Vera Bradley, Inc.
Form 10-Q
December 10, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended November 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 Number: 001-34918

VERA BRADLEY, INC.
(Exact name of registrant as specified in its charter)

Indiana (State or other jurisdiction of incorporation or organization)	27-2935063 (I.R.S. Employer Identification No.)
12420 Stonebridge Road, Roanoke, Indiana (Address of principal executive offices)	46783 (Zip Code)

(877) 708-8372
(Registrant’s telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

The registrant had 40,308,621 shares of its common stock outstanding as of December 10, 2014.

Table of Contents

TABLE OF CONTENTS

Table of Contents

FORWARD-LOOKING STATEMENTS

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

- possible adverse changes in general economic conditions and their impact on consumer confidence and consumer spending;
- possible inability to predict and respond in a timely manner to changes in consumer demand;
- possible loss of key management or design associates or inability to attract and retain the talent required for our business;
- possible inability to maintain and enhance our brand;
- possible inability to successfully implement our growth strategies or manage our growing business;
- possible inability to successfully open and operate new stores as planned;
- possible adverse changes in the cost of raw materials and labor used to manufacture our products; and
- possible adverse effects resulting from a significant disruption in our single distribution facility.

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

For a discussion of these risks and other risks and uncertainties that could cause actual results to differ materially from those contained in our forward-looking statements, please refer to “Risk Factors” in Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 1, 2014, as well as Item 1A of Part II of this Quarterly Report on Form 10-Q.

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Vera Bradley, Inc.
Consolidated Balance Sheets
(in thousands)
(unaudited)

	November 1, 2014	February 1, 2014
Assets		
Current assets:		
Cash and cash equivalents	$90,334	$59,215
Accounts receivable, net	38,136	29,174
Inventories	106,256	136,923
Income taxes receivable	2,717	—
Prepaid expenses and other current assets	9,303	9,952
Deferred income taxes	15,297	13,094
Total current assets	262,043	248,358
Property, plant, and equipment, net	103,567	84,940
Other assets	614	1,085
Total assets	$366,224	$334,383
Liabilities and Shareholders’ Equity		
Current liabilities:		
Accounts payable	$28,511	$27,745
Accrued employment costs	14,039	10,586
Other accrued liabilities	17,699	14,891
Income taxes payable	2,592	1,625
Total current liabilities	62,841	54,847
Deferred income taxes	3,323	4,643
Other long-term liabilities	24,010	19,746
Total liabilities	90,174	79,236
Commitments and contingencies		
Shareholders’ equity:		
Preferred stock; 5,000 shares authorized, no shares issued or outstanding	—	—
Common stock, without par value; 200,000 shares authorized, 40,689 and 40,607 shares issued and 40,520 and 40,607 outstanding, respectively	—	—
Additional paid-in-capital	80,488	78,153
Retained earnings	199,108	178,002
Accumulated other comprehensive loss	(13)	(1,008)
Treasury stock	(3,533)	—
Total shareholders’ equity	276,050	255,147
Total liabilities and shareholders’ equity	$366,224	$334,383

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

Table of Contents

Vera Bradley, Inc.
Consolidated Statements of Income
(in thousands, except per share data)
(unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net revenues	$125,204	$128,949	$356,361	$374,477
Cost of sales	59,436	57,710	167,394	164,900
Gross profit	65,768	71,239	188,967	209,577
Selling, general, and administrative expenses	53,274	47,565	153,982	148,691
Other income	1,110	1,027	3,152	3,608
Operating income	13,604	24,701	38,137	64,494
Interest expense, net	215	139	319	470
Income from continuing operations before income taxes	13,389	24,562	37,818	64,024
Income tax expense	4,668	8,905	14,326	23,799
Income from continuing operations	8,721	15,657	23,492	40,225
Loss from discontinued operations, net of taxes	(1,780)	(431)	(2,386)	(859)
Net income	$6,941	$15,226	$21,106	$39,366
Basic weighted-average shares outstanding	40,663	40,605	40,663	40,596
Diluted weighted-average shares outstanding	40,716	40,652	40,720	40,633
Net income (loss) per share - basic				
Continuing operations	$0.21	$0.39	$0.58	$0.99
Discontinued operations	(0.04)	(0.01)	(0.06)	(0.02)
Net income	$0.17	$0.37	$0.52	$0.97
Net income (loss) per share - diluted				
Continuing operations	$0.21	$0.39	$0.58	$0.99
Discontinued operations	(0.04)	(0.01)	(0.06)	(0.02)
Net income	$0.17	$0.37	$0.52	$0.97

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

Table of Contents

Vera Bradley, Inc.
Consolidated Statements of Comprehensive Income
(in thousands)
(unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net income	$6,941	$15,226	$21,106	$39,366
Cumulative translation adjustment	3	47	(1)	(234)
Comprehensive income	$6,944	$15,273	$21,105	$39,132

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

6

Table of Contents

Vera Bradley, Inc.
Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Thirty-Nine Weeks Ended	
	November 1, 2014	November 2, 2013
Cash flows from operating activities		
Net income	$21,106	$39,366
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property, plant, and equipment	10,957	10,651
Provision for doubtful accounts	(129)	(190)
Loss on disposal of property, plant, and equipment	—	9
Stock-based compensation	2,943	2,857
Deferred income taxes	(3,523)	(624)
Changes in assets and liabilities:		
Accounts receivable	(8,833)	(7,921)
Inventories	30,667	(19,154)
Prepaid expenses and other assets	1,120	1,531
Accounts payable	(6,901)	12,742
Income taxes payable	(1,750)	(8,726)
Accrued and other liabilities	10,596	4,305
Net cash provided by operating activities	56,253	34,846
Cash flows from investing activities		
Purchases of property, plant, and equipment	(22,358)	(15,418)
Net cash used in investing activities	(22,358)	(15,418)
Cash flows from financing activities		
Payments on financial-institution debt	—	(45,000)
Borrowings on financial-institution debt	—	30,000
Tax withholdings for equity compensation	(608)	(411)
Repurchase of common stock	(3,092)	—
Other financing activities, net	(71)	122
Net cash used in financing activities	(3,771)	(15,289)
Effect of exchange rate changes on cash and cash equivalents	995	(30)
Net increase in cash and cash equivalents	31,119	4,109
Cash and cash equivalents, beginning of period	59,215	9,603
Cash and cash equivalents, end of period	$90,334	$13,712
Supplemental disclosure of cash flow information		
Non-cash operating, investing, and financing activities		
Repurchase of common stock incurred but not yet paid	$441	$—
Property, plant, and equipment expenditures incurred but not yet paid	$7,226	$—

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

Table of Contents

Vera Bradley, Inc.
Notes to the Consolidated Financial Statements
(unaudited)

1. Description of the Company and Basis of Presentation

The terms “Company” and “Vera Bradley” refer to Vera Bradley, Inc. and its subsidiaries, except where context requires or where otherwise indicated.

Vera Bradley is a leading designer of women’s handbags and accessories, luggage and travel items, eyewear, and stationery and gifts. Founded in 1982 by friends Barbara Bradley Baekgaard and Patricia R. Miller, the brand’s iconic designs and versatile styles offer women of all ages a colorful way to accessorize every look.

Vera Bradley offers a unique, multi-channel sales model, as well as a focus on service and a high level of customer engagement. The Company sells its products through two reportable segments: Direct and Indirect. The Direct business consists of sales of Vera Bradley products through the Company’s full-line and factory outlet stores in the United States, verabradley.com, direct-to-consumer eBay sales, and the Company's annual outlet sale in Fort Wayne, Indiana. As of November 1, 2014, the Company operated 95 full-line stores and 27 factory outlet stores. The Indirect business consists of sales of Vera Bradley products to approximately 2,850 specialty retail doors, substantially all of which are located in the United States, as well as department stores, national accounts, third party e-commerce sites, the Company's wholesale business in Japan, and third party inventory liquidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been omitted. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended February 1, 2014, filed with the SEC.

The interim financial statements reflect all adjustments that are, in the opinion of management, necessary to present fairly the results for the interim periods presented. All such adjustments are of a normal, recurring nature. The results of operations for the thirteen and thirty-nine weeks ended November 1, 2014, are not necessarily indicative of the results to be expected for the full fiscal year.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The Company has eliminated intercompany balances and transactions in consolidation.

Fiscal Periods

The Company’s fiscal year ends on the Saturday closest to January 31. References to the fiscal quarters ended November 1, 2014, and November 2, 2013, refer to the thirteen-week periods ended on those dates.

Operating Leases and Tenant-Improvement Allowances

The Company has leases that contain rent holidays and predetermined, fixed escalations of minimum rentals. For each of these leases, the Company recognizes the related rent expense on a straight-line basis commencing on the date of initial possession of the leased property. The Company records the difference between the recognized rent expense and the amount payable under the lease as a deferred rent liability. As of November 1, 2014 and February 1, 2014, deferred rent liability was $8.6 million and $7.0 million, respectively, and is included within other long-term liabilities on the Consolidated Balance Sheets.

The Company receives tenant-improvement allowances from some of the landlords of its leased properties. These allowances generally are in the form of cash received by the Company from its landlords as part of the negotiated lease terms. The Company records each tenant-improvement allowance as a deferred credit and amortizes the allowance on a straight-line basis as a reduction to rent expense over the term of the lease, commencing on the possession date. As of November 1, 2014 and February 1, 2014, the deferred lease credit liability was $13.6 million and $10.3 million, respectively. Of these amounts, $1.8 million and $1.4 million is included within other accrued liabilities as of November 1, 2014 and February 1, 2014, respectively; and $11.8 million and $8.9 million is included within other long-term liabilities as of November 1, 2014 and February 1, 2014, respectively.

Table of Contents

Vera Bradley, Inc.
Notes to the Consolidated Financial Statements
(unaudited)

Recently Issued Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This guidance states that the disposal of a component of an entity is to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The pronouncement also requires additional disclosures regarding individually significant disposals of components that do not meet the criteria to be recognized as a discontinued operation as well as additional and expanded disclosures. The guidance is effective for all disposals (or classifications as held for sale) of components of an entity and all businesses or nonprofit activities that, on acquisition, are classified as held for sale that occur within annual periods beginning on or after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015; it is applied prospectively. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. The Company does not expect this standard to have a material impact on the Company's consolidated financial statements upon adoption.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. This guidance requires companies to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in amounts that reflect the consideration to which a company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. This guidance will be effective beginning in fiscal 2017, and early adoption is not permitted. The standard allows for either a full retrospective or a modified retrospective transition method. The Company is currently evaluating the impact of this standard, including the transition method, on its consolidated results of operations, financial position and cash flows. The Company does not expect the adoption of this standard to have a material impact on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements - Going Concern which requires management to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and provide related footnote disclosures. The guidance is effective for annual or interim reporting periods beginning on or after December 15, 2016. Early adoption is permitted for financial statements that have not been previously issued. The standard allows for either a full retrospective or modified retrospective transition method. The Company does not expect this standard to have an impact on the Company's consolidated financial statements upon adoption.

Table of Contents

2. Earnings Per Share

Basic earnings per share is computed based on the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed based on the weighted-average number of common shares outstanding, plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares represent outstanding restricted stock units. The components of basic and diluted earnings per share were as follows (in thousands, except per share data):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Numerator:				
Income from continuing operations	$8,721	$15,657	$23,492	$40,225
Loss from discontinued operations, net of taxes	(1,780)	(431)	(2,386)	(859)
Net income	$6,941	$15,226	$21,106	$39,366
Denominator:				
Weighted-average number of common shares (basic)	40,663	40,605	40,663	40,596
Dilutive effect of stock-based awards	53	47	57	37
Weighted-average number of common shares (diluted)	40,716	40,652	40,720	40,633
Earnings per share - basic:				
Continuing operations	$0.21	$0.39	$0.58	$0.99
Discontinued operations	(0.04)	(0.01)	(0.06)	(0.02)
Net income	$0.17	$0.37	$0.52	$0.97
Earnings per share - diluted:				
Continuing operations	$0.21	$0.39	$0.58	$0.99
Discontinued operations	(0.04)	(0.01)	(0.06)	(0.02)
Net income	$0.17	$0.37	$0.52	$0.97

As of November 1, 2014 and November 2, 2013, there were an immaterial number of additional shares issuable upon the vesting of restricted stock units that were excluded from the diluted share calculations because they were anti-dilutive.

3. Fair Value of Financial Instruments

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. Assets and liabilities measured at fair value are classified using the following hierarchy, which is based upon the transparency of inputs to the valuation as of the measurement date:

- Level 1 – Quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly;
- Level 3 – Unobservable inputs based on the Company’s own assumptions.

The classification of fair value measurements within the hierarchy is based upon the lowest level of input that is significant to the measurement.

The carrying amounts reflected on the Consolidated Balance Sheets for cash and cash equivalents, receivables, other current assets, and payables as of November 1, 2014, and February 1, 2014, approximated their fair values.

Table of Contents

4. Inventories

The components of inventories were as follows (in thousands):

	November 1, 2014	February 1, 2014
Raw materials	$8,471	$10,772
Work in process	514	850
Finished goods	97,271	125,301
Total inventories	$106,256	$136,923

5. Debt

As of November 1, 2014 and February 1, 2014, the Company had borrowing availability of $125.0 million under the amended and restated credit agreement.

6. Income Taxes

The provision for income taxes for interim periods is based on an estimate of the annual effective tax rate adjusted to reflect the impact of discrete items. Management judgment is required in projecting ordinary income to estimate the Company’s annual effective tax rate.

The effective tax rate for the thirteen weeks ended November 1, 2014, was 34.9%, compared to 36.3% for the thirteen weeks ended November 2, 2013. The year-over-year decrease is primarily due to state tax matters, including the reversal of FIN48 reserves, partially offset by the effect of non-deductible items becoming a larger percentage of income from continuing operations before income taxes.

The effective tax rate for the thirty-nine weeks ended November 1, 2014, was 37.9%, compared to 37.2% for the thirty-nine weeks ended November 2, 2013. The year-over-year increase is primarily due to the effect of non-deductible items becoming a larger percentage of income from continuing operations before income taxes, partially offset by state tax matters including a net reduction in FIN48 reserves.

7. Stock-Based Compensation

The Company recognizes share-based compensation expense, for its awards of restricted stock and restricted stock units, in an amount equal to the fair market value of the underlying stock on the grant date of the respective award. The Company reserved 6,076,001 shares of common stock for issuance or transfer under the 2010 Equity and Incentive Plan, which allows for grants of restricted stock units, as well as other equity awards.

Awards of Restricted Stock Units

During the thirteen weeks ended November 1, 2014, the Company granted 2,500 time-based restricted stock units with an aggregate fair value of $0.1 million to certain employees under the 2010 Equity and Incentive Plan compared to a total of 2,546 time-based restricted stock units with an aggregate fair value of $0.1 million granted in the same period of the prior year.

During the thirty-nine weeks ended November 1, 2014, the Company granted 280,991 time-based and performance-based restricted stock units with an aggregate fair value of $7.4 million to certain employees and non-employee directors under the 2010 Equity and Incentive Plan compared to a total of 247,360 time-based and performance-based restricted stock units with an aggregate fair value of $5.8 million granted in the same period of the prior year. The Company determined the fair value of the awards based on the closing price of the Company’s common stock on the grant date.

The majority of time-based restricted stock units vest and settle in shares of the Company’s common stock, on a one-for-one basis, in equal installments on each of the first three anniversaries of the grant date. Beginning in fiscal 2014, all restricted stock units issued to non-employee directors vest after a one-year period from grant date. The Company is recognizing the expense relating to these units, net of estimated forfeitures, on a straight-line basis over the vesting period.

Table of Contents

Vera Bradley, Inc.
Notes to the Consolidated Financial Statements
(unaudited)

Performance-based restricted stock units vest upon the completion of a three-year period of time (cliff vesting), subject to the employee's continuing employment throughout the three-year performance period and the Company's achievement of annual net income or earnings per share targets during the three-year performance period. The Company is recognizing the expense relating to these units, net of estimated forfeitures, based on the probable outcome of achievement of the financial targets, on a straight-line basis over three years.
The following table sets forth a summary of restricted stock unit activity for the period ended November 1, 2014 (units in thousands):

	Time-based Restricted Stock Units		Performance-based Restricted Stock Units	
	Number of Units	Weighted-Average Grant Date Fair Value (per unit)	Number of Units	Weighted-Average Grant Date Fair Value (per unit)
Nonvested units outstanding at February 1, 2014	231	$26.92	160	$25.75
Granted	169	25.71	112	26.94
Vested	(105)	27.05	—	—
Forfeited	(37)	25.91	(46)	26.08
Nonvested units outstanding at November 1, 2014	258	$26.22	226	$26.27

As of November 1, 2014, there was $6.4 million of total unrecognized compensation cost, net of estimated forfeitures, related to nonvested restricted stock units. That cost is expected to be recognized over a weighted-average period of 1.8 years.

8. Commitments and Contingencies

The Company is subject to various claims and contingencies arising in the normal course of business, including those relating to product liability, legal, employee benefit, environmental, and other matters. Management believes that it is not reasonably possible that any of these claims will have a material adverse effect on the Company's financial condition, results of operations, or cash flows.

9. Segment Reporting

The Company has two operating segments, which are also its reportable segments: Direct and Indirect. These operating segments are components of the Company for which separate financial information is available and for which operating results are evaluated on a regular basis by the chief operating decision maker in deciding how to allocate resources and in assessing the performance of the segments.
The Direct segment includes the Company's full-line and factory outlet stores, the Company's website, verabradley.com, direct-to-consumer eBay sales, and the annual outlet sale. Revenues generated through this segment are driven through the sale of Company-branded products from Vera Bradley to end consumers. The Company exited its direct Japan operations in the third quarter. Direct segment results for the current and prior periods presented are reported on a continuing operations basis unless otherwise stated. Discontinued operations are detailed in Note 11 Discontinued Operations of this Quarterly Report on Form 10-Q.
The Indirect segment represents revenues generated through the distribution of Company-branded products to specialty retailers representing approximately 2,850 doors, substantially all of which are located in the United States,

as well as key accounts, which include department stores, national accounts, third party e-commerce sites, the Company's wholesale business in Japan, and third party inventory liquidation.

Corporate costs represent the Company’s administrative expenses, which include, but are not limited to: human resources, legal, finance, information technology, design, merchandising, and various other corporate-level-activity-related expenses. All intercompany-related activities are eliminated in consolidation and are excluded from the segment reporting.

Table of Contents

Vera Bradley, Inc.
Notes to the Consolidated Financial Statements
(unaudited)

Company management evaluates segment operating results based on several indicators. The primary or key performance indicators for each segment are net revenues and operating income. Net revenues and operating income information for the Company's reportable segments consisted of the following (in thousands):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended
	November 1, 2014	November 2, 2013	November 1, 2014