3,114 owned stores of which 1,929 were located in all 50 states of the United States, Puerto Rico, Canada, the U.S. Virgin Islands and China (North America segment) and 1,185 stores were located in the United Kingdom, Switzerland, Austria, Germany, France, Ireland, Spain, Portugal, Netherlands, Belgium, Poland, Czech Republic, Hungary, Italy and Luxembourg (Europe segment). We operate our stores under two brand names: Claire’s® and Icing®. In January 2014, we made a decision to close our China stores, and are currently in the process of closing our 17 company-operated stores in that country. We are currently studying reintroduction of our brand in China via our franchise model.

As of February 1, 2014, we also franchise stores in Japan, the Middle East, Turkey, Greece, Guatemala, Malta, Ukraine, Mexico, India, Dominican Republic, El Salvador, Venezuela, Panama, Honduras, Indonesia, Philippines, Costa Rica, Colombia and Serbia. 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, net” in our Consolidated Statements of Operations and Comprehensive Income (Loss).

Financial activity for Fiscal 2013 includes the following:

- Sales decrease of 2.8%; excluding the additional week of net sales in Fiscal 2012, the sales decrease would have been 1.3%.
- Same store sales percentages ⁽¹⁾:

	<u>Fiscal 2013</u>
Consolidated	(3.9)%
North America	(4.6)%
Europe	(2.8)%

⁽¹⁾ Computed on comparable 52 week basis: 52 weeks ended February 1, 2014 compared to the 52 weeks ended January 26, 2013.

[Table of Contents](#)

- Merchandise margin increased 40 basis points.
- Operating income reduction of 27.3%; excluding the incremental expense of \$6.9 million related to investments in China, *Icing*[®] North America e-commerce and *Claire's*[®] Europe e-commerce platforms and the estimated impact of the additional week of operations in Fiscal 2012, the operating income reduction would have been 22.3%.
- Operating income margin of 11.4 %; excluding the incremental expense of \$6.9 million related to investments in China, *Icing*[®] North America e-commerce and *Claire's*[®] Europe e-commerce platforms, the operating income margin would have been 11.8%.

On March 15, 2013, we issued \$210.0 million aggregate principal amount of 6.125% Senior Secured First Lien Notes that mature March 15, 2020. We used approximately \$61.7 million of the net proceeds to purchase approximately \$60.5 million aggregate principal amount of our 9.25% senior fixed rate notes due 2015 (the "Senior Fixed Rate Notes") and 9.625%/10.375% senior toggle notes due 2015 (the "Senior Toggle Notes", and collectively, the "Senior Notes") and to pay related fees and premiums pursuant to a tender offer. We used the remaining net proceeds, together with cash on hand, to repurchase an additional \$149.5 million aggregate principal amount of Senior Fixed Rate Notes on June 3, 2013, pursuant to the redemption provisions applicable to such notes. On May 14, 2013, we issued \$320.0 million aggregate principal amount of 7.75% Senior Notes due 2020 and used the net proceeds to redeem in full the remaining outstanding Senior Notes on June 13, 2013 pursuant to the redemption provisions applicable to such notes. As a result of our refinancings, our next debt maturity is June 1, 2017.

Operational activity for Fiscal 2013 includes the following:

- Opened 127 new company-operated stores.
- Closed 98 company-operated stores due to underperformance or lease renewal terms that did not meet our criteria.
- Partnered with franchisees with the potential to develop stores in 9 new countries; opened 54 franchised stores in 4 new countries.
- Launched *Icing*[®] North America e-commerce and *Claire's*[®] Europe e-commerce platforms.

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

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Net sales	\$ 1,513,177	\$ 1,557,020	\$ 1,495,900
(Decrease) increase in same store sales	(3.9)%	1.8%	0.1%
Gross profit percentage	50.2%	51.4%	51.5%
Selling, general and administrative expenses as a percentage of net sales	33.9%	32.3%	33.7%
Depreciation and amortization as a percentage of net sales	4.9%	4.2%	4.6%
Severance and transaction-related costs as percentage of net sales	0.3%	0.2%	0.5%
Operating income	\$ 171,772	\$ 236,168	\$ 192,338
Gain (loss) on early debt extinguishment	\$ (4,795)	\$ (9,707)	\$ 6,405
Net income (loss)	\$ (65,307)	\$ 1,282	\$ 11,632
Number of stores at the end of the period (1)	3,114	3,085	3,071

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

Net sales

Net sales in Fiscal 2013 decreased \$43.8 million, or 2.8%, from Fiscal 2012. Fiscal 2012 included 53 weeks of operations compared to Fiscal 2013. The decrease was attributable to a decrease in same store sales of \$58.1 million, a decrease of \$36.9 million due to the effect of store closures, and a decrease of \$23.6 million for the additional week of net sales in Fiscal 2012, partially offset by new store sales of \$67.6 million and a favorable foreign currency translation effect of our non-U.S. net sales of \$7.2 million. Excluding the extra week of net sales in Fiscal 2012, net sales would have decreased 1.3%, or 1.8%, excluding the impact from foreign currency exchange rate changes.

[Table of Contents](#)

For Fiscal 2013, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 1.9% and a decrease in average transaction value of 1.0%.

Net sales in Fiscal 2012 increased \$61.1 million, or 4.1%, from Fiscal 2011. Fiscal 2012 included 53 weeks of operations compared to Fiscal 2011. The increase was attributable to new store sales of \$66.8 million, an increase in same store sales of \$25.9 million, the additional week of net sales of \$23.6 million, increased shipments to franchisees of \$2.7 million, partially offset by a decrease of \$32.1 million due to the effect of store closures and an unfavorable foreign currency translation effect of our non-U.S. net sales of \$25.8 million. Excluding the extra week of net sales in Fiscal 2012, net sales would have increased 2.5%, or 4.3%, excluding the impact from foreign currency exchange rate changes.

For Fiscal 2012, the increase in same store sales was primarily attributable to an increase in average transaction value of 4.2%, partially offset by a decrease in average number of transactions per store of 2.2%.

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

<u>Product Category</u>	<u>Percentage of Total</u>		
	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Jewelry	49.4	47.9	46.1
Accessories	50.6	52.1	53.9
	100.0	100.0	100.0

Gross profit

In calculating gross profit and gross profit percentages, we exclude our distribution center cost and depreciation and amortization expense. These costs are included instead in "Selling, general and administrative" expense and "Depreciation and amortization" expense, respectively, in our Consolidated Statements of Operations and Comprehensive Income (Loss). Other retail companies may include these costs in cost of sales, so our gross profit percentages may not be comparable to those retailers.

In Fiscal 2013, gross profit percentage decreased 120 basis points to 50.2% compared to the prior fiscal year of 51.4%. The decrease in gross profit percentage consisted of a 170 basis point increase in occupancy costs, partially offset by a 40 basis point increase in merchandise margin and a 10 basis point decrease in buying and buying-related costs. The increase in occupancy costs, as a percentage of net sales, resulted primarily from the effect of a decrease in same store sales combined with normal occupancy cost increases. The increase in merchandise margin resulted primarily from lower freight costs and inventory shrink, partially offset by an increase in markdowns. Markdowns fluctuate based upon many factors, including the amount of inventory purchased versus the rate of sale and promotional activity. We do not anticipate a significant change in the level of markdowns or shrink that would materially affect our merchandise margin.

In Fiscal 2012, gross profit percentage decreased 10 basis points to 51.4% compared to the prior fiscal year of 51.5%. The decrease in gross profit percentage consisted of an 80 basis point decrease in merchandise margin, partially offset by a 60 basis point decrease in occupancy costs and a 10 basis point decrease in buying and buying-related costs. The decrease in merchandise margin resulted primarily from an increase in markdowns and higher inventory shrink. The decrease in occupancy rate resulted primarily from the leveraging effect of an increase in same store sales.

Selling, general and administrative expenses

In Fiscal 2013, selling, general and administrative expenses increased \$10.0 million, or 2.0%, over the prior fiscal year. Excluding the estimated impact of the extra week of operations in Fiscal 2012 and an unfavorable \$2.4 million foreign currency translation effect, selling, general and administrative expenses would have increased \$16.0 million. This increase included \$6.9 million of incremental expense related to investments in the Company's *Icing*® North America and *Claire's*® Europe e-commerce platforms and the China division. The remainder of the increase primarily resulted from payroll and non-cash stock compensation expense. As a percentage of net sales, selling, general and administrative expenses increased 160 basis points compared to the prior year.

[Table of Contents](#)

In Fiscal 2012, selling, general and administrative expenses decreased \$1.1 million, or 0.2%, over the prior fiscal year. As a percentage of net sales, selling, general and administrative expenses decreased 140 basis points compared to the prior year. Excluding the estimated impact of the extra week of operations in Fiscal 2012 and a favorable \$9.9 million foreign currency translation effect, selling, general and administrative expenses would have increased \$0.4 million.

Depreciation and amortization expense

Depreciation and amortization expense increased \$9.1 million to \$74.0 million during Fiscal 2013 compared to Fiscal 2012. Excluding an unfavorable \$0.2 million foreign currency translation effect, the increase in depreciation and amortization expense would have been \$8.9 million.

Depreciation and amortization expense decreased \$3.9 million to \$64.9 million during Fiscal 2012 compared to Fiscal 2011. Excluding a favorable \$1.0 million foreign currency translation effect, the decrease in depreciation and amortization expense would have been \$2.9 million.

Severance and transaction-related costs

Since Fiscal 2007, we have incurred severance and various transaction-related costs. These costs consisted primarily of severance costs resulting from reductions in workforce occurring from time-to-time and financial advisory and legal fees. During Fiscal 2013, Fiscal 2012 and Fiscal 2011, we incurred \$5.1 million, \$2.8 million and \$6.9 million of such costs, respectively.

Other income, net

The following is a summary of other (income) expense activity for Fiscal 2013, Fiscal 2012 and Fiscal 2011 (in thousands):

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Foreign currency exchange loss (gain), net	\$ 342	\$ (1,437)	\$ 899
Franchise fees	(4,889)	(4,668)	(1,904)
Other income	(21)	—	(249)
	<u>\$ (4,568)</u>	<u>\$ (6,105)</u>	<u>\$ (1,254)</u>

Gain (loss) on early debt extinguishment

The following is a summary of our note repurchase activity during Fiscal 2013 and Fiscal 2011 (in thousands). All debt repurchases in Fiscal 2013 were pursuant to the tender offer and note redemptions. There was no debt repurchase activity during Fiscal 2012.

<u>Notes Repurchased</u>	<u>Fiscal 2013</u>		
	<u>Principal Amount</u>	<u>Repurchase Price</u>	<u>Recognized Loss (1)</u>
Senior Fixed Rate Notes	\$ 220,270	\$ 219,802	\$ 2,597
Senior Toggle Notes	302,190	301,947	2,198
	<u>\$ 522,460</u>	<u>\$ 521,749</u>	<u>\$ 4,795</u>

(1) Net of deferred issuance cost write-offs of \$1,829 for the Senior Fixed Rate Notes and \$1,766 for the Senior Toggle Notes and tender premiums and fees of \$1,236 for the Senior Fixed Rate Notes and \$675 for the Senior Toggle Notes.

[Table of Contents](#)

During Fiscal 2012, we recognized a \$9.7 million loss on early debt extinguishment attributed to the write-off of unamortized debt issuance costs associated with our early repayment of indebtedness under our former senior secured term loan facility and replacement of our former \$200.0 million senior secured revolving credit facility.

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

(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.

Interest expense, net

Interest expense for Fiscal 2013 aggregated \$223.4 million, an increase of \$12.6 million compared to the prior year. The increase is primarily due to indebtedness incurred under the 9.0% Senior Secured First Lien Notes that bears a higher rate of interest than the Former Credit Facility. For Fiscal 2013, interest expense includes approximately \$8.2 million of amortization of deferred debt issuance costs and approximately \$2.1 million of accretion of debt premium.

Interest expense for Fiscal 2012 aggregated \$210.8 million, an increase of \$34.3 million compared to the prior year. The increase is primarily due to indebtedness incurred under the 9.0% Senior Secured First Lien Notes that bear a higher rate of interest than the Former Credit Facility, partially offset by lower outstanding balance under our Former Credit Facility, a Euro denominated loan, and Senior Toggle Notes. For Fiscal 2012, interest expense includes approximately \$9.9 million of amortization of deferred debt issuance costs and approximately \$0.8 million of accretion of debt premium.

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 Former Credit Facility and additional indebtedness incurred under a Euro denominated loan, partially offset by lower outstanding balances under our Former 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.

See Note 4 – Debt in the Notes to Consolidated Financial Statements for components of interest expense, net.

Income taxes

In Fiscal 2013, our income tax expense was \$8.9 million and our effective income tax rate was (15.8)%. Our effective income tax rate for Fiscal 2013 reflects income tax benefit of \$19.7 million on book losses offset by income tax expense of \$10.9 million on earnings of foreign subsidiaries and income tax expense of \$37.2 million related to the effect of changes to our valuation allowance on deferred tax assets, partially offset by income tax benefits of \$14.8 million on income in our foreign jurisdictions that are taxed at lower income tax rates. In Fiscal 2013, we made net cash income tax payments of \$18.4 million primarily for Europe.

In Fiscal 2012, our income tax expense was \$14.4 million and our effective income tax rate was 91.8%. Our effective income tax rate for Fiscal 2012 reflects income tax expense of \$13.5 million on earnings of foreign subsidiaries and income tax expense of \$14.7 million related to the effect of changes to our

[Table of Contents](#)

valuation allowance on deferred tax assets, partially offset by income tax benefits of \$17.9 million on income in our foreign jurisdictions that are taxed at lower income tax rates. In Fiscal 2012, we made net cash income tax payments of \$14.8 million primarily for Europe.

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 and income tax expense of \$3.6 million related to the effect of changes to our valuation allowance on deferred tax assets, partially 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.

See Note 10 – 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):

	Fiscal 2013	Fiscal 2012	Fiscal 2011
Net sales	\$918,687	\$977,310	\$942,278
(Decrease) increase in same store sales	(4.6)%	1.9%	2.8%
Gross profit percentage	50.7%	52.9%	52.6%
Number of stores at the end of the period (1)	1,929	1,924	1,953

- (1) Number of stores excludes stores operated under franchise agreements and includes 17 and 3 China stores as of Fiscal 2013 and Fiscal 2012, respectively.

Net sales

Net sales in North America during Fiscal 2013 decreased \$58.6 million, or 6.0% from Fiscal 2012. Fiscal 2012 included 53 weeks of operations compared to Fiscal 2013. The decrease was attributable to a decrease in same store sales of \$42.4 million, a decrease of \$20.2 million due to the effect of store closures, a decrease of \$13.4 million for the additional week of net sales in Fiscal 2012, and an unfavorable foreign currency translation effect of our non-U.S. net sales of \$3.5 million, partially offset by new store sales of \$20.9 million. Excluding the extra week of net sales in Fiscal 2012, net sales would have decreased 4.7%, or 4.4%, excluding the impact from foreign currency exchange rate changes.

For Fiscal 2013, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 2.6% and a decrease in average transaction value of 1.5%.

Net sales in North America during Fiscal 2012 increased \$35.0 million, or 3.7% from Fiscal 2011. Fiscal 2012 included 53 weeks of operations compared to Fiscal 2011. The increase was attributable to new store sales of \$18.7 million, an increase in same store sales of \$17.1 million, the additional week of net sales of \$13.4 million, increased shipments to franchisees of \$2.7 million, partially offset by a decrease of \$16.7 million due to the effect of store closures and an unfavorable foreign currency translation effect of our non-U.S. net sales of \$0.2 million. Excluding the extra week of net sales in Fiscal 2012, net sales would have increased 2.3%, or unchanged, excluding the impact from foreign currency exchange rate changes.

For Fiscal 2012, the increase in same store sales was primarily attributable to an increase in average transaction value of 5.1%, partially offset by a decrease in average number of transactions per store of 2.5%.

Gross profit

In Fiscal 2013, gross profit percentage decreased 220 basis points to 50.7% compared to the gross profit percentage for Fiscal 2012 of 52.9%. The decrease in gross profit percentage consisted of a 220 basis

[Table of Contents](#)

point increase in occupancy costs and a 10 basis point decrease in merchandise margin, partially offset by a 10 basis point decrease in buying and buying-related costs. The increase in occupancy costs, as a percentage of net sales, resulted primarily from the effect of a decrease in same store sales combined with normal occupancy cost increases. The decrease in merchandise margin resulted primarily from an increase in markdowns, partially offset by lower freight costs and inventory shrink. Markdowns fluctuate based upon many factors including the amount of inventory purchased versus the rate of sale and promotional activity. We do not anticipate a significant change in the level of markdowns or shrink that would materially affect our merchandise margin.

In Fiscal 2012, gross profit percentage increased 30 basis points to 52.9% compared to the gross profit percentage for Fiscal 2011 of 52.6%. The increase in gross profit percentage consisted of a 50 basis point decrease in occupancy costs and a 20 basis point decrease in buying and buying-related costs, partially offset by a 40 basis point decrease in merchandise margin. The improvement in occupancy rate resulted primarily from the leveraging effect of an increase in same store sales. The decrease in merchandise margin resulted primarily from an increase in markdowns, partially offset by improvement in initial markups.

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

<u>Product Category</u>	<u>Percentage of Total</u>		
	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Jewelry	53.9	52.6	50.8
Accessories	46.1	47.4	49.2
	100.0	100.0	100.0

Europe

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

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Net sales	\$594,490	\$579,710	\$553,622
(Decrease) increase in same store sales	(2.8)%	1.7%	(4.4)%
Gross profit percentage	49.4%	49.0%	49.8%
Number of stores at the end of the period (1)	1,185	1,161	1,118

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

Net sales

Net sales in Europe during Fiscal 2013 increased \$14.8 million, or 2.5%, from Fiscal 2012. Fiscal 2012 included 53 weeks of operations compared to Fiscal 2013. The increase was attributable to new store sales of \$46.7 million, and a favorable foreign currency translation effect of our non-U.S. net sales of \$10.7 million, partially offset by a decrease of \$16.7 million due to the effect of store closures, a decrease in same store sales of \$15.7 million and a decrease of \$10.2 million for the additional week of net sales in Fiscal 2012. Excluding the extra week of sales in Fiscal 2012, net sales would have increased 4.4%, or 2.5%, excluding the impact from foreign currency exchange rate changes.

For Fiscal 2013, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 1.6%, partially offset by an increase in average transaction value of 0.5%.

Net sales in Europe during Fiscal 2012 increased \$26.1 million, or 4.7%, from Fiscal 2011. Fiscal 2012 included 53 weeks of operations compared to Fiscal 2011. The increase was attributable to new store sales of \$48.1 million, the additional week of net sales of \$10.2 million, an increase in same store sales of \$8.8 million, partially offset by an unfavorable foreign currency translation effect of our non-U.S. net sales of \$25.6 million and a decrease of \$15.4 million due to the effect of store closures. Excluding the extra week of sales in Fiscal 2012, net sales would have increased 2.9%, or 7.8%, excluding the impact from foreign currency exchange rate changes.

[Table of Contents](#)

For Fiscal 2012, the increase in same store sales was primarily attributable to an increase in average transaction value of 4.2%, partially offset by a decrease in average number of transactions per store of 3.3%.

Gross profit

In Fiscal 2013, gross profit percentage increased 40 basis points to 49.4% compared to the gross profit percentage for Fiscal 2012 of 49.0%. The increase in gross profit percentage consisted of a 120 basis point increase in merchandise margin and a 10 basis point decrease in buying and buying-related costs, partially offset by a 90 basis point increase in occupancy costs. The increase in merchandise margin resulted from a reduction in markdowns, and inventory shrink and higher initial markups. The increase in occupancy costs, as a percentage of net sales, resulted primarily from the effect of a decrease in same store sales combined with normal occupancy cost increases. Markdowns fluctuate based upon many factors including the amount of inventory purchased versus the rate of sale and promotional activity. We do not anticipate a significant change in the level of markdowns or shrink that would materially affect our merchandise margin.

In Fiscal 2012, gross profit percentage decreased 80 basis points to 49.0% compared to the gross profit percentage for Fiscal 2011 of 49.8%. The decrease in gross profit percentage consisted of a 160 basis point decrease in merchandise margin and a 10 basis point increase in buying and buying-related costs, partially offset by a 90 basis point decrease in occupancy costs. The decrease in merchandise margin resulted from a reduction in initial markups and an increase in inventory shrink. The improvement in occupancy rate resulted primarily from the leveraging effect of an increase in same store sales.

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

<u>Product Category</u>	<u>Percentage of Total</u>		
	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Jewelry	42.6	40.3	38.2
Accessories	57.4	59.7	61.8
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

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 higher in Fiscal 2013 than in prior years as a result of cash interest payments for the 9.0% Senior Secured First Lien Notes due 2019 (the “9.0% Senior Secured First Lien Notes”) and Senior Secured Toggle Notes. 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 cash generated from operations, borrowings under our Credit Facility (as described below) and future refinancings of our indebtedness will be sufficient to allow us to satisfy payments of interest and principal on our indebtedness as they become due, to fund new store expenditures, and future working capital requirements in both the next twelve months and over the longer term. Interest on the outstanding Notes will be approximately \$195.2 million in Fiscal 2014, and we expect to fund these interest payments through a combination of cash from operations and borrowings under our \$115.0 million Credit Facility. No principal is due on the Notes until Fiscal 2017, when our 10.50% Senior Subordinated Notes due 2017 (the “Senior Subordinated Notes”) will mature. We expect to pay the outstanding principal amount of these Notes at maturity through a combination of new indebtedness, cash from operations and other available sources. In addition, we anticipate the cash generated from operations, and borrowings under the Credit Facility will be sufficient to allow us to fund new store expenditures and future working capital requirements in both the next twelve months and over the longer term. However, our ability to make interest payments and meet operational liquidity needs, as well as our ability to refinance the Senior Subordinated Notes when they mature in Fiscal 2017, will depend, in part, on our future operating performance. Our future operating performance and liquidity, as well as our ability to refinance our indebtedness, may also be adversely affected by general economic, financial, and other factors beyond our control, including those disclosed in Part I, Item 1A – Risk Factors.

[Table of Contents](#)

Credit Facility

Our Former Credit Facility provided senior secured financing of up to \$1.65 billion that consisted of the \$1.45 billion Former Term Loan and the \$200.0 million Former Revolver. On May 29, 2007, upon closing of the Transactions, we borrowed \$1.45 billion under our Former Term Loan 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. During Fiscal 2012, we issued \$1,142.1 million of the 9.0% Senior Secured First Lien Notes, and used the net proceeds, together with cash on hand, to repay \$1,154.3 million of indebtedness under the Former Term Loan.

On September 20, 2012, we terminated the Former Credit Facility and entered into an Amended and Restated Credit Agreement by and among Claire's Inc. ("Parent"), us, Credit Suisse AG, as Administrative Agent, and the other Lenders named therein (the "Credit Facility"), pursuant to which we replaced the \$200.0 million senior secured Former Revolver maturing May 29, 2013 with a \$115.0 million five-year senior secured revolving credit facility maturing in September 2017.

Borrowings under the 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) the prime rate in effect on such day, (2) the federal funds effective rate plus 0.50% and (3) the one-month LIBOR rate plus 1.00%, 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 of 4.50% for LIBOR rate loans and 3.50% for alternate base rate loans. We also pay a facility fee of 0.50% per annum of the committed amount of the Credit Facility whether or not utilized.

All obligations under the Credit Facility are unconditionally guaranteed by (i) Parent, prior to an initial public offering of our stock, and (ii) our existing and future direct or indirect 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 and permitted liens, by a first priority lien on, (i) all of our capital stock, prior to an initial public offering of its stock, and (ii) substantially all of our material owned assets and the material owned assets of subsidiary guarantors, limited in the case of equity interests held by us or any subsidiary guarantor in a foreign subsidiary, to 100% of the non-voting equity interests and 65% of the voting equity interests of such foreign subsidiary held directly by us or a subsidiary guarantor. The liens securing the Credit Facility rank equally to the liens securing the 9.0% Senior Secured First Lien Notes and the 6.125% Senior Secured First Lien Notes (described below), and senior to those securing the Senior Secured Second Lien Notes (described below).

The 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 us to maintain any particular financial ratio or other measure of financial performance except that, when the revolving loans and letters of credit outstanding exceed \$15.0 million, we are required to comply with a maximum Total Net Secured Leverage Ratio of 5.5 to 1.0 based upon the ratio of our net senior secured first lien debt to adjusted earnings before interest, taxes, depreciation and amortization for the period of four consecutive fiscal quarters most recently ended. As of February 1, 2014, our Total Net Secured Leverage Ratio was 5.0 to 1.0. We must comply with this maximum Total Net Secured Leverage Ratio requirement, measured as of the most recent four consecutive quarter period for which financial statements have been (or were required to be) delivered to our lenders, at any time we request a borrowing that would result in such outstanding amount exceeding \$15.0 million.

[Table of Contents](#)

The Credit Facility also contains various covenants that limit our ability to engage in specified types of transactions. These covenants limit 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;
- 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. As of February 1, 2014, we were in compliance with the covenants.

As of February 1, 2014, we had \$6.3 million of letters of credit outstanding which reduces the borrowing availability under the Credit Facility to \$108.7 million as of that date.

Merger Notes

In connection with the Transactions, we also issued three series of Merger Notes. Our Senior Notes were issued 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 2015 (the "Senior Toggle Rate Notes" and together with the Senior Fixed Rate Notes, the "Senior Notes"). For any interest period through June 1, 2011, we were allowed to elect to pay interest on the Senior Toggle Rate Notes (i) entirely in cash, (ii) entirely by increasing the principal amount of the outstanding Senior Toggle Rate Notes or by issuing payment in kind (PIK) Notes, or (iii) 50% as cash interest and 50% as PIK interest. We elected to pay interest in kind on our 9.625%/10.375% Senior Toggle Rate 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 Rate Notes by \$109.5 million as of February 2, 2013. 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. As of June 13, 2013, the Senior Fixed Rate Notes and the Senior Toggle Rate Notes have been redeemed in full and are no longer outstanding.

We also issued 10.50% senior subordinated notes due 2017 (the "Senior Subordinated Notes" and together with the Senior Notes, the "Merger Notes") 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.

The Senior Subordinated Notes are guaranteed on an unsecured basis by all of our existing and future direct or indirect, wholly-owned domestic subsidiaries that guarantee the Credit Facility. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X.

Interest on the Senior Subordinated 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 Senior Subordinated Notes are also subject to certain redemption and repurchase rights as described in Note 4 – Debt in the Notes to Consolidated Financial Statements.

[Table of Contents](#)

8.875% 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. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. We used the net proceeds of the offering of the Senior Secured Second Lien Notes to reduce the entire amount outstanding under our Former Revolver (without terminating the commitment) and to repay indebtedness under the Former Term Loan.

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 4 – Debt in the Notes to Consolidated Financial Statements.

9.0% Senior Secured First Lien Notes

On February 28, 2012, we issued \$400.0 million aggregate principal amount of the 9.0% Senior Secured First Lien Notes. The notes were issued at a price equal to 100.00% of the principal amount. On March 12, 2012, we issued an additional \$100.0 million aggregate principal amount of the same series of 9.0% Senior Secured First Lien Notes at a price equal to 101.50% of the principal amount. On September 20, 2012, we issued an additional \$625.0 million aggregate principal amount of the same series of 9.0% Senior Secured First Lien Notes at a price equal to 102.5% of the principal amount.

Interest on the 9.0% 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 9.0% Senior Secured First Lien Notes are guaranteed on a first-priority senior secured basis by all of our existing and future direct or indirect wholly-owned domestic subsidiaries. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. The 9.0% Senior Secured First Lien Notes and related guarantees are secured, subject to certain exceptions and permitted liens, by a first-priority lien on substantially all of our material owned assets and the material owned assets of subsidiary guarantors, limited in the case of equity interest held by us or any subsidiary guarantor in a foreign subsidiary, to 100% of the non-voting equity interest and 65% of the voting equity interest of such foreign subsidiary held directly by us or a subsidiary guarantor. The liens rank equally with those securing the Credit Facility and the 6.125% Senior Secured First Lien Notes (described below), as and senior to those securing the Senior Secured Second Lien Notes. The notes are also subject to certain redemption and repurchase rights as discussed in Note 4 – Debt in the Notes to Consolidated Financial Statements.

We used the net proceeds of the offerings of the 9.0% Senior Secured First Lien Notes, together with cash on hand, to repay \$1,154.3 million of indebtedness under the Former Term Loan.

6.125% Senior Secured First Lien Notes

On March 15, 2013, we issued \$210.0 million aggregate principal amount of 6.125% senior secured first lien notes that mature on March 15, 2020 (the “6.125% Senior Secured First Lien Notes”). The notes were issued at a price equal to 100.00% of the principal amount. Interest on the 6.125% Senior Secured First Lien Notes is payable semi-annually to holders of record at the close of business on March 1 and September 1 immediately preceding the interest payment date on March 15 and September 15 of each year, commencing on September 15, 2013. The 6.125% Senior Secured First Lien Notes are guaranteed on a first-priority senior secured basis by all of our existing and future direct or indirect wholly-owned domestic subsidiaries. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of

Table of Contents

Regulation S-X. The 6.125% Senior Secured First Lien Notes and related guarantees are secured, subject to certain exceptions and permitted liens, by a first-priority lien on substantially all of the assets of our material owned assets and the material owned assets of subsidiary guarantors, limited in the case of equity interests held by us or any subsidiary guarantor in a foreign subsidiary, to 100% of the non-voting equity interest and 65% of the voting equity interest of such foreign subsidiary held directly by us or a subsidiary guarantor. The liens rank equally with those securing the Credit Facility and the 9.0% Senior Secured First Lien Notes, and senior to those securing the Senior Secured Second Lien Notes. The Notes are also subject to certain redemption and repurchase rights as described in Note 4 – Debt in the Notes to Consolidated Financial Statements. The notes are also subject to certain redemption and repurchase rights as discussed in Note 4 – Debt in the Notes to Consolidated Financial Statements.

We used approximately \$61.7 million of the net proceeds of the offering of the 6.125% Senior Secured First Lien Notes to purchase approximately \$60.5 million aggregate principal amount of Senior Notes and to pay related fees and premiums pursuant to a tender offer for such Senior Notes, including \$4.0 million in financing costs which have been recorded as “Deferred financing costs, net” in the accompanying Consolidated Balance Sheet. The remaining net proceeds, together with cash on hand, were used to repurchase an additional \$149.5 million aggregate principal amount of Senior Notes on June 3, 2013, pursuant to the redemption provisions applicable to such Notes.

7.75% Senior Notes

On May 14, 2013, we issued \$320.0 million aggregate principal amount of 7.75% senior notes that mature on June 1, 2020 (the “7.75% Senior Notes”). The 7.75% Senior Notes were issued at a price equal to 100.00% of the principal amount. Interest on the 7.75% Senior Notes is payable semi-annually to holders of record at the close of business on May 15 and November 15 immediately preceding the interest payment date on June 1 and December 1 of each year, commencing on December 1, 2013. The 7.75% Senior Notes are guaranteed by all of our existing and future direct or indirect wholly-owned domestic subsidiaries. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. The 7.75% Senior Notes and related guarantees are unsecured and will: (i) rank equal in right of payment with all of our existing and future indebtedness, (ii) rank senior to any of our existing and future indebtedness that is expressly subordinated to the 7.75% Senior Notes, and (iii) rank junior in priority to our obligations under all of our secured indebtedness, including the Credit Facility, the Senior Secured Second Lien Notes, the 9.0% Senior Secured First Lien Notes and the 6.125% Senior Secured First Lien Notes, to the extent of the value of assets securing such indebtedness.

We used the net proceeds of the offering of the 7.75% Senior Notes to redeem all outstanding \$31.8 million aggregate principal amount of Senior Fixed Rate Notes and all outstanding \$280.7 million aggregate principal amount of Senior Toggle Notes on June 13, 2013 pursuant to the redemption provisions applicable to such notes. The notes are also subject to certain redemption and repurchase rights as discussed in Note 4 – Debt in the Notes to Consolidated Financial Statements.

Note Covenants

Our Senior Subordinated Notes, Senior Secured Second Lien Notes, 9.0% Senior Secured First Lien Notes, 6.125% Senior Secured First Lien Notes and 7.75% Senior Notes, (collectively, the “Notes”) contain certain covenants that, among other things, and subject to certain exceptions and other basket amounts. These exceptions are basket amounts are intended to provide us flexibility to operate our business in the ordinary course. These covenants 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 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 us. None of these covenants, however, require us to maintain any particular financial ratio or other measure of financial performance. As of February 1, 2014, we were in compliance with the covenants.

Europe Credit Facilities

Our non-U.S. subsidiaries have bank credit facilities totaling \$2.5 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. As of February 1, 2014, we had a reduction of \$2.4 million for outstanding bank guarantees, which reduces the borrowing availability to \$0.1 million as of that date.

Analysis of Consolidated Financial Condition

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

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Operating activities	\$ (3,153)	\$ 106,695	\$ 102,560
Investing activities	(98,791)	(68,494)	(57,384)
Financing activities	(3,575)	(40,179)	(132,687)

Our working capital at the end of Fiscal 2013 was \$31.8 million compared to \$122.1 million at the end of Fiscal 2012, a decrease of \$90.3 million. The decrease in working capital mainly reflects a decrease in cash and cash equivalents of \$108.6 million, a decrease in prepaid expense and other items of \$3.6 million, and a net increase in trade accounts and income tax payables of \$4.1 million, partially offset by an increase in inventories of \$21.3 million and a decrease in accrued liabilities of \$4.7 million.

Cash flows from operating activities

In Fiscal 2013, cash used in operations increased \$109.8 million compared to Fiscal 2012. The primary reason for the increase was an increase in interest payments of \$51.6 million, a decrease in operating income before depreciation and amortization expense, stock compensation expense (benefit) and other non-cash items of \$50.9 million, and a net change in working capital and other items of \$7.3 million.

In Fiscal 2012, cash provided by operations increased \$4.1 million compared to Fiscal 2011. The primary reason for the increase was an increase in operating income before depreciation and amortization expense, stock compensation benefit and foreign exchange loss on the Euro denominated loan of \$42.1 million; partially offset by an increase in interest payments of \$29.0 million and, an increase in net change in working capital and other items, excluding cash and cash equivalents and restricted cash, of \$9.0 million.

Cash flows from investing activities

In Fiscal 2013, cash used in investing was \$98.8 million and consisted of \$98.8 million for net capital expenditures.

In Fiscal 2012, cash used in investing was \$68.5 million and primarily consisted of \$72.8 million for net capital expenditures, partially offset by a \$4.4 million decrease in restricted cash associated with the termination of the interest rate swap agreement.

[Table of Contents](#)

In Fiscal 2014, we currently expect to fund approximately \$45.0 million to \$50.0 million of capital expenditures to open new stores and remodel existing stores.

Cash flows from financing activities

In Fiscal 2013, cash used in financing activities was \$3.6 million and primarily consisted of proceeds of \$530.0 million from the issuance of \$210.0 million aggregate principal amount of 6.125% Senior Secured First Lien Notes and \$320.0 million aggregate principal amounts of 7.75% Senior Notes, partially offset by note repurchases of \$521.8 million to retire \$220.3 million aggregate principal amount of Senior Fixed Rate Notes and \$302.2 million aggregate principal amount of Senior Toggle Notes pursuant to a tender offer and note redemptions, payment of \$1.9 million in tender premiums and fees, and payment of \$9.9 million in financing costs.

In Fiscal 2012, cash used in financing activities was \$40.2 million and primarily consisted of the issuance of \$1,142.1 million of 9.0% Senior Secured First Lien Notes used, together with cash on hand, to repay \$1,154.3 million of indebtedness under the Former Term Loan and to pay \$28.0 million in financing costs.

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 February 1, 2014, we had consolidated cash and cash equivalents of \$58.3 million and all cash equivalents were maintained in one money market fund invested exclusively in U.S. Treasury Securities.

As of February 1, 2014, our foreign subsidiaries held cash and cash equivalents of \$44.4 million. In Fiscal 2013 and Fiscal 2012, 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 as of February 1, 2014, we do not expect to pay U.S. income tax on Fiscal 2014 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, net of any foreign tax credit benefit, on any such repatriation.

Parent Company Registration Statement Filing

On May 3, 2013, Claire's Inc., our Parent, filed a registration statement with the Securities and Exchange Commission for an initial public offering of Claire's Inc.'s common stock.

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, 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

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

[Table of Contents](#)

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.

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 from those estimates, which could materially impact our impairment assessment.

Goodwill

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 has a two-step process for determining goodwill impairment. In accordance with *ASU 2011-08, Intangibles - Goodwill and Other (Topic 350)*, we have the option of performing a qualitative assessment before calculating the fair value of our reporting units or bypassing the qualitative assessment for any reporting unit for any period and proceeding directly to the first step of the two-step goodwill impairment test. If we determine, on the basis of qualitative factors, it is not more likely than not that the fair value of the reporting unit is less than the carrying amount, then performing the two-step impairment test would be unnecessary. We opted to bypass the qualitative assessment and proceeded directly to the first step of the two-step goodwill impairment test. 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

[Table of Contents](#)

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 2013 and the fiscal years 2014 through 2018. Beyond fiscal year 2018, 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 and closures, 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 our past performance post-recession.

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 projected 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 each 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 2013, Fiscal 2012 or Fiscal 2011. The fair value of our Europe reporting unit was substantially in excess of its carrying value. However, in connection with our Fiscal 2013 annual impairment testing, we noted one reporting unit which was more sensitive to near-term changes in same store sale percentages and discounted cash flow assumptions: North America with \$1.24 billion of goodwill as of November 2, 2013 and fair value in excess of its carrying value of net assets of approximately 6%. While the reporting unit passed the first step of the impairment test, if the reporting unit’s operating income or another valuation assumption were to deteriorate significantly in the future, it could adversely affect the estimated fair value. If we are unsuccessful in our plans to increase the profitability of this reporting unit, the estimated fair value could decline and lead to a goodwill impairment charge in the future.

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. 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.

[Table of Contents](#)

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. We did not recognize any impairment charges during Fiscal 2013, Fiscal 2012 or Fiscal 2011.

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.

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 2013, we reported an increase of \$32.0 million in valuation allowance against our U.S. deferred tax assets and an increase of \$1.6 million in the valuation allowance against our foreign deferred tax assets. During Fiscal 2012, we reported an increase of \$9.4 million in the valuation allowance against our U.S. deferred tax assets and an increase of \$4.3 million in the valuation allowance against our foreign deferred tax assets. During Fiscal 2011, we reported an increase of \$4.0 million in the valuation allowance against our U.S. deferred tax assets and no change in the 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.

In Fiscal 2008, we recorded a charge of \$95.8 million 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.

Table of Contents

Income tax expense also reflects our best estimates 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, plans for repatriation of foreign earnings, 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* (“ASC Topic 718”), 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 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’s 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 2013, Fiscal 2012 and Fiscal 2011 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.

Buy one, get one (“BOGO”) options issued prior to May 2011 were immediately vested, exercisable upon issuance, and accounted for at fair value at date of grant. The compensation expense for these BOGOs was 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. BOGOs issued subsequent to May 2011 are accounted for at the fair value at date of grant and the compensation expense is recognized over the requisite service period.

The fair values of time-vested stock options and BOGO options granted during Fiscal 2013, Fiscal 2012 and Fiscal 2011 were determined using the Black-Scholes option-pricing model. The fair values of performance based stock options issued during Fiscal 2013, Fiscal 2012 and Fiscal 2011 were 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.

Performance Based Stock Option Exchange Offer

On June 15, 2012, Claire’s Inc., the parent corporation (“Parent”), of the Company commenced an offer (the “Exchange Offer”) to exchange certain performance based stock options held by employees of the Company for new performance based stock options (the “New Options”) granted on a 1 for 2 basis. The Exchange Offer was completed on July 16, 2012. The New Options expire on July 16, 2019.

Table of Contents

The New Options issued under the Exchange Offer provide for the following performance conditions:

- Vest in equal installments on the first two anniversaries after the first to occur of:
 - (i) the date of an initial public offering (“IPO”) at a price of at least \$25 per share,
 - (ii) any date following an IPO when the average stock price over the preceding 30 consecutive trading days exceeds \$25, or
 - (iii) any date before an IPO where more than 25% of the outstanding shares of the Parent are sold for cash or marketable consideration having a value of at least \$25 per share;
- Vest immediately if, on or after the occurrence of a performance condition described in (i), (ii) or (iii), but prior to the second anniversary thereof, there occurs a change of control of Parent.

The Exchange Offer resulted in \$1.2 million in total incremental compensation cost that will be recognized when a performance condition occurs. The Exchange Offer affected approximately 125 employees.

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, we determined that the achievement of vesting events for the Performance Stock Options was not 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.

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.

[Table of Contents](#)

Our estimates of stock price volatility, interest rate, grant date fair value and expected term of options and restricted stock are affected by illiquidity in 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 8 – Stock Options and Stock-Based Compensation in the Notes to Consolidated Financial Statements.

Derivatives and Hedging

We do not have any derivative and hedging activity since September 20, 2012, when we terminated our former interest rate swap. During the periods when we had the interest rate swap, we followed the accounting treatment described below.

We account for derivative instruments in accordance with ASC Topic 815, *Derivatives and Hedging* (“ASC Topic 815”). 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 derivative credit 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 reclassify 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. No ineffective portion was recorded into earnings during Fiscal 2012 and Fiscal 2011, 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. 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.

On September 20, 2012, we terminated the interest rate swap agreement entered into on July 28, 2010 (the “Swap”), settled the contract at fair value of the liability and also extinguished the associated hedged debt instrument. Accordingly, we reclassified \$1.8 million of unrealized loss associated with the Swap from “Accumulated other comprehensive income (loss), net of tax” in the Consolidated Balance Sheets into “Interest expense, net” in the Consolidated Statements of Operations and Comprehensive Income.

[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 February 1, 2014:

Contractual Obligations (in millions)	Payments Due by Period				
	Total	1 year	2-3 years	4-5 years	More than 5 years
Recorded Contractual Obligations:					
Debt (1)	\$ 2,364.6	\$ —	\$ —	\$ 259.6	\$ 2,105.0(2)
Capital lease obligation	42.3	2.3	4.8	5.0	30.2
Unrecorded Contractual Obligations:					
Operating lease obligations (3)	1,082.7	222.4	350.5	221.3	288.5
Interest (4)	1,131.0	195.2	414.6	373.1	148.1
Letters of credit	6.3	6.3	—	—	—
Total	<u>\$4,626.9</u>	<u>\$ 426.2</u>	<u>\$769.9</u>	<u>\$ 859.0</u>	<u>\$ 2,571.8</u>

- (1) Represents debt expected to be paid and does not assume any note repurchases or prepayments.
- (2) Includes \$1,125.0 million (excluding unamortized premium of \$14.2 million) under our 9.0% Senior Secured First Lien Notes, \$450.0 million under our 8.875% Senior Secured Second Lien Notes, \$210.0 million under our 6.125% Senior Secured First Lien Notes, and \$320.0 million under our 7.75% Senior Notes.
- (3) 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.
- (4) Represents interest expected to be paid on our debt and does not assume any note repurchases or prepayments.

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 2013 were 23%, 24%, 24% and 29%, respectively. See Note 12 – Selected Quarterly Financial Data in the Notes to Consolidated Financial Statements for our quarterly results of operations.

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.

[Table of Contents](#)

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 at financial institutions that are in excess of federally insured limits. With the current financial environment, 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 and maintaining bank accounts with a group of credit worthy financial institutions. As of February 1, 2014, all cash equivalents were maintained in one money market fund that was invested exclusively in U.S. Treasury securities.

Interest Rates

We no longer have exposure to interest rate risk associated with derivative instruments. On September 20, 2012, we terminated the interest rate swap agreement entered into on July 28, 2010 (the “Swap”), settled the contract at fair value of the liability and also extinguished the associated hedged debt instrument. We previously entered into the Swap to manage exposure to fluctuations in interest rates. The Swap had an expiration date of July 30, 2013. The Swap represented a contract to exchange floating rate for fixed interest rates periodically over the life of the Swap without exchange of the underlying notional amount. The Swap covered an aggregate notional amount of \$200.0 million of the outstanding principal balance of the Former Term Loan. The fixed rate of the Swap was 1.2235% and was designated and accounted for as a cash flow hedge.

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 February 1, 2014, 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 \$(4.4) million, \$5.5 million and \$(4.8) million, net of tax, reflecting the unrealized (loss) gain on foreign currency translations and intra-entity foreign currency transactions during Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively.

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

[Table of Contents](#)

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 foreign currency exchange rates for the months that comprise the periods presented. As a result, if exchange rates fluctuate significantly from one period to the next, results in local currency can vary significantly upon translation into U.S. dollars. Accordingly, fluctuations in foreign currency exchange 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 we have 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 United States 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>Page No.</u>
Report of Independent Registered Public Accounting Firm	51
Consolidated Balance Sheets as of February 1, 2014 and February 2, 2013	52
Consolidated Statements of Operations and Comprehensive Income (Loss) for the fiscal years ended February 1, 2014, February 2, 2013 and January 28, 2012	53
Consolidated Statements of Changes in Stockholder's Deficit for the fiscal years ended February 1, 2014, February 2, 2013 and January 28, 2012	54
Consolidated Statements of Cash Flows for the fiscal years ended February 1, 2014, February 2, 2013 and January 28, 2012	55
Notes to Consolidated Financial Statements	56

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 February 1, 2014 and February 2, 2013, and the related consolidated statements of operations and comprehensive income (loss), changes in stockholder's deficit, and cash flows for each of the fiscal years in the three-year period ended February 1, 2014. 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 February 1, 2014 and February 2, 2013, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended February 1, 2014 in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

April 2, 2014
Miami, Florida
Certified Public Accountants

CLAIRE'S STORES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	February 1, 2014	February 2, 2013
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 58,343	\$ 166,956
Inventories	178,882	157,549
Prepaid expenses	19,471	19,701
Other current assets	26,305	29,621
Total current assets	<u>283,001</u>	<u>373,827</u>
Property and equipment:		
Furniture, fixtures and equipment	260,709	234,209
Leasehold improvements	335,858	312,789
	596,567	546,998
Less accumulated depreciation and amortization	(347,408)	(325,618)
	<u>249,159</u>	<u>221,380</u>
Leased property under capital lease:		
Land and building	18,055	18,055
Less accumulated depreciation and amortization	(3,611)	(2,708)
	<u>14,444</u>	<u>15,347</u>
Goodwill	1,550,056	1,550,056
Intangible assets, net of accumulated amortization of \$65,194 and \$57,672, respectively	541,095	547,433
Deferred financing costs, net of accumulated amortization of \$38,917 and \$27,156, respectively	39,481	41,381
Other assets	54,396	49,848
	<u>2,185,028</u>	<u>2,188,718</u>
Total assets	<u>\$ 2,731,632</u>	<u>\$ 2,799,272</u>
LIABILITIES AND STOCKHOLDER'S DEFICIT		
Current liabilities:		
Trade accounts payable	84,364	73,445
Income taxes payable	3,729	10,508
Accrued interest payable	68,338	68,254
Accrued expenses and other current liabilities	94,727	99,529
Total current liabilities	<u>251,158</u>	<u>251,736</u>
Long-term debt	2,378,786	2,373,366
Obligation under capital lease	17,124	17,232
Deferred tax liability	119,564	120,968
Deferred rent expense	32,000	29,859
Unfavorable lease obligations and other long-term liabilities	16,033	20,551
	<u>2,563,507</u>	<u>2,561,976</u>
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	619,499	618,403
Accumulated other comprehensive income (loss), net of tax	(1,109)	3,273
Accumulated deficit	(701,423)	(636,116)
	<u>(83,033)</u>	<u>(14,440)</u>
Total liabilities and stockholder's deficit	<u>\$ 2,731,632</u>	<u>\$ 2,799,272</u>

See accompanying notes to consolidated financial statements.

CLAIRE'S STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(in thousands)

	Fiscal Year Ended February 1, 2014	Fiscal Year Ended February 2, 2013	Fiscal Year Ended January 28, 2012
Net sales	\$1,513,177	\$1,557,020	\$1,495,900
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	753,631	755,996	724,775
Gross profit	<u>759,546</u>	<u>801,024</u>	<u>771,125</u>
Other expenses:			
Selling, general and administrative	513,253	503,254	504,360
Depreciation and amortization	73,971	64,879	68,753
Severance and transaction-related costs	5,118	2,828	6,928
Other income, net	<u>(4,568)</u>	<u>(6,105)</u>	<u>(1,254)</u>
	<u>587,774</u>	<u>564,856</u>	<u>578,787</u>
Operating income	171,772	236,168	192,338
Gain (loss) on early debt extinguishment	(4,795)	(9,707)	6,405
Interest expense, net	<u>223,361</u>	<u>210,797</u>	<u>176,475</u>
Income (loss) before income tax expense	(56,384)	15,664	22,268
Income tax expense	<u>8,923</u>	<u>14,382</u>	<u>10,636</u>
Net income (loss)	<u>\$ (65,307)</u>	<u>\$ 1,282</u>	<u>\$ 11,632</u>
Net income (loss)	\$ (65,307)	\$ 1,282	\$ 11,632
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustments	(940)	1,182	(663)
Net gain (loss) on intra-entity foreign currency transactions, net of tax (benefit) of \$(36), \$142 and \$(171)	(3,442)	4,283	(4,111)
Unrealized gain (loss) on interest rate swap, net of tax of \$0, \$0 and \$0	—	375	(993)
Reclassification adjustment of unrealized loss on termination of interest rate swap into net income	—	1,784	—
Other comprehensive income (loss)	<u>(4,382)</u>	<u>7,624</u>	<u>(5,767)</u>
Comprehensive income (loss)	<u>\$ (69,689)</u>	<u>\$ 8,906</u>	<u>\$ 5,865</u>

See accompanying notes to consolidated financial statements.

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

(In thousands, except 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 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 translations adjustments	—	—	—	(663)	—	(663)
Net gain (loss) on intra-entity foreign currency transactions, net of tax (benefit)	—	—	—	(4,111)	—	(4,111)
Unrealized (loss) gain on interest rate swap, net of tax	—	—	—	(993)	—	(993)
Balance: January 28, 2012	100	—	619,453	(4,351)	(637,398)	(22,296)
Net income	—	—	—	—	1,282	1,282
Stock option benefit	—	—	(1,050)	—	—	(1,050)
Foreign currency translations adjustments	—	—	—	1,182	—	1,182
Net gain (loss) on intra-entity foreign currency transactions, net of tax (benefit)	—	—	—	4,283	—	4,283
Unrealized (loss) gain on interest rate swap, net of tax	—	—	—	375	—	375
Reclassification adjustment of unrealized loss on termination of interest rate swap into net income	—	—	—	1,784	—	1,784
Balance: February 2, 2013	100	—	618,403	3,273	(636,116)	(14,440)
Net loss	—	—	—	—	(65,307)	(65,307)
Stock option expense	—	—	1,096	—	—	1,096
Foreign currency translations adjustments	—	—	—	(940)	—	(940)
Net gain (loss) on intra-entity foreign currency transactions, net of tax (benefit)	—	—	—	(3,442)	—	(3,442)
Balance: February 1, 2014	100	\$ —	\$ 619,499	\$ (1,109)	\$ (701,423)	\$ (83,033)

See accompanying notes to consolidated financial statements.

CLAIRE'S STORES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Fiscal Year Ended February 1, 2014	Fiscal Year Ended February 2, 2013	Fiscal Year Ended January 28, 2012
Cash flows from operating activities:			
Net income (loss)	\$ (65,307)	\$ 1,282	\$ 11,632
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:			
Depreciation and amortization	73,971	64,879	68,753
Amortization of lease rights and other assets	3,675	3,279	3,189
Amortization of debt issuance costs	8,166	9,927	13,106
Accretion of debt premium	(2,120)	(831)	—
Payment of in kind interest expense	—	—	11,831
Foreign currency exchange net gain on Euro Loan	—	—	(1,953)
Net unfavorable accretion of lease obligations	(691)	(826)	(657)
Loss on sale/retirement of property and equipment, net	1,481	96	42
Loss (gain) on early debt extinguishment	4,795	9,707	(6,405)
Gain on sale of intangible assets/lease rights	(172)	(493)	(90)
Stock compensation expense (benefit)	1,096	(1,050)	(1,646)
(Increase) decrease in:			
Inventories	(21,079)	(13,418)	(8,394)
Prepaid expenses	735	578	1,376
Other assets	(2,964)	(9,833)	(5,852)
Increase (decrease) in:			
Trade accounts payable	9,094	10,517	7,311
Income taxes payable	(6,435)	629	(1,991)
Accrued interest payable	83	36,395	15,081
Accrued expenses and other liabilities	(6,592)	(4,804)	(3,511)
Deferred income taxes	(2,411)	(196)	(1,582)
Deferred rent expense	1,522	857	2,320
Net cash (used in) provided by operating activities	<u>(3,153)</u>	<u>106,695</u>	<u>102,560</u>
Cash flows from investing activities:			
Acquisition of property and equipment	(92,123)	(68,234)	(70,515)
Acquisition of construction-in-process	(4,115)	(570)	(393)
Acquisition of intangible assets/lease rights	(2,756)	(5,049)	(5,709)
Proceeds from sales of intangible assets/lease rights	203	1,009	816
Changes in restricted cash	—	4,350	18,417
Net cash used in investing activities	<u>(98,791)</u>	<u>(68,494)</u>	<u>(57,384)</u>
Cash flows from financing activities:			
Proceeds from revolving credit facility	137,800	—	—
Payments on revolving credit facility	(137,800)	—	—
Payments on former credit facility	—	(1,154,310)	(438,940)
Proceeds from notes	530,000	1,142,125	450,000
Payment of short-term debt	—	—	(54,653)
Repurchases of notes, including tender premiums and fees	(523,660)	—	(78,343)
Payment of debt issuance costs	(9,861)	(27,990)	(10,751)
Principal payments of capital lease	(54)	(4)	—
Net cash used in financing activities:	<u>(3,575)</u>	<u>(40,179)</u>	<u>(132,687)</u>
Effect of foreign currency exchange rate changes on cash and cash equivalents	<u>(3,094)</u>	<u>(1,090)</u>	<u>1,633</u>
Net decrease in cash and cash equivalents	(108,613)	(3,068)	(85,878)
Cash and cash equivalents, at beginning of period	166,956	170,024	255,902
Cash and cash equivalents, at end of period	58,343	166,956	170,024
Restricted cash, at end of period	—	—	4,350
Cash and cash equivalents and restricted cash, at end of period	<u>\$ 58,343</u>	<u>\$ 166,956</u>	<u>\$ 174,374</u>
Supplemental disclosure of cash flow information:			
Interest paid	\$ 217,081	\$ 165,495	\$ 136,533
Income taxes paid	18,358	14,830	14,283

See accompanying notes to consolidated financial statements.

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 young women, teens, tweens and kids. The Company is organized into two segments: North America and Europe. The Company has company-operated stores throughout the United States, Puerto Rico, Canada, the U.S. Virgin Islands and China (North America segment) and the United Kingdom, Switzerland, Austria, Germany, France, Ireland, Spain, Portugal, Netherlands, Belgium, Poland, Czech Republic, Hungary, Italy and Luxembourg (Europe segment). In January 2014, we made a decision to close our China stores, and are currently in the process of closing our 17 company-operated stores in that country.

Acquisition of Claire's Stores, Inc. - In May 2007, the Company was acquired by investment funds affiliated with, and co-investment vehicles managed by, Apollo Management VI, L.P. ("Apollo Management," and such funds and co-investment vehicles, the "Apollo Funds"), and Claire's Stores, Inc. became a wholly-owned subsidiary of Claire's Inc. (the "Acquisition").

The purchase of the Company and the payment of the related fees and expenses were financed through the Company's borrowings under a bank credit facility (the "Former Credit Facility"), the Company's issuance of senior and senior subordinated notes (the "Merger Notes"), equity contributions by the Apollo Funds and cash on hand at the Company. At the time of the Acquisition, the Company did not have any material indebtedness.

The closing of the Acquisition occurred simultaneously with:

- the closing of the Company's Former Credit Facility, consisting of a senior secured term loan facility (the "Former Term Loan") and a revolving credit facility (the "Former Revolver") of \$1.65 billion;
- the closing of the Company's Merger Notes offering in the aggregate principal amount of \$935.0 million; and
- the equity investment by the Apollo Funds, collectively, of approximately \$595.7 million.

The aforementioned transactions, including the Acquisition, the incurrence of indebtedness pursuant to the Former Credit Facility and the Merger Notes 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation - The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. 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 years ended February 1, 2014 ("Fiscal 2013") and January 28, 2012 ("Fiscal 2011") consisted of 52 weeks, respectively. The fiscal year ended February 2, 2013 ("Fiscal 2012") consisted of 53 weeks.

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, 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.

Cash and Cash Equivalents - The Company considers all highly liquid instruments purchased with an original maturity of 90 days or less to be cash equivalents. As of February 1, 2014, all cash equivalents were maintained in one money market fund that was invested exclusively in U.S. Treasury securities.

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 for North America and average cost method, at an individual item level, for Europe.

Prepaid Expenses - Prepaid expenses as of February 1, 2014 and February 2, 2013 included the following components (in thousands):

	February 1, 2014	February 2, 2013
Prepaid rent and occupancy	\$ 17,071	\$ 17,853
Prepaid insurance	438	636
Other	1,962	1,212
Total prepaid expenses	<u>\$ 19,471</u>	<u>\$ 19,701</u>

Other Current Assets - Other current assets as of February 1, 2014 and February 2, 2013 included the following components (in thousands):

	February 1, 2014	February 2, 2013
Credit card receivables	\$ 7,064	\$ 6,968
Franchise receivables	3,708	4,367
Store supplies	5,976	7,158
Deferred tax assets, net of valuation allowance	4,600	6,606
Income taxes receivable	4	37
Other	4,953	4,485
Total other current assets	<u>\$ 26,305</u>	<u>\$ 29,621</u>

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

Table of Contents

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 (Loss). 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 (Loss). 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. At the date of acquisition, the Company allocated the purchase price to assets and liabilities based on estimated fair market values and 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, at the Company's option, by first performing a qualitative assessment for any reporting unit for any period or by bypassing the qualitative assessment and proceeding directly to the first step of our two-step goodwill impairment test. If the Company determines, on the basis of qualitative factors, it is not more likely than not that the fair value of a reporting unit is less than the carrying value amount, then performing the two-step impairment test would be unnecessary. The first step of the two-step goodwill impairment test 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 of the two-step goodwill impairment test 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 – Goodwill and Other Intangible Assets.

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 (Loss). See Note 3 – Goodwill and Other Intangible Assets.

[Table of Contents](#)

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 (Loss), were \$8.2 million, \$9.9 million and \$13.1 million for Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively.

Other Assets - Other assets as of February 1, 2014 and February 2, 2013 included the following components (in thousands):

	February 1, 2014	February 2, 2013
Initial direct costs of leases	\$ 17,568	\$ 17,811
Prepaid lease payments	8,235	8,390
Deferred tax assets, non-current	4,244	1,152
Other	24,349	22,495
Total other assets	\$ 54,396	\$ 49,848

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 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.

Accrued Expenses and Other Current Liabilities – Accrued expenses and other current liabilities as of February 1, 2014 and February 2, 2013 included the following components (in thousands):

	February 1, 2014	February 2, 2013
Compensation and benefits	\$ 33,444	\$ 40,025
Gift cards and certificates	23,125	22,695
Sales and local taxes	17,441	15,708
Store rent	2,460	3,012
Other	18,257	18,089
Total accrued expenses and other current liabilities	\$ 94,727	\$ 99,529

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 (Loss).

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 (Loss). The franchise fees the Company charges under the franchising agreements are reported in “Other income, net” in the Company’s Consolidated Statements of Operations and Comprehensive Income (Loss).

Table of Contents

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 (Loss) 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 \$12.3 million, \$11.7 million and \$12.4 million, for Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively. All depreciation and amortization expense is reported on a separate financial statement line item on the Company’s Consolidated Statements of Operations and Comprehensive Income (Loss).

Advertising Expenses - The Company expenses advertising costs as incurred, including in-store marketing, mall association dues and digital interactive media. Advertising expenses were \$12.6 million, \$11.9 million and \$15.9 million for Fiscal 2013, Fiscal 2012 and Fiscal 2011, 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 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 6 – 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.

Buy one, get one (“BOGO”) options issued prior to May 2011 were immediately vested, exercisable upon issuance, and accounted for at fair value at date of grant. The compensation expense for these BOGOs was 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. BOGOs issued subsequent to May 2011 are accounted for at the fair value at date of grant and the compensation expense is recognized over the requisite service period.

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.

Table of Contents

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 10 – 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 the Company’s Consolidated Statements of Operations and Comprehensive Income (Loss). These foreign currency transaction losses (gains) were approximately \$0.3 million, \$(1.4) million and \$0.9 million, for Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively.

Comprehensive Income (Loss) - Comprehensive income (loss) 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 (loss) consists of net income (loss), foreign currency translation adjustments, gain (loss) on intra-entity foreign currency transactions, reclassification of foreign currency translation adjustments into net income (loss) and adjustments for derivative instruments accounted for as cash flow hedges. Amounts included in “Comprehensive income (loss)” are recorded net of income taxes.

Derivative Financial Instruments – The Company recognizes the fair value of derivative financial instruments in the Consolidated Balance Sheets. Gains 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 (loss). The ineffective portion of the change in fair value of a hedge is recognized in income immediately. The Company did not have any derivative instruments as of February 1, 2014 or February 2, 2013. See Note 5 – Derivatives and Hedging Activities for further information.

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.

[Table of Contents](#)

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

The Company does not have any assets (liabilities) measured at fair value on a recurring basis. The Company's former interest rate swap, which was previously measured at fair value on a recurring basis, was terminated on September 20, 2012.

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. There was no impairment of the Company's non-financial assets during Fiscal 2013, Fiscal 2012 and Fiscal 2011.

Financial Instruments Not Measured at Fair Value

The Company's financial instruments consist primarily of cash and cash equivalents, accounts receivable, current liabilities, and long-term debt. Cash and cash equivalents, accounts receivable, 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 consist of U.S. Treasury securities. The estimated fair value of the Company's long-term debt was approximately \$2.36 billion at February 1, 2014, compared to a carrying value of \$2.38 billion at that date. The estimated fair value of the Company's long-term debt was approximately \$2.41 billion at February 2, 2013, compared to a carrying value of \$2.37 billion at that date. For publicly-traded debt, the fair value (estimated market value) is based on quoted market prices in less active markets. For non-publicly traded debt, fair value is estimated based on quoted prices for similar instruments. If measured at fair value in the financial statements, long-term debt would be classified as Level 2 in the fair value hierarchy.

Recent Accounting Pronouncements – In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, which clarifies guidance and eliminates diversity in practice on the presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments in this ASU are effective for interim and annual fiscal periods beginning after December 15, 2013 and early adoption is permitted. The Company does not expect adoption of ASU 2013-11 will have a material impact on the Company's financial position, results of operations or cash flows.

In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles ("GAAP") to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account instead of directly to income or expense in the same reporting period. The amendments are effective prospectively for interim and annual periods beginning after December 15, 2012. The Company adopted this guidance in first quarter of Fiscal 2013 and it did not have any impact on the Company's financial position, results of operations or cash flows.

[Table of Contents](#)

In July 2012, the FASB issued ASU 2012-02, *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets 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. 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, then the entity is not required to take further action. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption is permitted. The Company adopted this guidance in the first quarter of Fiscal 2013 and it did not have any 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 position, results of operations or cash flows.

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

3. 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 2013 and Fiscal 2012 by reporting unit are as follows (in thousands):

	<u>North America</u>	<u>Europe</u>	<u>Total</u>
Balance as of February 1, 2014 and February 2, 2013:			
Goodwill	\$ 1,415,651	\$ 431,405	\$ 1,847,056
Accumulated impairment losses	(180,000)	(117,000)	(297,000)
	<u>\$ 1,235,651</u>	<u>\$ 314,405</u>	<u>\$ 1,550,056</u>

The carrying amount and accumulated amortization of identifiable intangible assets as of February 1, 2014 and February 2, 2013 were (in thousands):

	<u>Estimated Life in Years</u>	<u>February 1, 2014</u>		<u>February 2, 2013</u>	
		<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Intangible assets subject to amortization:					
Lease rights (1)	Lease terms ranging from 4 to 19	\$ 86,145	\$ (13,142)	\$ 85,125	\$ (10,758)
Franchise agreements	4 to 9	40,738	(23,005)	40,738	(19,813)
Favorable lease obligations	10	30,827	(28,509)	30,815	(26,690)
Other	5	872	(538)	718	(411)
Total intangible assets subject to amortization		158,582	(65,194)	157,396	(57,672)
Indefinite-lived intangible assets:					
Indefinite-lived tradenames		\$ 447,107	\$ —	\$ 447,109	\$ —
Indefinite-lived territory rights		600	—	600	—
Total indefinite-lived intangible assets		447,707	—	447,709	—
Total intangible assets		<u>\$ 606,289</u>	<u>\$ (65,194)</u>	<u>\$ 605,105</u>	<u>\$ (57,672)</u>

[Table of Contents](#)

- (1) Amounts include lease rights not currently subject to amortization of \$52,350 and \$53,998 as of February 1, 2014 and February 2, 2013, respectively.

For Fiscal 2013, Fiscal 2012 and Fiscal 2011, amortization expense of \$8.2 million, \$8.4 million and \$10.8 million, respectively, was recognized by the Company.

<u>Intangible Asset Acquisitions (in 000's)</u>	<u>Amortizable</u>	<u>Weighted Average Amortization Period for Amortizable Intangible Asset Acquisitions</u>
Lease rights:		
Fiscal 2013	\$ 1,389	10.0
Fiscal 2012	2,276	9.3
Fiscal 2011	1,855	9.9
Other:		
Fiscal 2013	154	5.0
Fiscal 2012	173	5.0
Fiscal 2011	46	5.0

The weighted average amortization period of amortizable intangible assets acquired in Fiscal 2013 was 9.5 years.

The remaining net amortization as of February 1, 2014 of identifiable intangible assets with finite lives by year is as follows (in thousands):

<u>Fiscal Year</u>	<u>Amortization</u>
2014	\$ 7,329
2015	6,202
2016	5,528
2017	5,011
2018	4,792
2019 and thereafter	12,176
Total	\$ 41,038

4. DEBT

Debt as of February 1, 2014 and February 2, 2013 included the following components (in thousands):

	<u>February 1, 2014</u>	<u>February 2, 2013</u>
Long-term debt:		
9.25% Senior fixed rate notes due 2015	\$ —	\$ 220,270
9.625%/10.375% Senior toggle notes due 2015	—	302,190
10.5% Senior subordinated notes due 2017	259,612	259,612
9.0% Senior secured first lien notes due 2019 ⁽¹⁾	1,139,174	1,141,294
8.875% Senior secured second lien notes due 2019	450,000	450,000
6.125% Senior secured first lien notes due 2020	210,000	—
7.75% Senior notes due 2020	320,000	—
Long-term debt	\$ 2,378,786	\$ 2,373,366
Obligation under capital lease (including current portion)	\$ 17,232	\$ 17,286

- (1) Amount includes unamortized premium of \$14,174 and \$16,294 as of February 1, 2014 and February 2, 2013, respectively.

[Table of Contents](#)

As of February 1, 2014, the Company's total debt maturities are as follows for each of the following fiscal years (in thousands):

	<u>Capital Leases</u>	<u>Debt</u>
2014	\$ 2,311	\$ —
2015	2,357	—
2016	2,404	—
2017	2,453	259,612
2018	2,502	—
Thereafter	30,272	2,105,000
Total	<u>42,299</u>	<u>\$2,364,612</u>
Imputed interest	(25,067)	
Present value of minimum capital lease principal payments	17,232	
Current portion	108	
Long-term capital lease obligation	<u>\$ 17,124</u>	

The Company's interest expense, net for Fiscal 2013, Fiscal 2012 and Fiscal 2011 included the following components (in thousands):

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Term loan facility	\$ —	\$ 17,644	\$ 38,226
Revolving credit facility	1,745	935	1,576
9.25% Senior fixed rate notes due 2015	6,021	20,663	20,663
9.625%/10.375% Senior toggle notes due 2015	9,895	29,493	32,263
10.5% Senior subordinated notes due 2017	27,191	27,642	27,118
9.0% Senior secured first lien notes due 2019 ⁽¹⁾	100,999	62,504	—
8.875% Senior secured second lien notes due 2019	39,838	40,716	36,120
6.125% Senior secured first lien notes due 2020	11,379	—	—
7.75% Senior notes due 2020	17,875	—	—
Note payable to bank	—	—	5,535
Capital lease obligation	2,205	2,203	2,151
Amortization of deferred debt issue costs	8,166	9,927	13,106
Accretion of debt premium	(2,120)	(831)	—
Other interest expense	232	99	98
Interest income	(65)	(198)	(381)
Interest expense, net	<u>\$ 223,361</u>	<u>\$ 210,797</u>	<u>\$ 176,475</u>

Accrued interest payable as of February 1, 2014 and February 2, 2013 consisted of the following components (in thousands):

	<u>February 1, 2014</u>	<u>February 2, 2013</u>
Revolving credit facility	\$ 78	\$ 75
9.25% Senior fixed rate notes due 2015	—	3,582
9.625%/10.375% Senior toggle notes due 2015	—	5,114
10.5% Senior subordinated notes due 2017	4,718	4,793
9.0% Senior secured first lien notes due 2019 ⁽¹⁾	38,942	39,220
8.875% Senior secured second lien notes due 2019	15,361	15,470
6.125% Senior secured first lien notes due 2020	4,947	—
7.75% Senior notes due 2020	4,292	—
Total accrued interest payable	<u>\$ 68,338</u>	<u>\$ 68,254</u>

LONG-TERM DEBT

Credit Facility

The Former Credit Facility was with a syndication of lenders and consisted of a \$1.45 billion senior secured Former Term Loan and a \$200.0 million senior secured Former Revolver. At the consummation of the Merger, the Company drew the full amount of the Former Term Loan 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. During Fiscal 2012, we issued \$1,142.1 million of the 9.0% Senior Secured First Lien Notes that mature on March 15, 2019 (the "9.0% Senior Secured First Lien Notes"). We used the net proceeds together with cash on hand, to repay \$1,154.3 million of indebtedness under the Former Term Loan.

On September 20, 2012, the Company terminated the Former Credit Facility and entered into an Amended and Restated Credit Agreement by and among Claire's Inc. ("Parent"), the Company, Credit Suisse AG, as Administrative Agent, and the other Lenders named therein (the "Credit Facility"), pursuant to which the Company replaced the \$200.0 million senior secured Former Revolver maturing May 29, 2013 with a \$115.0 million five-year senior secured revolving credit facility maturing in 2017.

Borrowings under the Credit Facility will 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) the prime rate in effect on such day, (2) the federal funds effective rate plus 0.50% and (3) the one-month LIBOR rate plus 1.00%, 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 of 4.50% for LIBOR rate loans and 3.50% for alternate base rate loans. The Company will also pay a facility fee of 0.50% per annum of the committed amount of the Credit Facility whether or not utilized.

All obligations under the Credit Facility are unconditionally guaranteed by (i) Parent, prior to an initial public offering of the Company's stock, and (ii) the Company's existing and future direct or indirect 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 and permitted liens, by a first priority lien on, (i) all of the Company's capital stock, prior to an initial public offering of its stock, and (ii) substantially all of the Company's material owned assets and the material owned assets of subsidiary guarantors, limited in the case of equity interests held by the Company or any subsidiary guarantor in a foreign subsidiary, to 100% of the non-voting equity interests and 65% of the voting equity interests of such foreign subsidiary held directly by the Company or a subsidiary guarantor. The liens securing the Credit Facility rank equally to the liens securing the 9.0% Senior Secured First Lien Notes (described below) and the 6.125% Senior Secured First Lien Notes (described below), and senior to those securing the Senior Secured Second Lien Notes (described below).

The 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 except that, when the revolving loans and letters of credit outstanding exceed \$15.0 million, the Company will be required to comply with a maximum Total Net Secured Leverage Ratio of 5.5 to 1.0 based upon the ratio of its net senior secured first lien debt to adjusted earnings before interest, taxes, depreciation and amortization for the period of four consecutive fiscal quarters most recently ended. As of February 1, 2014, our Total Net Secured Leverage Ratio was 5.0 to 1.0. In addition, under the Credit Facility, the Company must comply with this maximum Total Net Secured Leverage Ratio requirement, measured as of the most recent four consecutive quarter period for which financial statements have been (or were required to be) delivered to our lenders, at any time we request a borrowing that would result in such outstanding amount exceeding \$15.0 million.

At February 1, 2014 and February 2, 2013, there were no borrowings outstanding under the Credit Facility. The Company must also pay customary letter of credit fees and agency fees. As of February 1, 2014, the Company had \$6.3 million of letters of credit outstanding.

[Table of Contents](#)

The Credit Facility also contains various covenants that limit our ability to engage in specified types of transactions. These covenants limit the Company's Parent's and the Company's 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;
- 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 the Company's other indebtedness. If the Company were unable to repay those amounts, the lenders under the Credit Facility could proceed against the collateral granted to them to secure that indebtedness.

10.50% Senior Subordinated Notes

In connection with the Transactions, the Company issued \$335.0 million of 10.50% Senior Subordinated Notes due 2017 (the "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. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X.

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:

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

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.

8.875% 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 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 Credit Facility. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. 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:

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

The Company may also redeem the Senior Secured Second Lien Notes prior to March 15, 2015, subject to certain notice periods, at a price equal to 100% of the principal amount of the Senior Secured Second Lien Notes redeemed plus an applicable premium and accrued and unpaid interest, if any.

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 Former Revolver (without terminating the commitment) and to repay \$241.0 million indebtedness under the Former Term Loan.

9.0% Senior Secured First Lien Notes

On February 28, 2012, the Company issued \$400.0 million aggregate principal amount of the 9.0% 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 9.0% Senior Secured First Lien Notes at a price equal to 101.50% of the principal amount. On September 20, 2012, the Company issued an additional \$625.0 million aggregate principal amount of the same series of 9.0% Senior Secured First Lien Notes at a price equal to 102.50% of the principal amount.

Interest on the 9.0% 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 9.0% 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. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. The 9.0% Senior Secured First Lien Notes and related guarantees are secured, subject to certain exceptions and permitted liens, by a first priority lien on substantially all of the Company's material owned assets and the material owned assets of subsidiary guarantors, limited in the case of equity interests held by the Company or any subsidiary guarantor in a foreign subsidiary, to 100% of the non-voting equity interests and 65% of the voting equity interests of such foreign subsidiary held directly by the Company or a subsidiary guarantor. The liens securing the 9.0% Senior Secured First Lien Notes rank equally to the liens securing the Credit Facility and the 6.125% Senior Secured First Lien Notes (described below), and senior to those securing the Senior Secured Second Lien Notes. The 9.0% Senior Secured First Lien Notes are subject to customary covenants, (described below), and events of default.

[Table of Contents](#)

On or after March 15, 2015, the Company may redeem the 9.0% Senior Secured First 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:

<u>Period</u>	<u>Redemption Price</u>
2015	106.750%
2016	104.500%
2017	102.250%
2018 and thereafter	100.000%

In addition, prior to March 15, 2015, the Company may redeem in the aggregate up to 35% of the original aggregate principal amount of the 9.0% Senior Secured First Lien Notes with the net cash proceeds of certain equity offerings at a redemption price of 109.000%, plus accrued unpaid interest. The Company may also redeem 9.0% Senior Secured First Lien Notes prior to March 15, 2015, subject to certain notice periods, at a price equal to 100% of the principal amount of the 9.0% Senior Secured First Lien Notes redeemed plus an applicable premium and accrued and unpaid interest, if any.

The Company used the proceeds of the offerings of the 9.0% Senior Secured First Lien Notes to reduce \$1,154.3 million of indebtedness under the Former Term Loan, and to pay \$28.0 million in financing costs which have been recorded as Deferred financing costs, net in the accompanying Consolidated Balance Sheets.

6.125% Senior Secured First Lien Notes

On March 15, 2013, the Company issued \$210.0 million aggregate principal amount of 6.125% senior secured first lien notes that mature on March 15, 2020 (the “6.125% Senior Secured First Lien Notes”). The notes were issued at a price equal to 100.00% of the principal amount.

Interest on the 6.125% Senior Secured First Lien Notes is payable semi-annually to holders of record at the close of business on March 1 and September 1 immediately preceding the interest payment date on March 15 and September 15 of each year, commencing on September 15, 2013. The 6.125% 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. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. The 6.125% Senior Secured First Lien Notes and related guarantees are secured, subject to certain exceptions and permitted liens, by a first-priority lien on substantially all of the assets of the Company’s material owned assets and the material owned assets of subsidiary guarantors, limited in the case of equity interests held by the Company or any subsidiary guarantor in a foreign subsidiary, to 100% of the non-voting equity interest and 65% of the voting equity interest of such foreign subsidiary held directly by the Company or a subsidiary guarantor. The liens rank equally with those securing the Credit Facility and the 9.0% Senior Secured First Lien Notes, and senior to those securing the Senior Secured Second Lien Notes.

On or after March 15, 2017, the Company may redeem the 6.125% Senior Secured First 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:

<u>Period</u>	<u>Redemption Price</u>
2017	103.063%
2018	101.531%
2019 and thereafter	100.000%

[Table of Contents](#)

In addition, prior to March 15, 2016, the Company may redeem in the aggregate up to 35% of the original aggregate principal amount of the 6.125% Senior Secured First Lien Notes with the net cash proceeds of certain equity offerings at a redemption price of 106.125%, plus accrued and unpaid interest. The Company may also redeem 6.125% Senior Secured First Lien Notes prior to March 15, 2017, subject to certain notice periods, at a price equal to 100% of the principal amount of the 6.125% Senior Secured First Lien Notes redeemed plus an applicable premium and accrued and unpaid interest.

The Company used approximately \$61.7 million of the net proceeds of the offering of the 6.125% Senior Secured First Lien Notes to purchase approximately \$60.5 million aggregate principal amount of the Company's 9.25% Senior Fixed Rate Notes due 2015 and 9.625%/10.375% Senior Toggle Notes due 2015 (collectively, the "Senior Notes"), and to pay related fees and premiums pursuant to a tender offer for such Senior Notes, including \$4.0 million in financing costs which have been recorded as "Deferred financing costs, net" in the accompanying Consolidated Balance Sheet. The remaining net proceeds, together with cash on hand, were to repurchase the remaining outstanding \$149.5 million aggregate principal amount of Senior Notes on June 3, 2013, pursuant to the redemption provisions applicable to the Senior Notes.

7.75% Senior Notes

On May 14, 2013, the Company issued \$320.0 million aggregate principal amount of 7.75% senior notes that mature on June 1, 2020 (the "7.75% Senior Notes"). The 7.75% Senior Notes were issued at a price equal to 100.00% of the principal amount.

Interest on the 7.75% Senior Notes is payable semi-annually to holders of record at the close of business on May 15 and November 15 immediately preceding the interest payment date on June 1 and December 1 of each year, commencing on December 1, 2013. The 7.75% Senior Notes are guaranteed by all of the Company's existing and future direct or indirect wholly-owned domestic subsidiaries. These guarantees are full and unconditional as defined in Rule 3-10(h)(2) of Regulation S-X. The 7.75% Senior Notes and related guarantees are unsecured and will: (i) rank equal in right of payment with all of our existing and future indebtedness, (ii) rank senior to any of our existing and future indebtedness that is expressly subordinated to the 7.75% Senior Notes, and (iii) rank junior in priority to our obligations under all of our secured indebtedness, including the Credit Facility, the Senior Secured Second Lien Notes, the 9.0% Senior Secured First Lien Notes and the 6.125% Senior Secured First Lien Notes, to the extent of the value of assets securing such indebtedness.

On or after June 1, 2016, the Company may redeem the 7.75% Senior 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:

<u>Period</u>	<u>Redemption Price</u>
2016	103.875%
2017	101.938%
2018 and thereafter	100.000%

Prior to June 1, 2016, the Company may redeem in the aggregate up to 35% of the original aggregate principal amount of the 7.75% Senior Notes with the net cash proceeds of certain equity offerings other than an initial public offering that is consummated prior to December 1, 2014, at a redemption price of 107.750%, plus accrued and unpaid interest. In addition, within sixty days of the closing of an initial

Table of Contents

public offering occurring prior to December 1, 2014, the Company may redeem in the aggregate up to 100% of the original aggregate principal amount of the 7.75% Senior Notes, at a redemption price of 103.000%, plus accrued and unpaid interest.

The Company may also redeem 7.75% Senior Notes prior to June 1, 2016, subject to certain notice periods, at a price equal to 100% of the principal amount of the 7.75% Senior Notes redeemed plus an applicable premium and accrued and unpaid interest.

The Company used the net proceeds of the offering of the 7.75% Senior Notes to redeem all outstanding \$31.8 million aggregate principal amount of Senior Fixed Rate Notes and all outstanding \$280.7 million aggregate principal amount of Senior Toggle Notes on June 13, 2013 pursuant to the redemption provisions applicable to such notes.

Note Repurchases and Gain (Loss) in Early Debt Extinguishment

The following is a summary of the Company's note repurchase activity during Fiscal 2013 and Fiscal 2011 (in thousands). All debt repurchases in Fiscal 2013 were pursuant to the tender offer and note redemptions described above. There was no debt repurchase activity during Fiscal 2012.

<u>Notes Repurchased</u>	<u>Fiscal 2013</u>		
	<u>Principal Amount</u>	<u>Repurchase Price</u>	<u>Recognized Loss (1)</u>
Senior Fixed Rate Notes	\$ 220,270	\$ 219,802	\$ 2,597
Senior Toggle Notes	302,190	301,947	2,198
	<u>\$ 522,460</u>	<u>\$ 521,749</u>	<u>\$ 4,795</u>

- (1) Net of deferred issuance cost write-offs of \$1,829 for the Senior Fixed Rate Notes and \$1,766 for the Senior Toggle Notes and tender premiums and fees of \$1,236 for the Senior Fixed Rate Notes and \$675 for the Senior Toggle Notes.

During Fiscal 2012, the Company recognized a \$9.7 million loss on early debt extinguishment attributed to the write-off of unamortized debt issuance costs associated with the early repayment of indebtedness under the former senior secured term loan facility and replacement of the \$200.0 million senior secured revolving credit facility.

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

- (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.

Note Covenants

The Senior Subordinated Notes, Senior Secured Second Lien Notes, 9.0% Senior Secured First Lien Notes, 6.125% Senior Secured First Lien Notes, and 7.75% Senior Notes (collectively, the "Notes") contain certain covenants that, among other things, are subject to certain exceptions and other basket amounts. These exceptions and basket amounts are intended to provide the Company flexibility to operate its business in the ordinary course. These covenants restrict the ability of the Company and its subsidiaries to:

- incur additional indebtedness;
- pay dividends or distributions on its capital stock, repurchase or retire its capital stock and redeem, repurchase or defease any subordinated indebtedness;
- make certain investments;

[Table of Contents](#)

- create or incur certain liens;
- create restrictions on the payment of dividends or other distributions to us from the Company's subsidiaries;
- transfer or sell assets;
- engage in certain transactions with its affiliates; and
- 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.

Europe Credit Facilities

The Company's non-U.S. subsidiaries have bank credit facilities totaling approximately \$2.5 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 February 1, 2014, there was a reduction of \$2.4 million for outstanding bank guarantees, which reduces the borrowing availability to \$0.1 million as of that date.

5. DERIVATIVES AND HEDGING ACTIVITIES

The Company does not have any derivative and hedging activity since September 20, 2012 when the Company terminated its former interest rate swap. During periods when the Company had the interest rate swap, it followed the accounting treatment described below.

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 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 2012 and Fiscal 2011, 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 (Loss).

[Table of Contents](#)

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 (Loss) at that time.

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 2012 and Fiscal 2011 (in thousands):

<u>Derivatives in Cash Flow Hedging Relationships</u>	<u>Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)</u>	
	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Interest Rate Swap	\$ 375	\$ (993)

<u>Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</u>	<u>Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) (1)</u>	
	<u>Fiscal 2012(2)</u>	<u>Fiscal 2011</u>
Interest expense, net	\$ (2,620)	\$ (1,839)

- (1) Represents reclassification of amounts from accumulated other comprehensive income (loss) into earnings as interest expense is recognized on the Former Term Loan. No ineffectiveness is associated with the interest rate cash flow hedges.
- (2) Includes a reclassification amount of \$1,784 from accumulated other comprehensive income (loss) into interest expense resulting from the termination of the former interest rate swap.

6. 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 2013, Fiscal 2012 and Fiscal 2011 is set forth below (in thousands):

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Minimum store rentals	\$229,937	\$217,777	\$212,519
Store rentals based on net sales	2,550	3,224	3,152
Other rental expense	11,314	9,312	11,352
Total rental expense	<u>\$ 243,801</u>	<u>\$ 230,313</u>	<u>\$ 227,023</u>

[Table of Contents](#)

Minimum aggregate rental commitments as of February 1, 2014 under non-cancelable operating leases are summarized by fiscal year as follows (in thousands):

2014	\$ 222,364
2015	192,087
2016	158,412
2017	124,034
2018	97,270
Thereafter	288,541
Total	<u>\$ 1,082,708</u>

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 \$5.4 million and \$5.1 million as of February 1, 2014 and February 2, 2013, 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.

[Table of Contents](#)

7. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following summary sets forth the components of accumulated other comprehensive income (loss), net of tax for Fiscal 2013, Fiscal 2012 and Fiscal 2011 (in thousands, net of tax):

	Foreign Currency Translation	Derivative Instruments	Total
Balance as of January 29, 2011	\$ (3,150)	\$ 4,566	\$ 1,416
Foreign currency translation adjustment	(663)	—	(663)
Net loss on intra-entity foreign currency transactions, net of tax (benefit) of \$(171)	(4,111)	—	(4,111)
Unrealized gain on interest rate swap, net of tax of \$0	—	(993)	(993)
Balance as of January 28, 2012	(7,924)	3,573	(4,351)
Foreign currency translation adjustment	1,182	—	1,182
Net gain on intra-entity foreign currency transactions, net of tax of \$142	4,283	—	4,283
Unrealized gain on interest rate swap, net of tax of \$0	—	375	375
Reclassification adjustment of unrealized loss on termination of interest rate swap into net income, net of tax of \$0	—	1,784	1,784
Balance as of February 2, 2013	(2,459)	5,732	3,273
Foreign currency translation adjustment	(940)	—	(940)
Net loss on intra-entity foreign currency transactions, net of tax (benefit) of \$(36)	(3,442)	—	(3,442)
Balance as of February 1, 2014	\$ (6,841)	\$ 5,732	\$ (1,109)

There were no income tax effects on other comprehensive income (loss) related to unrealized losses on foreign currency translation adjustments in Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively.

8. STOCK OPTIONS AND STOCK-BASED COMPENSATION

On June 29, 2007, the Board of Directors and stockholders of Parent 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 Parent 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 February 1, 2014, 3,033,434 shares were available for future grants. The Board of Directors of Parent 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 2013, Fiscal 2012 and Fiscal 2011 was \$1.1 million, \$(1.1) million and \$(1.6) million, respectively. During Fiscal 2013 and Fiscal 2012, the Company recorded reversals of stock compensation expense of \$1.4 million and \$3.2 million, respectively, associated with forfeitures of stock options, including \$1.7 million for our former executive officers in Fiscal 2012. Related income tax expense (benefit) of approximately \$(0.4) million, \$0.4 million and \$0.6 million were recognized in Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively. Stock-based compensation is recorded in "Selling, general and administrative expenses" in the Company's Consolidated Statements of Operations and Comprehensive Income (Loss).

[Table of Contents](#)

Performance Based Stock Option Exchange Offer

On June 15, 2012, Parent commenced an offer (the “Exchange Offer”) to exchange certain performance based stock options held by employees of the Company for new performance based stock options (the “New Options”) granted on a 1 for 2 basis. The Exchange Offer was completed on July 16, 2012. The New Options expire on July 16, 2019.

The New Options issued under the Exchange Offer provide for the following performance condition:

- Vest in equal installments on the first two anniversaries after the first to occur of:
 - (i) the date of an initial public offering (“IPO”) at a price of at least \$25 per share,
 - (ii) any date following an IPO when the average stock price over the preceding 30 consecutive trading days exceeds \$25, or
 - (iii) any date before an IPO where more than 25% of the outstanding shares of the Parent are sold for cash or marketable consideration having a value of at least \$25 per share;
- Vest immediately if, on or after the occurrence of an event described in (i), (ii) or (iii), but prior to the second anniversary thereof, there occurs a change of control of Parent.

The Exchange Offer resulted in \$1.2 million in total incremental compensation cost that will be recognized when a performance condition occurs. The Exchange Offer affected approximately 125 employees.

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.

[Table of Contents](#)**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. 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 Parent 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 2013, Fiscal 2012 and Fiscal 2011, the Board of Directors approved the grant of approximately 786,690, 3,025,164 and 713,800, respectively, of similar stock options. The Company recognized stock-based compensation expense (benefit) of \$0.9 million, \$(1.2) million and \$(2.2) million in Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively, related to Time and Performance Options.

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 2013, Fiscal 2012, and Fiscal 2011, the Board of Directors granted 70,000, 55,000 and 186,000, respectively, BOGO options. The Company recognized stock-based compensation expense of \$0.1 million, \$0.2 million and \$0.5 million in Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively, related to these options.

The following is a summary of activity in the Company's stock option plan from February 2, 2013 through February 1, 2014:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (Years)</u>
Outstanding as of February 2, 2013	5,027,665	\$ 10.00	
Options granted	856,690	\$ 10.00	
Options exercised	—	—	
Options forfeited	(474,937)	\$ 10.00	
Options expired	<u>(242,852)</u>	\$ 10.00	
Outstanding as of February 1, 2014	<u>5,166,566</u>	\$ 10.00	4.2
Options vested and expected to vest as of February 1, 2014	<u>4,689,599</u>	\$ 10.00	4.0
Exercisable at end of period	<u>2,058,356</u>	\$ 10.00	2.0

[Table of Contents](#)

The weighted average grant date fair value of options granted in Fiscal 2013, Fiscal 2012 and Fiscal 2011 was \$3.43, \$1.61 and \$2.63, respectively.

As of February 1, 2014, there was \$2.5 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 2.8 years.

For options granted during Fiscal 2013, Fiscal 2012 and Fiscal 2011, 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:

<u>Time Options and BOGO Options (Black-Scholes)</u>	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Expected dividend yield	0.00%	0.00%	0.00%
Weighted average expected stock price volatility	54.01%	59.96%	58.79%
Weighted average risk-free interest rate	0.77%	0.70%	1.23%
Range of risk-free interest rate	0.63% - 1.61%	0.56% - 1.04%	0.69% - 2.20%
Weighted average expected term (years)	4.70	4.92	4.57

<u>Performance Options (Monte Carlo)</u>	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Expected dividend yield	0.00%	0.00%	0.00%
Weighted average expected stock price volatility	53.66%	54.19%	55.61%
Weighted average risk-free interest rate	1.07%	0.81%	1.63%
Range of risk-free interest rate	0.92% - 1.63%	0.53% - 1.56%	1.24% - 2.59%
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.

Parent will issue new shares to satisfy exercise of stock options. During Fiscal 2013, Fiscal 2012 and Fiscal 2011, 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, Parent 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 vested 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 approximated \$15,000. At January 28, 2012, all restricted shares were vested and unearned stock-based compensation related to these shares was \$0.

9. 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 2013, Fiscal 2012 and Fiscal 2011.

[Table of Contents](#)

10. INCOME TAXES

The components of income (loss) before income taxes for Fiscal 2013, Fiscal 2012 and Fiscal 2011 were as follows (in thousands):

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
U.S.	\$(116,323)	\$(58,274)	\$(24,910)
Foreign	59,939	73,938	47,178
Total income (loss) before income taxes	<u>\$ (56,384)</u>	<u>\$ 15,664</u>	<u>\$ 22,268</u>

The components of income tax expense (benefit) for Fiscal 2013, Fiscal 2012 and Fiscal 2011 were as follows (in thousands):

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Federal:			
Current	\$ —	\$ —	\$ 107
Deferred	(1,837)	(852)	109
	<u>(1,837)</u>	<u>(852)</u>	<u>216</u>
State			
Current	785	762	1,477
Deferred	65	49	(84)
	<u>850</u>	<u>811</u>	<u>1,393</u>
Foreign			
Current	12,375	14,707	10,608
Deferred	(2,465)	(284)	(1,581)
	<u>9,910</u>	<u>14,423</u>	<u>9,027</u>
Total income tax expense	<u>\$ 8,923</u>	<u>\$ 14,382</u>	<u>\$ 10,636</u>

The provision for income taxes for Fiscal 2013, Fiscal 2012 and Fiscal 2011 differs from an amount computed at the statutory federal rate as follows:

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
U.S. income taxes at statutory federal rate	35.0%	35.0%	35.0%
Foreign rate differential	26.2	(114.3)	(41.4)
Valuation allowance	(66.0)	93.5	16.1
Earnings of foreign subsidiaries	(19.4)	86.5	27.3
State and local income taxes, net of federal tax benefit	3.3	(17.2)	5.9
Change in accrual for estimated tax contingencies	3.3	(5.4)	0.5
Other, net	1.8	13.7	4.4
	<u>(15.8)%</u>	<u>91.8%</u>	<u>47.8%</u>

In Fiscal 2013, the Company's income tax expense was \$8.9 million and its effective income tax rate was (15.8)%, including income tax expense of \$37.2 million related to the effect of changes to its valuation allowance on deferred tax assets. In Fiscal 2012, the Company's income tax expense was \$14.4 million and its effective income tax rate was 91.8%, including income tax expense of \$14.7 million related to the effect of changes to its valuation allowance on deferred tax assets. 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.

The effective income tax rates for Fiscal 2013, Fiscal 2012 and Fiscal 2011 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 interest payments, and other permanent book to tax return adjustments.

[Table of Contents](#)

The tax effects on the significant components of the Company's net deferred tax asset (liability) as of February 1, 2014 and February 2, 2013 are as follows (in thousands):

	<u>February 1, 2014</u>	<u>February 2, 2013</u>
Deferred tax assets:		
Tax carryforwards	\$ 195,502	\$ 107,347
Debt related	—	25,163
Compensation and benefits	9,369	11,026
Deferred rent	7,842	7,446
Depreciation	1,998	4,867
Accrued expenses	3,836	4,890
Gift cards	2,857	2,832
Inventory	1,318	1,172
Other	407	233
Total gross deferred tax assets	223,129	164,976
Valuation allowance	(171,570)	(137,965)
Total deferred tax assets, net	<u>51,559</u>	<u>27,011</u>
Deferred tax liabilities:		
Tradename intangibles	110,569	110,569
Earnings from foreign subsidiaries	31,452	21,508
Debt related	12,944	—
Lease rights	7,099	7,823
Other	215	321
Total deferred tax liabilities	<u>162,279</u>	<u>140,221</u>
Net deferred tax liability	<u>\$ (110,720)</u>	<u>\$ (113,210)</u>

The deferred tax assets and deferred tax liabilities as of February 1, 2014 and February 2, 2013 are as follows (in thousands):

	<u>February 1, 2014</u>	<u>February 2, 2013</u>
Current deferred tax assets, net of valuation allowance	\$ 4,600	\$ 6,606
Non-current deferred tax assets	4,244	1,152
Non-current deferred tax liabilities, net of valuation allowance	(119,564)	(120,968)
Net deferred tax liability	<u>\$ (110,720)</u>	<u>\$ (113,210)</u>

The amount and expiration dates of operating loss and tax credit carryforwards as of February 1, 2014 are as follows (in thousands):

	<u>Amount</u>	<u>Expiration Date</u>
U.S. federal net operating loss carryforwards	\$ 132,550	2028 – 2034
Non-U.S. net operating loss carryforwards	14,491	2015 – 2031
Non-U.S. net operating loss carryforwards	9,614	Indefinite
State net operating loss carryforwards	11,575	2014 – 2034
U.S. foreign tax credits	27,272	2019 – 2024
Total	<u>\$ 195,502</u>	

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.

In Fiscal 2013, the Company recorded an increase of \$32.0 million in valuation allowance against deferred tax assets in the U.S. In Fiscal 2012, the Company recorded an increase of \$9.4 million in

[Table of Contents](#)

valuation allowance against deferred tax assets in the U.S. 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 2008, the Company recorded a charge of \$95.8 million to establish a valuation allowance against its deferred tax assets in the U.S. 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 2013, Fiscal 2012 and Fiscal 2011 was an increase of \$33.6 million, an increase of \$13.7 million and an increase of \$4.0 million, respectively.

U.S. income taxes have not been recognized on the balance of accumulated unremitted earnings from the Company's foreign subsidiaries at February 1, 2014 of \$226.4 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 February 1, 2014. 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 \$10.9 million, \$13.5 million and \$6.1 million in Fiscal 2013, Fiscal 2012 and Fiscal 2011 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):

	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Beginning balance	\$ 11,229	\$ 12,435	\$ 12,670
Additions based on tax positions related to the current year	1,354	1,241	1,163
Additions for tax positions of prior years	—	—	77
Reductions for tax positions of prior years	(18)	—	(370)
Statute expirations	(2,745)	(2,026)	(815)
Settlements	—	(421)	(290)
Ending balance	<u>\$ 9,820</u>	<u>\$ 11,229</u>	<u>\$ 12,435</u>

The amount of unrecognized tax benefits as of February 1, 2014 of \$9.8 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 \$2.8 million and \$3.2 million for the payment of interest and penalties accrued as of February 1, 2014 and February 2, 2013, respectively, and are classified as "Unfavorable lease obligations and other long-term liabilities" in the Company's Consolidated Balance Sheets. For Fiscal 2013, Fiscal 2012 and Fiscal 2011, the Company recognized \$(0.4) million, \$(0.2) million and \$0.3 million, respectively, in interest and penalties.

In April 2011, the Company received from the Canada Revenue Agency withholding tax assessments for 2003 through 2007 of approximately \$5.2 million, including penalties and interest. In conjunction with this assessment, a security deposit will be required in the amount of approximately \$5.2 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, 2013, the Internal Revenue Service concluded its tax examination of our U.S. Federal income tax return for Fiscal 2008 and Fiscal 2009 and did not assess any additional tax liability.

[Table of Contents](#)

The Company files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company is no longer subject to U.S. federal income tax examinations for years before Fiscal 2010, and with few exceptions, for state, and local, or non-U.S. income tax examinations for years before Fiscal 2006. We have also concluded tax examinations in our significant foreign tax jurisdictions including the United Kingdom through Fiscal 2008, France through Fiscal 2004, and Canada through Fiscal 2006.

The Company does not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

11. RELATED PARTY TRANSACTIONS

Upon consummation of the Merger, the Company entered into a management services agreement with Apollo Management and Tri-Artisan Capital Partners, LLC, a member of one of the co-investment vehicles managed by Apollo Management (“Tri-Artisan”). Under this management services agreement, Apollo Management and Tri-Artisan 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 plus reimbursement of out-of-pocket expenses. Under this management services agreement, Apollo Management and Tri-Artisan 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 Tri-Artisan. Under this management services agreement, the Company also agreed to provide customary indemnification. The Company paid Apollo Management and Tri-Artisan \$3.1 million in Fiscal 2013 and \$3.0 million in each of Fiscal 2012 and Fiscal 2011 for fees and out-of-pocket expenses. These amounts are included in “Selling, general and administrative expenses” in the Company’s Consolidated Statements of Operations and Comprehensive Income (Loss).

The initial purchasers of the 6.125% Senior Secured First Lien Notes on March 15, 2013 and the 7.75% Senior Notes on May 14, 2013 included Apollo Global Securities, LLC, an affiliate of the Apollo Funds, which is the Company’s controlling stockholder. In connection with the issuance of the 6.125% Senior Secured First Lien Notes and the 7.75% Senior Notes the Company paid fees in the aggregate amount of approximately \$0.4 million to Apollo Global Securities, LLC.

The initial purchasers of the 9.0% Senior Secured First Lien Notes on February 28, 2012 included 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 9.0% 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.

The initial purchasers of the Senior Secured Second Lien Notes on March 4, 2011, included 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.

The Company paid store planning and retail design fees to a business owned by a family member of one of the Company’s former 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 (Loss). During the time that the former executive officer was employed by the Company, the Company paid fees of approximately \$0.8 million and \$1.5 million for Fiscal 2012 and Fiscal 2011, respectively. This arrangement was approved by the Audit Committee of the Board of Directors.

[Table of Contents](#)

12. SELECTED QUARTERLY FINANCIAL DATA

(Unaudited, in thousands)

	Fiscal 2013				
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total Year
Net sales	\$354,006	\$366,703	\$356,938	\$435,530	\$1,513,177
Gross profit	175,440	185,730	174,491	223,885	759,546
Severance and transaction related costs	915	889	978	2,336	5,118
Loss on early debt extinguishment	(1,674)	(3,121)	—	—	(4,795)
Interest expense, net	58,219	57,755	53,210	54,177	223,361
Income tax (benefit) expense (a)	(720)	4,118	2,873	2,652	8,923
Net income (loss)	(26,584)	(20,672)	(25,466)	7,415	(65,307)

(a) Includes a \$37.2 million charge for an increase in the valuation allowance related to deferred tax assets.

	Fiscal 2012				
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total Year
Net sales	\$340,617	\$359,617	\$363,388	\$493,398	\$1,557,020
Gross profit	166,614	181,751	183,805	268,854	801,024
Severance and transaction related costs	53	1,144	(29)	1,660	2,828
Loss on early debt extinguishment	(4,602)	—	(5,105)	—	(9,707)
Interest expense, net	47,022	48,879	54,042	60,854	210,797
Income tax (benefit) expense (b)	(870)	3,048	4,398	7,806	14,382
Net income (loss)	(19,921)	(7,273)	(13,730)	42,206	1,282

(b) Includes a \$14.7 million charge for an increase in the valuation allowance related to deferred tax assets.

13. 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 (Loss) within its North America division. The franchise fees the Company charges under the franchising agreements are reported in “Other income, net” in the Company’s Consolidated Statements of Operations and Comprehensive Income (Loss) within its Europe division. 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 2013	Fiscal 2012	Fiscal 2011
Net sales:			
North America	\$918,687	\$977,310	\$942,278
Europe	594,490	579,710	553,622
Total net sales	<u>\$1,513,177</u>	<u>\$1,557,020</u>	<u>\$1,495,900</u>
Depreciation and amortization:			
North America	\$43,159	\$39,829	\$41,650
Europe	30,812	25,050	27,103
Total depreciation and amortization	<u>\$73,971</u>	<u>\$64,879</u>	<u>\$68,753</u>

[Table of Contents](#)

	Fiscal 2013	Fiscal 2012	Fiscal 2011
Segment operating income:			
North America	\$ 120,656	\$ 173,568	\$ 153,121
Europe	56,234	65,428	46,145
Total segment operating income	<u>\$ 176,890</u>	<u>\$ 238,996</u>	<u>\$ 199,266</u>
Interest expense, net:			
North America	\$ 223,345	\$ 210,224	\$ 171,211
Europe	16	573	5,264
Total interest expense, net	<u>\$ 223,361</u>	<u>\$ 210,797</u>	<u>\$ 176,475</u>
Income (loss) before income taxes:			
North America	\$ (110,587)	\$ (48,554)	\$ (15,637)
Europe	54,203	64,218	37,905
Total income (loss) before income taxes	<u>\$ (56,384)</u>	<u>\$ 15,664</u>	<u>\$ 22,268</u>
Income tax expense (benefit):			
North America	\$ (563)	\$ 874	\$ 1,883
Europe	9,486	13,508	8,753
Total income tax expense	<u>\$ 8,923</u>	<u>\$ 14,382</u>	<u>\$ 10,636</u>
Net income (loss):			
North America	\$ (110,024)	\$ (49,428)	\$ (17,520)
Europe	44,717	50,710	29,152
Net income (loss)	<u>\$ (65,307)</u>	<u>\$ 1,282</u>	<u>\$ 11,632</u>
Goodwill:			
North America	\$1,235,651	\$1,235,651	\$1,235,651
Europe	314,405	314,405	314,405
Total goodwill	<u>\$1,550,056</u>	<u>\$1,550,056</u>	<u>\$1,550,056</u>
Long-lived assets:			
North America	\$ 165,916	\$ 140,269	\$ 135,555
Europe	97,687	96,458	88,215
Total long lived assets	<u>\$ 263,603</u>	<u>\$ 236,727</u>	<u>\$ 223,770</u>
Total assets:			
North America	\$ 1,374,772	\$ 1,448,412	\$ 1,402,946
Europe	1,356,860	1,350,860	1,360,079
Total assets	<u>\$ 2,731,632</u>	<u>\$ 2,799,272</u>	<u>\$ 2,763,025</u>
Capital Expenditures			
North America	\$ 68,778	\$ 41,924	\$ 33,830
Europe	30,216	31,929	42,787
Total capital expenditures	<u>\$ 98,994</u>	<u>\$ 73,853</u>	<u>\$ 76,617</u>

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).

	Fiscal 2013	Fiscal 2012	Fiscal 2011
Total segment operating income	\$176,890	\$238,996	\$199,266
Severance and transaction-related costs	5,118	2,828	6,928
Consolidated operating income	<u>\$ 171,772</u>	<u>\$ 236,168</u>	<u>\$ 192,338</u>

For Fiscal 2013, Fiscal 2012 and Fiscal 2011, segment operating income also excludes severance and transaction-related costs for North America of \$3.1 million, \$2.2 million and \$3.9 million, respectively, and for Europe of \$2.0 million, \$0.6 million and \$3.0 million, respectively.

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.

[Table of Contents](#)

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

<u>Product Category</u>	<u>Percentage of Total</u>		
	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Jewelry:			
North America	32.4	32.7	31.8
Europe	17.0	15.2	14.3
	<u>49.4</u>	<u>47.9</u>	<u>46.1</u>
Accessories:			
North America	27.7	29.5	30.7
Europe	22.9	22.6	23.2
	<u>50.6</u>	<u>52.1</u>	<u>53.9</u>
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

The following table provides data for selected geographical areas.

<u>Net Sales:</u>	<u>Percentage of Total Net Sales</u>		
	<u>Fiscal 2013</u>	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
United Kingdom	12.5	13.0	13.7
France	10.7	9.8	9.6

<u>Long-lived Assets:</u>	<u>Percentage of Total Long-lived Assets</u>	
	<u>February 1, 2014</u>	<u>February 2, 2013</u>
United Kingdom	6.6	7.0
France	5.6	5.1

14. SUPPLEMENTAL FINANCIAL INFORMATION

On May 29, 2007, Claire's Stores, Inc. (the "Issuer"), issued the Senior Subordinated Notes, (collectively, the "2007 Notes"). On March 4, 2011, the Issuer issued the Senior Secured Second Lien Notes, (collectively, the "2011 Notes"). On February 28, 2012, March 12, 2012 and September 20, 2012, the Issuer issued the 9.0% Senior Secured First Lien Notes (collectively, the "2012 Notes"). On March 15, 2013, the Issuer issued the 6.125% Senior Secured First Lien Notes and on May 14, 2013, the Issuer issued the 7.75% Senior Notes (the "2013 Notes"). The 2007 Notes and the 2011 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 2012 Notes and the 2013 Notes are unconditionally guaranteed, jointly and severally, by all wholly-owned domestic current and future subsidiaries of Claire's Stores, Inc. As of February 1, 2014, Claire's Stores, Inc. owned 100% of its domestic subsidiaries that guarantee the 2007 Notes, 2011 Notes, 2012 Notes, and 2013 Notes. All guarantors are collectively referred to as the "Guarantors." The Company's other subsidiaries, principally its international subsidiaries including its European, 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.

Condensed Consolidating Balance Sheet
February 1, 2014
(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 9,911	\$ 4,055	\$ 44,377	\$ —	\$ 58,343
Inventories	—	100,292	78,590	—	178,882
Prepaid expenses	443	2,023	17,005	—	19,471
Other current assets	644	16,953	8,708	—	26,305
Total current assets	<u>10,998</u>	<u>123,323</u>	<u>148,680</u>	<u>—</u>	<u>283,001</u>
Property and equipment:					
Furniture, fixtures and equipment	6,956	164,902	88,851	—	260,709
Leasehold improvements	1,471	189,407	144,980	—	335,858
	8,427	354,309	233,831	—	596,567
Less accumulated depreciation and amortization	<u>(4,625)</u>	<u>(220,617)</u>	<u>(122,166)</u>	<u>—</u>	<u>(347,408)</u>
	3,802	133,692	111,665	—	249,159
Leased property under capital lease:					
Land and building	—	18,055	—	—	18,055
Less accumulated depreciation and amortization	—	(3,611)	—	—	(3,611)
	—	14,444	—	—	14,444
Intercompany receivables	—	158,450	—	(158,450)	—
Investment in subsidiaries	2,199,771	(49,924)	—	(2,149,847)	—
Goodwill	—	1,235,650	314,406	—	1,550,056
Intangible assets, net	286,000	2,471	252,624	—	541,095
Deferred financing costs, net	39,481	—	—	—	39,481
Other assets	74	3,890	50,433	(1)	54,396
	<u>2,525,326</u>	<u>1,350,537</u>	<u>617,463</u>	<u>(2,308,298)</u>	<u>2,185,028</u>
Total assets	<u>\$ 2,540,126</u>	<u>\$ 1,621,996</u>	<u>\$ 877,808</u>	<u>\$ (2,308,298)</u>	<u>\$ 2,731,632</u>
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)					
Current liabilities:					
Trade accounts payable	\$ 10,630	\$ 33,800	\$ 39,934	\$ —	\$ 84,364
Income taxes payable	—	33	3,696	—	3,729
Accrued interest payable	68,338	—	—	—	68,338
Accrued expenses and other current liabilities	7,405	36,669	50,653	—	94,727
Total current liabilities	<u>86,373</u>	<u>70,502</u>	<u>94,283</u>	<u>—</u>	<u>251,158</u>
Intercompany payables	158,000	—	451	(158,451)	—
Long-term debt	2,378,786	—	—	—	2,378,786
Obligation under capital lease	—	17,124	—	—	17,124
Deferred tax liability	—	106,890	12,674	—	119,564
Deferred rent expense	—	20,609	11,391	—	32,000
Unfavorable lease obligations and other long-term liabilities	—	15,812	221	—	16,033
	<u>2,536,786</u>	<u>160,435</u>	<u>24,737</u>	<u>(158,451)</u>	<u>2,563,507</u>
Stockholder's equity (deficit):					
Common stock	—	367	2	(369)	—
Additional paid in capital	619,499	1,435,909	797,836	(2,233,745)	619,499
Accumulated other comprehensive income (loss), net of tax	(1,109)	205	(4,779)	4,574	(1,109)
Accumulated deficit	(701,423)	(45,422)	(34,271)	79,693	(701,423)
	<u>(83,033)</u>	<u>1,391,059</u>	<u>758,788</u>	<u>(2,149,847)</u>	<u>(83,033)</u>
Total liabilities and stockholder's equity (deficit)	<u>\$ 2,540,126</u>	<u>\$ 1,621,996</u>	<u>\$ 877,808</u>	<u>\$ (2,308,298)</u>	<u>\$ 2,731,632</u>

Condensed Consolidating Balance Sheet
February 2, 2013
(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 56,392	\$ 4,299	\$ 106,265	\$ —	\$ 166,956
Inventories	36	88,127	69,386	—	157,549
Prepaid expenses	592	2,390	16,719	—	19,701
Other current assets	262	19,422	9,937	—	29,621
Total current assets	<u>57,282</u>	<u>114,238</u>	<u>202,307</u>	<u>—</u>	<u>373,827</u>
Property and equipment:					
Furniture, fixtures and equipment	6,079	141,232	86,898	—	234,209
Leasehold improvements	1,177	165,075	146,537	—	312,789
	7,256	306,307	233,435	—	546,998
Less accumulated depreciation and amortization	<u>(3,686)</u>	<u>(199,402)</u>	<u>(122,530)</u>	<u>—</u>	<u>(325,618)</u>
	3,570	106,905	110,905	—	221,380
Leased property under capital lease:					
Land and building	—	18,055	—	—	18,055
Less accumulated depreciation and amortization	—	<u>(2,708)</u>	—	—	<u>(2,708)</u>
	—	15,347	—	—	15,347
Intercompany receivables	—	252,709	—	<u>(252,709)</u>	—
Investment in subsidiaries	2,205,303	<u>(56,381)</u>	—	<u>(2,148,922)</u>	—
Goodwill	—	1,235,650	314,406	—	1,550,056
Intangible assets, net	286,000	4,054	257,379	—	547,433
Deferred financing costs, net	41,381	—	—	—	41,381
Other assets	129	3,867	45,845	7	49,848
	<u>2,532,813</u>	<u>1,439,899</u>	<u>617,630</u>	<u>(2,401,624)</u>	<u>2,188,718</u>
Total assets	<u>\$ 2,593,665</u>	<u>\$ 1,676,389</u>	<u>\$ 930,842</u>	<u>\$ (2,401,624)</u>	<u>\$ 2,799,272</u>
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)					
Current liabilities:					
Trade accounts payable	\$ 993	\$ 31,584	\$ 40,868	\$ —	\$ 73,445
Income taxes payable	—	(12)	10,520	—	10,508
Accrued interest payable	68,254	—	—	—	68,254
Accrued expenses and other current liabilities	11,420	39,274	48,835	—	99,529
Total current liabilities	<u>80,667</u>	<u>70,846</u>	<u>100,223</u>	<u>—</u>	<u>251,736</u>
Intercompany payables	154,072	—	98,631	<u>(252,703)</u>	—
Long-term debt	2,373,366	—	—	—	2,373,366
Obligation under capital lease	—	17,232	—	—	17,232
Deferred tax liability	—	107,618	13,350	—	120,968
Deferred rent expense	—	18,481	11,378	—	29,859
Unfavorable lease obligations and other long-term liabilities	—	20,080	471	—	20,551
	<u>2,527,438</u>	<u>163,411</u>	<u>123,830</u>	<u>(252,703)</u>	<u>2,561,976</u>
Stockholder's equity (deficit):					
Common stock	—	367	2	(369)	—
Additional paid in capital	618,403	1,435,909	797,819	<u>(2,233,728)</u>	618,403
Accumulated other comprehensive income (loss), net of tax	3,273	3,909	(6,731)	2,822	3,273
Accumulated deficit	<u>(636,116)</u>	<u>1,947</u>	<u>(84,301)</u>	<u>82,354</u>	<u>(636,116)</u>
	<u>(14,440)</u>	<u>1,442,132</u>	<u>706,789</u>	<u>(2,148,921)</u>	<u>(14,440)</u>
Total liabilities and stockholder's equity (deficit)	<u>\$ 2,593,665</u>	<u>\$ 1,676,389</u>	<u>\$ 930,842</u>	<u>\$ (2,401,624)</u>	<u>\$ 2,799,272</u>

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)
Fiscal 2013
(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	\$ —	\$ 840,186	\$ 672,991	\$ —	\$ 1,513,177
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	541	415,753	337,337	—	753,631
Gross profit (deficit)	(541)	424,433	335,654	—	759,546
Other expenses:					
Selling, general and administrative	18,596	259,887	234,770	—	513,253
Depreciation and amortization	1,639	36,549	35,783	—	73,971
Severance and transaction-related costs	3,104	—	2,014	—	5,118
Other (income) expense	(10,241)	2,527	3,146	—	(4,568)
	13,098	298,963	275,713	—	587,774
Operating income (loss)	(13,639)	125,470	59,941	—	171,772
Loss on early debt extinguishment	(4,795)	—	—	—	(4,795)
Interest expense, net	220,976	2,385	—	—	223,361
Income (loss) before income taxes	(239,410)	123,085	59,941	—	(56,384)
Income tax expense (benefit)	—	(987)	9,910	—	8,923
Income (loss) from continuing operations	(239,410)	124,072	50,031	—	(65,307)
Equity in earnings (loss) of subsidiaries	174,103	3,823	—	(177,926)	—
Net income (loss)	(65,307)	127,895	50,031	(177,926)	(65,307)
Foreign currency translation adjustments	(940)	(674)	5,561	(4,887)	(940)
Net (loss) gain on intra-entity foreign currency transactions, net of tax	(3,442)	(3,030)	(3,609)	6,639	(3,442)
Other comprehensive income (loss)	(4,382)	(3,704)	1,952	1,752	(4,382)
Comprehensive income (loss)	\$ (69,689)	\$ 124,191	\$ 51,983	\$ (176,174)	\$ (69,689)

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)
Fiscal 2012
(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	\$ —	\$ 897,434	\$ 659,586	\$ —	\$ 1,557,020
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	2,288	424,812	328,896	—	755,996
Gross profit (deficit)	(2,288)	472,622	330,690	—	801,024
Other expenses:					
Selling, general and administrative	22,092	258,978	222,184	—	503,254
Depreciation and amortization	1,098	35,273	28,508	—	64,879
Severance and transaction-related costs	2,192	—	636	—	2,828
Other (income) expense	(10,883)	(129)	4,907	—	(6,105)
	14,499	294,122	256,235	—	564,856
Operating income (loss)	(16,787)	178,500	74,455	—	236,168
Loss on early debt extinguishment	(9,707)	—	—	—	(9,707)
Interest expense, net	208,081	2,199	517	—	210,797
Income (loss) before income taxes	(234,575)	176,301	73,938	—	15,664
Income tax expense (benefit)	—	(41)	14,423	—	14,382
Income (loss) from continuing operations	(234,575)	176,342	59,515	—	1,282
Equity in earnings (loss) of subsidiaries	235,857	2,648	—	(238,505)	—
Net income (loss)	1,282	178,990	59,515	(238,505)	1,282
Foreign currency translation adjustments	1,182	(127)	968	(841)	1,182
Net (loss) gain on intra-entity foreign currency transactions, net of tax	4,283	361	4,081	(4,442)	4,283
Unrealized gain on interest rate swap, net of tax	375	—	—	—	375
Reclassification adjustment of unrealized loss on termination of interest rate swap into net income	1,784	—	—	—	1,784
Other comprehensive income (loss)	7,624	234	5,049	(5,283)	7,624
Comprehensive income (loss)	\$ 8,906	\$ 179,224	\$ 64,564	\$ (243,788)	\$ 8,906

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)
Fiscal 2011
(in thousands)

	<u>Issuer</u>	<u>Guarantors</u>	<u>Non- Guarantors</u>	<u>Eliminations</u>	<u>Consolidated</u>
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)
	<u>15,675</u>	<u>295,892</u>	<u>267,220</u>	<u>—</u>	<u>578,787</u>
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 adjustments	(663)	52	(605)	553	(663)
Net (loss) gain on intra-entity foreign currency transactions, net of tax	(4111)	(40)	(4,095)	4,135	(4,111)
Unrealized gain on interest rate swap, net of tax	(993)	—	—	—	(993)
Other comprehensive income (loss)	(5,767)	12	(4,700)	4,688	(5,767)
Comprehensive income	<u>\$ 5,865</u>	<u>\$ 162,399</u>	<u>\$ 33,451</u>	<u>\$ (195,850)</u>	<u>\$ 5,865</u>

Condensed Consolidating Statement of Cash Flows
Fiscal 2013
(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	\$ (65,307)	\$ 127,895	\$ 50,031	\$ (177,926)	\$ (65,307)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries	(174,103)	(3,823)	—	177,926	—
Depreciation and amortization	1,639	36,549	35,783	—	73,971
Amortization of lease rights and other assets	—	—	3,675	—	3,675
Amortization of debt issuance costs	8,166	—	—	—	8,166
Accretion of debt premium	(2,120)	—	—	—	(2,120)
Net accretion of favorable (unfavorable) lease obligations	—	(646)	(45)	—	(691)
Loss on sale/retirement of property and equipment, net	—	1,363	118	—	1,481
Loss on early debt extinguishment	4,795	—	—	—	4,795
Gain on sale of intangible assets/lease rights	—	—	(172)	—	(172)
Stock compensation benefit	529	206	361	—	1,096
(Increase) decrease in:					
Inventories	36	(12,165)	(8,950)	—	(21,079)
Prepaid expenses	149	366	220	—	735
Other assets	(327)	1,622	(4,259)	—	(2,964)
Increase (decrease) in:					
Trade accounts payable	9,637	(192)	(351)	—	9,094
Income taxes payable	—	77	(6,512)	—	(6,435)
Accrued interest payable	83	—	—	—	83
Accrued expenses and other liabilities	(4,014)	(4,672)	2,094	—	(6,592)
Deferred income taxes	—	65	(2,476)	—	(2,411)
Deferred rent expense	—	2,128	(606)	—	1,522
Net cash (used in) provided by operating activities	(220,837)	148,773	68,911	—	(3,153)
Cash flows from investing activities:					
Acquisition of property and equipment, net	(1,871)	(57,146)	(33,106)	—	(92,123)
Acquisition of construction-in-process	—	(4,115)	—	—	(4,115)
Acquisition of intangible assets/lease rights	—	(154)	(2,602)	—	(2,756)
Proceeds from sale of intangible assets/lease rights	—	—	203	—	203
Net cash used in investing activities	(1,871)	(61,415)	(35,505)	—	(98,791)
Cash flows from financing activities:					
Proceeds from revolving credit facility	137,800	—	—	—	137,800
Payments on revolving credit facility	(137,800)	—	—	—	(137,800)
Proceeds from notes	530,000	—	—	—	530,000
Repurchases of notes, including tender premiums and fees	(523,660)	—	—	—	(523,660)
Payment of debt issuance costs	(9,861)	—	—	—	(9,861)
Principal payments of capital lease	—	(54)	—	—	(54)
Intercompany activity, net	179,748	(81,211)	(98,537)	—	—
Net cash provided by (used in) financing activities	176,227	(81,265)	(98,537)	—	(3,575)
Effect of foreign currency exchange rate changes on cash and cash equivalents					
	—	(6,337)	3,243	—	(3,094)
Net (decrease) increase in cash and cash equivalents	(46,481)	(244)	(61,888)	—	(108,613)
Cash and cash equivalents at beginning of period	56,392	4,299	106,265	—	166,956
Cash and cash equivalents at end of period	\$ 9,911	\$ 4,055	\$ 44,377	\$ —	\$ 58,343

Condensed Consolidating Statement of Cash Flows
Fiscal 2012
(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	\$ 1,282	\$ 178,990	\$ 59,515	\$(238,505)	\$ 1,282
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries	(235,857)	(2,648)	—	238,505	—
Depreciation and amortization	1,098	35,273	28,508	—	64,879
Amortization of lease rights and other assets	—	—	3,279	—	3,279
Amortization of debt issuance costs	9,319	—	608	—	9,927
Accretion of debt premium	(831)	—	—	—	(831)
Net accretion of favorable (unfavorable) lease obligations	—	(901)	75	—	(826)
Loss on sale/retirement of property and equipment, net	—	91	5	—	96
Gain on early debt extinguishment	9,707	—	—	—	9,707
Gain on sale of intangible assets/lease rights	—	—	(493)	—	(493)
Stock compensation benefit	(737)	(476)	163	—	(1,050)
(Increase) decrease in:					
Inventories	(34)	(3,519)	(9,865)	—	(13,418)
Prepaid expenses	85	(860)	1,353	—	578
Other assets	(259)	(2,822)	(6,752)	—	(9,833)
Increase (decrease) in:					
Trade accounts payable	(475)	4,496	6,496	—	10,517
Income taxes payable	—	(747)	1,376	—	629
Accrued interest payable	36,395	—	—	—	36,395
Accrued expenses and other liabilities	(1,322)	(1,576)	(1,906)	—	(4,804)
Deferred income taxes	—	49	(245)	—	(196)
Deferred rent expense	—	801	56	—	857
Net cash (used in) provided by operating activities	(181,629)	206,151	82,173	—	106,695
Cash flows from investing activities:					
Acquisition of property and equipment, net	(1,818)	(32,897)	(33,519)	—	(68,234)
Acquisition of construction-in-process	—	(570)	—	—	(570)
Acquisition of intangible assets/lease rights	—	(173)	(4,876)	—	(5,049)
Proceeds from sale of intangible assets/lease rights	—	—	1,009	—	1,009
Changes in restricted cash	4,350	—	—	—	4,350
Net cash used in investing activities	2,532	(33,640)	(37,386)	—	(68,494)
Cash flows from financing activities:					
Payments on former credit facility	(1,154,310)	—	—	—	(1,154,310)
Proceeds from notes	1,142,125	—	—	—	1,142,125
Payment of short-term debt	—	—	—	—	—
Repurchase of notes	—	—	—	—	—
Payment of debt issuance costs	(27,976)	—	(14)	—	(27,990)
Principal payments of capital lease	—	(4)	—	—	(4)
Intercompany activity, net	172,707	(173,537)	830	—	—
Net cash provided by (used in) financing activities	132,546	(173,541)	816	—	(40,179)
Effect of foreign currency exchange rate changes on cash and cash equivalents					
	28	421	(1,539)	—	(1,090)
Net (decrease) increase in cash and cash equivalents	(46,523)	(609)	44,064	—	(3,068)
Cash and cash equivalents at beginning of period	102,915	4,908	62,201	—	170,024
Cash and cash equivalents at end of period	\$ 56,392	\$ 4,299	\$ 106,265	\$ —	\$ 166,956

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

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
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)
(Increase) decrease in:					
Inventories	—	260	(8,654)	—	(8,394)
Prepaid expenses	175	150	1,051	—	1,376
Other assets	—	746	(6,598)	—	(5,852)
Increase (decrease) in:					
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)	1,734	1,828	—	(3,511)
Deferred income taxes	—	(100)	(1,482)	—	(1,582)
Deferred rent expense	—	450	1,870	—	2,320
Net cash (used in) provided by operating activities	<u>(157,903)</u>	<u>196,829</u>	<u>63,634</u>	<u>—</u>	<u>102,560</u>
Cash flows from investing activities:					
Acquisition of property and equipment, net	(1,466)	(26,529)	(42,790)	—	(70,515)
Acquisition of construction-in-process	—	(393)	—	—	(393)
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	<u>(2,366)</u>	<u>(26,698)</u>	<u>(28,320)</u>	<u>—</u>	<u>(57,384)</u>
Cash flows from financing activities:					
Payments on former credit facility	(438,940)	—	—	—	(438,940)
Proceeds from notes	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	<u>87,105</u>	<u>(168,751)</u>	<u>(51,041)</u>	<u>—</u>	<u>(132,687)</u>
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	<u>\$ 107,265</u>	<u>\$ 4,908</u>	<u>\$ 62,201</u>	<u>\$ —</u>	<u>\$ 174,374</u>

[Table of Contents](#)

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 Chief Executive Officer 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 February 1, 2014. 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 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 Chief Executive Officer and the Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of February 1, 2014.

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 Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal controls over financial reporting based on the framework in *Internal Control – Integrated Framework* (1992) 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 February 1, 2014.

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

Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act

Apollo Global Management, LLC ("Apollo") has provided notice to us that, as of October 24, 2013, certain investment funds managed by affiliates of Apollo beneficially owned approximately 22% of the limited liability company interests of CEVA Holdings, LLC ("CEVA"). Under the limited liability company agreement governing CEVA, certain investment funds managed by affiliates of Apollo hold a majority of the voting power of CEVA and have the right to elect a majority of the board of CEVA. CEVA may be deemed to be under common control with us, but this statement is not meant to be an admission that common control exists. As a result, it appears that we are required to provide disclosures

[Table of Contents](#)

as set forth below pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 (“ITRA”) and Section 13(r) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

Apollo has informed us that CEVA has provided it with the information below relevant to Section 13(r) of the Exchange Act. The disclosure below does not relate to any activities conducted by us and does not involve us or our management. The disclosure relates solely to activities conducted by CEVA and its consolidated subsidiaries. We have not independently verified or participated in the preparation of the disclosure below.

Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act by CEVA

“Through an internal review of its global operations, CEVA has identified the following transactions in an Initial Notice of Voluntary Self-Disclosure that CEVA filed with the U.S. Treasury Department Office of Foreign Assets Control (“OFAC”) on October 28, 2013. CEVA’s review is ongoing. CEVA will file a further report with OFAC after completing its review.

The internal review indicates that, in February 2013, CEVA Freight Holdings (Malaysia) SDN BHD (“CEVA Malaysia”) provided customs brokerage for export and local haulage services for a shipment of polyethylene resin to Iran shipped on a vessel owned and/or operated by HDS Lines, also an SDN. The revenues and net profits for these services were approximately \$779.54 USD and \$311.13 USD, respectively. In September 2013, CEVA Malaysia provided customs brokerage services for the import into Malaysia of fruit juice from Alifard Co. in Iran via HDS Lines. The revenues and net profits for these services were approximately \$227.41 USD and \$89.29 USD, respectively.

These transactions violate the terms of internal CEVA compliance policies, which prohibit transactions involving Iran. Upon discovering these transactions, CEVA promptly launched an internal investigation, and is taking action to block and prevent such transactions in the future. CEVA intends to cooperate with OFAC in its review of this matter.”

PART III.

An amendment to this Annual Report on Form 10-K to include the items required by Part III of Form 10-K will be filed with the Securities and Exchange Commission no later than 120 days after the end of Fiscal 2013.

PART IV.

Item 15. Exhibits, Financial Statement Schedules

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

1. Financial Statements

	<u>Page No.</u>
Report of Independent Registered Public Accounting Firm	51
Consolidated Balance Sheets as of February 1, 2014 and February 2, 2013	52
Consolidated Statements of Operations and Comprehensive Income (Loss) for the fiscal years ended February 1, 2014, February 2, 2013 and January 28, 2012	53
Consolidated Statements of Changes in Stockholder's Deficit for the fiscal years ending February 1, 2014, February 2, 2013 and January 28, 2012	54
Consolidated Statements of Cash Flows for the fiscal years ending February 1, 2014, February 2, 2013 and January 28, 2012	55
Notes to Consolidated Financial Statements	56

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 Subordinated 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 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)
- 4.3 Form of 10.50% Senior Subordinated Notes due 2017 (1)
- 4.4 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 (5)
- 4.5 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 (5)
- 4.6 Form of 8.875% Senior Secured Second Lien Notes due 2019 (included in the Indenture filed as Exhibit 4.10 hereto) (5)
- 4.7 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 (5)
- 4.8 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 (8)
- 4.9 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 (8)
- 4.10 Form of 9.00% Senior Secured First Lien Notes due 2019 (included in the Indenture filed as Exhibit 4.15 hereto) (8)
- 4.11 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 (8)

[Table of Contents](#)

- 4.12 Third Supplemental Indenture, dated as of September 20, 2012, by and among Claire’s Stores, Inc., the Guarantors named therein and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent (12)
- 4.13 Indenture, dated as of March 15, 2013, by and among Claire’s Stores, Inc., the guarantors party thereto and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent (13)
- 4.14 Form of 6.125% Senior Secured First Lien Notes due 2020 (included in the Indenture filed as Exhibit 4.19 hereto) (13)
- 4.15 Indenture, dated as of May 14, 2013, by and between Claire’ Stores, Inc. the guarantors party thereto and The Bank of New York Mellon Trust Company, N.A., as Trustee (15)
- 4.16 Form of 7.750% Senior Note due 2020 (included in the indenture filed as Exhibit 4.21 hereto (15)
- 10.1 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)
- 10.2 Standard Form of Director Option Grant Letter (1)
- 10.3 Standard Form of Co-Investment Letter (5)
- 10.4 Employment Agreement with Eugene S. Kahn (1)
- 10.5 Lease Agreement, dated as of February 19, 2010, by and between AGNL Bling, L.L.C. and Claire’s Boutiques, Inc. (3)
- 10.6 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 (2)
- 10.7 Mortgage, Assignment of Leases and Rents, Security Agreement and Fixture Filing, dated as of May 29, 2007 (2)
- 10.8 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 (4)
- 10.9 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 (4)
- 10.10 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 (4)
- 10.11 Claire’s Inc. Amended and Restated Stock Incentive Plan, dated May 20, 2011 (5)
- 10.12 Standard Form of Option Grant Letter under Claire’s Inc. Amended and Restated Stock Incentive Plan (5)
- 10.13 Contract of Employment with Beatrice Lafon (6)

[Table of Contents](#)

- 10.14 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 (7)
- 10.15 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 (7)
- 10.16 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 (7)
- 10.17 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 (7)
- 10.18 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 (7)
- 10.19 Employment Agreement with James D. Fielding (9)
- 10.20 Standard Form of Option Grant Letter (Target Performance Option), effective July 16, 2012 (10)
- 10.21 Amended and Restated Credit Agreement, dated as of September 20, 2012, by and among Claire's Inc., Claire's Stores, Inc., Credit Suisse AG, as Administrative Agent, and other Lenders named therein (11)
- 10.22 Offer Letter Amendment dated August 28, 2012 with Beatrice Lafon (12)
- 10.23 Collateral Agreement, dated as of March 15, 2013, by and among Claire's Stores, Inc., the guarantors party thereto and The Bank of New York Mellon Trust Company, N.A., as Collateral Agent (13)
- 10.24 Trademark Security Agreement, dated as of March 15, 2013, by and between CBI Distributing Corp. and The Bank of New York Mellon Trust Company, as Collateral Agent (13)
- 10.25 Joinder No. 1, dated as of March 15, 2013, by and between The Bank of New York Mellon Trust Company, N.A., as New Agent and Credit Suisse AG, Cayman Islands Branch, as Applicable Collateral Agent (13)
- 10.26 Joinder Agreement No. 2, dated as of March 15, 2013, by and among The Bank of New York Mellon Trust Company, N.A., as New Agent, Credit Suisse AG, Cayman Islands Branch (f/k/a Credit Suisse, Cayman Islands Branch), as Credit Agreement Agent, The Bank of New York Mellon Trust Company, N.A., as Trustee, and The Bank of New York Trust Company, N.A., as First Lien Agent (13)
- 10.27 Employment Agreement with Linda Hefner Filler (14)
- 10.28 Employment Agreement with J. Per Brodin (16)

[Table of Contents](#)

21.1	Subsidiaries of Claire's Stores, Inc. (17)
24	Power of Attorney (included on signature page) (17)
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) (18)
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) (18)
32.1	Certification of Chief Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18)
32.2	Certification of Chief Financial Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18)
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

- (1) Filed previously as exhibit to the Registration Statement on Form S-4 (File No. 333-148108) by the Company on December 17, 2007.
- (2) Filed previously as exhibit to Form 10-Q on December 8, 2009.
- (3) Filed previously as exhibit to Form 8-K on February 25, 2010.
- (4) Filed previously as exhibit to Form 8-K by the Company on March 9, 2011.
- (5) Filed previously as exhibit to Form 8-K by the Company on May 20, 2011.
- (6) Filed previously as exhibit to Form 10-Q on December 2, 2011.
- (7) Filed previously as exhibit to Form 8-K on March 5, 2012.
- (8) Filed previously as exhibit to Form 8-K on March 14, 2012.
- (9) Filed previously as exhibits to Form 8-K on June 12, 2012.
- (10) Filed previously as exhibits to Form 8-K on July 17, 2012.
- (11) Filed previously as exhibits to Form 8-K on September 25, 2012.
- (12) Filed previously as exhibits to Form 10-Q on November 30, 2012.
- (13) Filed previously as exhibits to Form 8-K on March 19, 2013.
- (14) Filed previously as exhibits to Form 10-K on April 3, 2013.
- (15) Filed previously as exhibit to Form 8-K on May 16, 2013.
- (16) Filed previously as exhibits to Form 8-K on July 3, 2013.
- (17) Filed herewith.
- (18) Furnished herewith.

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 2, 2014

By: /s/ James D. Fielding
James D. Fielding, Chief Executive Officer (principal executive officer)

April 2, 2014

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 2, 2014

/s/ Peter Copses
Peter Copses, Chairman of the Board of Directors

April 2, 2014

/s/ James D. Fielding
James D. Fielding, Chief Executive Officer and Director

April 2, 2014

/s/ Lance Milken
Lance Milken, Director

April 2, 2014

/s/ George Golleher
George Golleher, Director

April 2, 2014

/s/ Robert J. DiNicola
Robert J. DiNicola, Director

April 2, 2014

/s/ Rohit Manocha
Rohit Manocha, Director

April 2, 2014

/s/ Ron Marshall
Ron Marshall, Director

INDEX TO EXHIBITS

<u>EXHIBIT NO.</u>	<u>DESCRIPTION</u>
21.1	Claire's Stores, Inc. Subsidiaries.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a).
32.1	Certification of 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 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

**CLAIRE'S STORES, INC.
SUBSIDIARIES
AS OF FEBRUARY 1, 2014**

<u>Name</u>	<u>Jurisdiction</u>
BMS Distributing Corp.	Delaware
CBI Distributing Corp.	Delaware
Claire's Accessories Spain, S.L.	Spain
Claire's Austria GmbH	Austria
Claire's Belgium B.V.B.A.	Belgium
Claire's Boutiques, Inc.	Colorado
Claire's Canada Corp.	Delaware
Claire's Czech Republic s.r.o.	Czech Republic
Claire's European Distribution Limited	United Kingdom
Claire's European Services Limited	United Kingdom
Claire's Fashion Property Corp.	Cayman Islands
Claire's France S.A.S.	France
Claire's Germany GmbH	Germany
Claire's Holding GmbH	Switzerland
Claire's Hungary Kft.	Hungary
Claire's International Europe GmbH	Switzerland
Claire's Netherlands B.V.	Netherlands
Claire's Poland Sp. z o.o.	Poland
Claire's Puerto Rico Corp.	Delaware
Claire's Stores Canada Corp.	Canada
Claire's Switzerland GmbH	Switzerland
Claire's Accessories UK Ltd	United Kingdom
CSI Luxembourg S.a.r.l.	Luxembourg
RSI International Limited	Hong Kong
WhiteClaire's Acessorios Portugal, Unipessoal LDA	Portugal
BMS Fashion Corp.	Cayman Islands
CSI Canada LLC	Canada
Claire's China Services	China
Claire's Swiss Holdings LLC	Delaware
Claire's (Gibraltar) Holdings Limited	Gibraltar
Claire's Holdings S.a.r.l.	Luxembourg
Femina Hgmbh	Austria
Femina Hgmbh Co Kg	Austria
Claire's Stores Hong Kong Limited	Hong Kong
Claire's Stores (Shanghai) Limited	China
Claire's Italy S.R.L.	Italy
Claire's Luxembourg S.a.r.l.	Luxembourg

CERTIFICATE PURSUANT TO
RULES 13a-14(a) and 15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James D. Fielding, certify that:

1. I have reviewed this annual report on Form 10-K of Claire's Stores, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

April 2, 2014

/s/ James D. Fielding

James D. Fielding
Chief Executive Officer

CERTIFICATE PURSUANT TO
RULES 13a-14(a) and 15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, J. Per Brodin, certify that:

1. I have reviewed this annual report on Form 10-K of Claire's Stores, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

April 2, 2014

/s/ J. Per Brodin

J. Per Brodin
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 USC. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report on Form 10-K of Claire's Stores, Inc. (the "Company") for the fiscal year ended February 1, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James D. Fielding, Chief Executive Officer of the Company, hereby certify, pursuant to 18 USC. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James D. Fielding

James D. Fielding
Chief Executive Officer
April 2, 2014

CERTIFICATION PURSUANT TO
18 USC. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report on Form 10-K of Claire's Stores, Inc. (the "Company") for the fiscal year ended February 1, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, J. Per Brodin, Chief Financial Officer of the Company, hereby certify, pursuant to 18 USC. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ J. Per Brodin

J. Per Brodin
Chief Financial Officer
April 2, 2014