CLAIRES STORES INC
Form 10-Q
September 19, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended July 30, 2016

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	**59-0940416**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
2400 West Central Road, Hoffman Estates, Illinois	**60192**
(Address of principal executive offices)	**(Zip Code)**

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

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 x

Explanatory Note: While registrant is not subject to the filing requirements of Section 13 or 15(d) of the Exchange Act, it has filed all reports pursuant to Section 13 or 15(d) of the Exchange Act during the preceding 12 months.

Indicate by check mark whether registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes 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 definition of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x	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

As of September 1, 2016, 100 shares of the Registrant s common stock, $0.001 par value, were outstanding.

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CLAIRE S STORES, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

CLAIRE S STORES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	July 30, 2016	January 30, 2016
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 75,272	$ 18,871
Inventories	153,614	151,954
Prepaid expenses	17,904	15,676
Other current assets	24,676	26,254
Total current assets	271,466	212,755
Property and equipment:		
Furniture, fixtures and equipment	243,940	245,954
Leasehold improvements	308,220	310,021
	552,160	555,975
Accumulated depreciation and amortization	(395,236)	(383,334)
	156,924	172,641
Leased property under capital lease:		
Land and building	18,055	18,055
Accumulated depreciation and amortization	(5,862)	(5,416)
	12,193	12,639
Goodwill	1,301,922	1,301,922
Intangible assets, net of accumulated amortization of $77,961 and $74,683, respectively	469,141	470,227
Other assets	45,980	43,371
	1,817,043	1,815,520
Total assets	$ 2,257,626	$ 2,213,555
LIABILITIES AND STOCKHOLDER S DEFICIT		
Current liabilities:		
Revolving credit facilities	$ 158,367	$ 41,059

Current portion of long-term debt		268,157		
Trade accounts payable		67,339		73,133
Income taxes payable		4,335		6,165
Accrued interest payable		68,263		67,984
Accrued expenses and other current liabilities		77,259		85,225
Total current liabilities		643,720		273,566
Long-term debt		2,094,410		2,351,072
Obligation under capital lease		16,557		16,712
Deferred tax liability		102,989		103,309
Deferred rent expense		35,001		36,144
Unfavorable lease obligations and other long-term liabilities		11,701		12,996
		2,260,658		2,520,233
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		618,828		618,831
Accumulated other comprehensive loss, net of tax		(44,909)		(49,239)
Accumulated deficit		(1,220,671)		(1,149,836)
		(646,752)		(580,244)
Total liabilities and stockholder s deficit	$	2,257,626	$	2,213,555

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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CLAIRE S STORES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(in thousands)

	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Net sales	$ 317,172	$ 347,587	$ 616,819	$ 667,582
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	170,683	179,076	329,036	351,928
Gross profit	146,489	168,511	287,783	315,654
Other expenses:				
Selling, general and administrative	112,372	116,369	220,094	229,387
Depreciation and amortization	13,796	15,634	27,856	30,188
Severance and transaction-related costs	125	420	1,698	827
Other income, net	(4,538)	(2,606)	(1,593)	(2,466)
	121,755	129,817	248,055	257,936
Operating income	24,734	38,694	39,728	57,718
Interest expense, net	55,623	55,044	110,702	109,464
Loss before income tax (benefit) expense	(30,889)	(16,350)	(70,974)	(51,746)
Income tax (benefit) expense	1,188	2,519	(139)	2,541
Net loss	$ (32,077)	$ (18,869)	$ (70,835)	$ (54,287)
Net loss	$ (32,077)	$ (18,869)	$ (70,835)	$ (54,287)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(2,340)	(516)	520	(601)
Net gain (loss) on intra-entity foreign currency transactions, net of tax expense (benefit) of $209, $(108), $735 and $(372)	(6,385)	(3,547)	3,810	(2,998)
Other comprehensive income (loss)	(8,725)	(4,063)	4,330	(3,599)
Comprehensive loss	$ (40,802)	$ (22,932)	$ (66,505)	$ (57,886)

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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CLAIRE S STORES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Cash flows from operating activities:		
Net loss	$ (70,835)	$ (54,287)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	27,856	30,188
Amortization of lease rights and other assets	1,371	1,551
Amortization of debt issuance costs	4,222	4,084
Accretion of debt premium	(1,339)	(1,229)
Non-cash in kind interest expense	9,156	
Net unfavorable accretion of lease obligations	(126)	(189)
Loss on sale/retirement of property and equipment, net	170	248
Gain on sale of intangible assets/lease rights		(1,596)
Stock-based compensation benefit	(3)	(561)
(Increase) decrease in:		
Inventories	(1,143)	(25,667)
Prepaid expenses	(3,051)	(1,536)
Other assets	(281)	(4,488)
Increase (decrease) in:		
Trade accounts payable	(5,988)	11,513
Income taxes payable	(41)	1,809
Accrued interest payable	284	76
Accrued expenses and other liabilities	(11,997)	(5,514)
Deferred income taxes	(545)	(134)
Deferred rent expense	(1,213)	2,932
Net cash used in operating activities	(53,503)	(42,800)
Cash flows from investing activities:		
Acquisition of property and equipment	(8,523)	(14,379)
Acquisition of intangible assets/lease rights	(103)	(127)
Proceeds from sale of intangible assets/lease rights		1,736
Net cash used in investing activities	(8,626)	(12,770)
Cash flows from financing activities:		
Proceeds from revolving credit facilities	120,618	250,198
Payments on revolving credit facilities		(138,898)
Payment of debt issuance costs	(79)	(82)

Principal payments on capital lease		(116)		(81)
Net cash provided by financing activities		120,423		111,137
Effect of foreign currency exchange rate changes on cash and cash equivalents		(1,893)		(326)
Net increase in cash and cash equivalents		56,401		55,241
Cash and cash equivalents, at beginning of period		18,871		27,386
Cash and cash equivalents, at end of period		75,272		82,627
Restricted cash, at end of period				336
Cash and cash equivalents and restricted cash, at end of period	$	75,272	$	82,963
Supplemental disclosure of cash flow information:				
Interest paid	$	98,316	$	106,452
Income taxes paid		658		735
Non-cash investing activities				
Restricted cash received in escrow (bank)				(1,693)

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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CLAIRE S STORES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying Unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair statement of the results for the interim periods presented have been included. These statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in the Annual Report on Form 10-K for the year ended January 30, 2016 filed with the Securities and Exchange Commission, including Note 2 to the Consolidated Financial Statements included therein, which discusses principles of consolidation and summary of significant accounting policies.

The Unaudited Condensed 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, 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. Illiquid credit markets, volatile 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.

Due to the seasonal nature of the retail industry and the Company s business, the results of operations for interim periods of the year are not necessarily indicative of the results of operations on an annualized basis.

2. Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-04, Liabilities - Extinguishments of Liabilities (Subtopic 405-20), *Recognition of Breakage for Certain Prepaid Stored-Value Products*. The new guidance addresses diversity in practice related to the derecognition of a prepaid stored-value product liability. ASU 2016-04 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017, with early adoption permitted. The amended standard may be adopted on either a modified retrospective or a retrospective basis. The Company does not expect adoption of ASU 2016-04 to have a material impact on the Company s financial position, results of operations or cash flows.

In March 2016, FASB issued ASU 2016-09, *Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting,* which simplifies several aspects of the accounting for share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company will be required to recognize all excess tax benefits and shortfalls as income tax expense or benefit in the income statement within the reporting period in which they occur. The requirements of the new standard will be effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual reporting periods, which for the Company is the first quarter of fiscal 2017. The Company has not yet evaluated the impact that this standard will have on its consolidated financial position, results of operations, and cash flows.

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In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for substantially all leases. Leases will be classified as either financing or operating, with classification affecting the pattern of expense recognition in the statement of income. The new standard is effective for years beginning after December 15, 2018, including interim periods within those years. The Company has not yet evaluated the impact that this standard will have on its consolidated financial position, results of operations, and cash flows.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance when it becomes effective. On August 12, 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): *Deferral of the Effective Date*, which delays the effective date of ASU 2014-09 by one year. The new standard is effective for the Company on January 1, 2018. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

3. 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 Unaudited Condensed Consolidated Balance Sheets. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. There is a three-level valuation hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs are inputs market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the factors market participants would use in valuing the asset or liability.

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

The Company does not have any assets (liabilities) measured at fair value on a recurring basis.

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.

Financial Instruments Not Measured at Fair Value

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

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The Company considers all investments with a maturity of three months or less when acquired to be cash equivalents. The Company s cash equivalent instruments are valued using quoted market prices and are primarily U.S. Treasury securities. The revolving credit facilities approximate fair value due to the variable component of the interest rate. Excluding unamortized debt issuance costs, the estimated fair value of the Company s long-term debt (including current portion) was approximately $1.03 billion as of July 30, 2016, compared to a carrying value of $2.38 billion at that date. Excluding unamortized debt issuance costs, the estimated fair value of the Company s long-term debt was approximately $1.04 billion as of January 30, 2016, 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.

4. Debt

Debt as of July 30, 2016 and January 30, 2016 included the following components (in thousands):

	July 30, 2016	January 30, 2016
U.S. senior secured revolving credit facility due 2017	$ 110,200	$ 42,200
Europe unsecured revolving credit facility due 2017	49,339	
Unamortized debt issuance cost	(1,172)	(1,141)
Total revolving credit facilities	$ 158,367	$ 41,059
Current portion of long-term debt:		
10.5% Senior subordinated notes due 2017	$ 85,212	$
10.5% PIK Senior subordinated notes due 2017	183,556	
Unamortized debt issuance cost	(611)	
Total current portion of long-term debt	$ 268,157	$
Long-term debt:		
10.5% Senior subordinated notes due 2017	$	$ 259,612
9.0% Senior secured first lien notes due 2019 (1)	1,133,015	1,134,354
8.875% Senior secured second lien notes due 2019	450,000	450,000
6.125% Senior secured first lien notes due 2020	210,000	210,000
7.75% Senior notes due 2020	320,000	320,000
Unamortized debt issuance cost	(18,605)	(22,894)
Total long-term debt	$ 2,094,410	$ 2,351,072

Obligation under capital lease (including current portion)	$	16,839	$	16,954

(1) Amount includes unamortized premium of $8,015 and $9,354 as of July 30, 2016 and January 30, 2016, respectively.

10.5% PIK Senior Subordinated Notes

On May 4, 2016, the Company entered into two exchange agreements with certain funds managed by affiliates of Apollo Global Management, LLC (the Apollo Funds), pursuant to which the Company exchanged (i) $174.4 million aggregate principal amount of its 10.5% Senior Subordinated Notes due 2017 (the Existing Subordinated Notes) held by the Apollo Funds, for (ii) $174.4 million aggregate principal amount of its newly-issued 10.5% PIK Senior Subordinated Notes due 2017 (the New PIK Subordinated Notes). The Existing Subordinated Notes had been acquired by the Apollo Funds in open market transactions. The Company has caused all $174.4 million aggregate principal amount of the acquired Existing Subordinated Notes to be cancelled. The Apollo Funds are the indirect controlling shareholders of the Company.

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The terms of the New PIK Subordinated Notes are substantially the same as those of the Existing Subordinated Notes except that interest, which accrues at 10.5% per annum from December 1, 2015, will be paid-in-kind (PIK) with respect to the June 1, 2016 interest payment and may be PIK, paid in cash or paid 50% cash/50% PIK with respect to the December 1, 2016 interest payment. Interest on the New PIK Subordinated Notes and the Existing Subordinated Notes is payable semi-annually in June and December. The New PIK Subordinated Notes and the Existing Subordinated Notes will mature June 1, 2017.

On June 1, 2016, the Company issued an additional $9.2 million aggregate principal amount of New PIK Subordinated Notes in payment of interest due June 1, 2016. The New PIK Subordinated Notes rank pari passu with the Existing Subordinated Notes, and both series are subordinated to all senior indebtedness of the Company and the Guarantors. See Note 9 Related Party Transactions.

U.S. Revolving Credit Facility and Note Covenants

The Amended and Restated Credit Agreement with respect to the Company s senior secured revolving credit facility due 2017, as amended (the U.S. Credit Facility) in the amount of $115 million and our 10.5% Senior Subordinated Notes due 2017 (the Senior Subordinated Notes), 8.875% Senior Secured Second Lien Notes due 2019 (the Senior Secured Second Lien Notes), 9.0% Senior Secured First Lien Notes due 2019 (the 9.0% Senior Secured First Lien Notes), 6.125% Senior Secured First Lien Notes due 2020 (the 6.125% Senior Secured First Lien Notes), 7.75% Senior Notes due 2020 (the 7.75% Senior Notes) and the New PIK Subordinated Notes (collectively, the Notes) contain certain covenants that, among other things, subject to certain exceptions and other basket amounts, restrict our ability and the ability of our subsidiaries to:

- incur additional indebtedness;
- pay dividends or distributions on our capital stock, repurchase or retire our capital stock and redeem, repurchase or defease any subordinated indebtedness;
- make certain investments;
- create or incur certain liens;
- create restrictions on the payment of dividends or other distributions to us from our subsidiaries;
- transfer or sell assets;
- engage in certain transactions with our affiliates; and
- merge or consolidate with other companies or transfer all or substantially all of our assets.

Certain of these covenants in the indentures governing the Notes, 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.

The U.S. Credit Facility also contains customary provisions relating to mandatory prepayments, voluntary payments, affirmative and negative covenants, and events of default. In addition, so long as the revolving loans and letters of credit outstanding exceed $15.0 million, the Company is required to maintain, at each borrowing date measured at the end of the prior fiscal quarter (but reflecting borrowings and repayments under the U.S. Credit Facility through the measurement date) and at the end of each quarter, a maximum Total Net Secured Leverage Ratio 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. Effective September 10, 2015, the Company amended the provisions in its U.S. Credit Facility to increase the maximum Total Net Secured Leverage Ratio. Commencing with the third quarter of Fiscal 2015, the maximum ratio is 6.75:1.0 for all quarters through the end of Fiscal 2016 except the fourth quarters of Fiscal 2015 and Fiscal 2016 when the ratio will be 6.35:1.0. See Note 12- Subsequent Events for discussion of a waiver and an amendment to the U.S. Credit Facility.

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Europe Revolving Credit Facility

Certain of the Company s European subsidiaries are parties to an unsecured multi-currency revolving credit facility, dated October 2, 2014, as amended on July 15, 2015 (as amended, the Europe Credit Facility) in the amount of $50 million that will terminate on August 20, 2017. Loans under the Europe Credit Facility bear interest at 2.50% per annum plus the Euro Interbank Offered Rate as in effect for interest periods of one, three or six months or any other period agreed upon. The Europe Credit Facility also provides for a facility fee of 0.875% per annum on the unused amount of the facility.

All obligations under the Europe Credit Facility are unconditionally and fully guaranteed by Claire s (Gibraltar) Holdings Limited (Claire s Gibraltar) and certain of its existing direct or indirect wholly-owned European subsidiaries, subject to certain exceptions and limitations.

The Europe Credit Facility contains customary affirmative and negative covenants applicable to Claire s Gibraltar and its subsidiaries, events of default and provisions relating to mandatory and voluntary payments, which include an annual requirement that for at least five successive Business Days in each year no loans under the Europe Credit Facility may be outstanding. The Europe Credit Facility also contains covenants that require Claire s Gibraltar to maintain particular financial ratios so long as any amounts are outstanding under the facility: a Fixed Charge Cover Ratio not lower than 1.5:1.0 based upon the ratio of adjusted earnings before interest, taxes, depreciation, amortization, and rent to net interest and rent for each period of four consecutive fiscal quarters and a Leverage Ratio not more than 1.5:1.0 based upon the ratio of net debt to adjusted earnings before interest, taxes, depreciation and amortization for each period of four consecutive fiscal quarters. See Note 12- Subsequent Events for discussion of a waiver to the Europe Credit Facility.

Europe Bank Credit Facilities

Our non-U.S. subsidiaries have bank credit facilities totaling $2.3 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 July 30, 2016, we had a reduction of $2.1 million for outstanding bank guarantees, which reduces the borrowing availability to $0.2 million as of that date.

See Note 3 Fair Value Measurements for related fair value disclosure on debt.

5. Commitments and Contingencies

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.

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6. Accumulated Other Comprehensive Income (Loss)

The following summary sets forth the components of accumulated other comprehensive income (loss), net of tax as follows (in thousands, net of tax):

	Foreign Currency Items	Derivative Instrument	Total
Balance as of January 30, 2016	$ (54,971)	$ 5,732	$ (49,239)
Other comprehensive income	4,330		4,330
Balance as of July 30, 2016	$ (50,641)	$ 5,732	$ (44,909)

7. Stock Options and Stock-Based Compensation

The following is a summary of activity in the Company s stock option plan for the six months ended July 30, 2016:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)
Outstanding as of January 30, 2016	3,710,022	$ 9.43	
Options granted	1,085,500	$ 1.26	
Options exercised			
Options forfeited	(897,135)	$ 9.07	
Options expired	(309,595)	$ 10.00	
Outstanding as of July 30, 2016	3,588,792	$ 6.99	4.3
Options vested and expected to vest as of July 30, 2016	3,328,970	$ 7.19	4.1
Exercisable as of July 30, 2016	1,902,149	$ 8.88	3.0

The weighted average grant date fair value of options granted during the six months ended July 30, 2016 and August 1, 2015 was $0.32 and $0.51, respectively.

During the three and six months ended July 30, 2016 and August 1, 2015, the Company recorded stock-based compensation expense (benefit) and additional paid-in capital relating to stock-based compensation of approximately $0.0 million, $0.1 million, $(0.0) million and $(0.6) million, respectively. During the three and six months ended July 30, 2016, the Company recorded reversals of stock option expense of $0.1 million and $0.2 million, respectively, associated with the forfeitures of stock options, including $0.1 million and $0.1 million, respectively, for former executive officers. Stock-based compensation benefit is recorded in Selling, general and administrative expenses in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss.

8. Income Taxes

The effective income tax rate was (3.8)% and 0.2 % for the three and six months ended July 30, 2016. This effective income tax rate differed from the statutory federal income tax rate of 35% primarily from increases in the valuation allowance recorded for additional deferred tax assets generated primarily from operating losses in the three and six months ended July 30, 2016 by the Company s U.S. operations.

The effective income tax rate was (15.4)% and (4.9)% for the three and six months ended August 1, 2015. This effective income tax rate differed from the statutory federal income tax rate of 35% primarily from increases in the valuation allowance recorded for additional deferred tax assets generated primarily from operating losses in the three and six months ended August 1, 2015 by the Company s U.S. operations.

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9. Related Party Transactions

The Company, Parent, and affiliates have purchased and may, from time to time, purchase portions of the Company s indebtedness. All of these purchases have been open market transactions and any interest payments to Parent or affiliates made thereon are paid in accordance with the associated indenture. As of July 30, 2016 and January 30, 2016, Parent and affiliates held $242.3 million and $233.0 million of the Company s indebtedness and the Company had accrued interest payable associated with the indebtedness in the amounts of $16.4 million and $4.0 million, respectively. For the three and six months ended July 30, 2016 and August 1, 2015, the Company recognized interest expense related to the indebtedness held by Parent and affiliates of $6.3 million, $12.4 million, $5.7 million and $11.4 million, respectively. On June 1, 2016, the Company issued an additional $9.2 million aggregate principal amount of New PIK Subordinated Notes in payment of interest due June 1, 2016.

10. Segment Information

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 Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss within its North America segment. The franchise fees the Company charges under the franchising agreements are reported in Other income, net in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss within its Europe segment. Substantially all of the interest expense on the Company s outstanding debt is recorded in the Company s North America segment.

Net sales, depreciation and amortization and operating income for the three and six months ended July 30, 2016 and August 1, 2015 are as follows (in thousands):

	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Net sales:				
North America	$ 194,774	$ 210,567	$ 394,080	$ 416,295
Europe	122,398	137,020	222,739	251,287
Total net sales	317,172	347,587	616,819	667,582
Depreciation and amortization:				
North America	8,337	10,166	17,432	19,359
Europe	5,459	5,468	10,424	10,829
Total depreciation and amortization	13,796	15,634	27,856	30,188
Operating income for reportable segments:				
North America	16,184	24,870	40,755	44,455

Europe	8,675	14,244	671	14,090
Total operating income for reportable segments	24,859	39,114	41,426	58,545
Severance and transaction-related costs	125	420	1,698	827
Consolidated operating income	24,734	38,694	39,728	57,718
Interest expense, net	55,623	55,044	110,702	109,464
Consolidated loss before income tax expense	$ (30,889)	$ (16,350)	$ (70,974)	$ (51,746)

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Excluded from operating income for the North America segment are severance and transaction-related costs of approximately $0.0 million and $0.2 million for the three months ended July 30, 2016 and August 1, 2015, respectively, and $1.3 million and $0.4 million for the six months ended July 30, 2016 and August 1, 2015, respectively.

Excluded from operating income for the Europe segment are severance and transaction-related costs of approximately $0.1 million and $0.2 million for the three months ended July 30, 2016 and August 1, 2015, respectively, and $0.4 million and $0.4 million for the six months ended July 30, 2016 and August 1, 2015, respectively.

11. 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 (collectively, the 2013 Notes). On May 4, 2016 and June 1, 2016, the Issuer issued the New PIK Subordinated Notes (the 2016 Notes). The 2007 Notes, the 2011 Notes and the 2016 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 U.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 July 30, 2016, Claire s Stores, Inc. owned 100% of its domestic subsidiaries that guarantee the 2007 Notes, 2011 Notes, 2012 Notes, 2016 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. See Note 12 Subsequent Event.

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.

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Condensed Consolidating Balance Sheet

July 30, 2016

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 33,298	$ 4,644	$ 37,330	$	$ 75,272
Inventories		89,012	64,602		153,614
Prepaid expenses	1,182	1,652	15,070		17,904
Other current assets		15,601	9,075		24,676
Total current assets	34,480	110,909	126,077		271,466
Property and equipment:					
Furniture, fixtures and equipment	5,926	158,918	79,096		243,940
Leasehold improvements	1,315	188,953	117,952		308,220
	7,241	347,871	197,048		552,160
Accumulated depreciation and amortization	(4,935)	(259,589)	(130,712)		(395,236)
	2,306	88,282	66,336		156,924
Leased property under capital lease:					
Land and building		18,055			18,055
Accumulated depreciation and amortization		(5,862)			(5,862)
		12,193			12,193
Intercompany receivables		224,498	5,811	(230,309)	
Investment in subsidiaries	1,834,608	(46,111)		(1,788,497)	
Goodwill		987,517	314,405		1,301,922
Intangible assets, net	257,000	443	211,698		469,141
Other assets	3,443	4,939	37,598		45,980
	2,095,051	1,171,286	569,512	(2,018,806)	1,817,043
Total assets	$ 2,131,837	$ 1,382,670	$ 761,925	$ (2,018,806)	$ 2,257,626

LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)					
Current liabilities:					
Revolving credit facilities	$ 109,407	$	$ 48,960	$	$ 158,367
Current portion of long-term debt	268,157				268,157
Trade accounts payable	(413)	21,945	45,807		67,339
Income taxes payable		5	4,330		4,335
Accrued interest payable	68,211		52		68,263
Accrued expenses and other current liabilities	8,508	34,308	34,443		77,259
Total current liabilities	453,870	56,258	133,592		643,720
Intercompany payables	230,309			(230,309)	
Long-term debt	2,094,410				2,094,410
Obligation under capital lease		16,557			16,557
Deferred tax liability		94,700	8,289		102,989
Deferred rent expense		23,842	11,159		35,001
Unfavorable lease obligations and other long-term liabilities		11,694	7		11,701
	2,324,719	146,793	19,455	(230,309)	2,260,658
Stockholder s equity (deficit):					
Common stock		367	2	(369)	
Additional paid in capital	618,828	1,435,909	797,656	(2,233,565)	618,828
Accumulated other comprehensive income (loss), net of tax	(44,909)	(4,831)	(40,536)	45,367	(44,909)
Accumulated deficit	(1,220,671)	(251,826)	(148,244)	400,070	(1,220,671)
	(646,752)	1,179,619	608,878	(1,788,497)	(646,752)
Total liabilities and stockholder s equity (deficit)	$ 2,131,837	$ 1,382,670	$ 761,925	$ (2,018,806)	$ 2,257,626

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Condensed Consolidating Balance Sheet

January 30, 2016

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 2,664	$ 3,394	$ 12,813	$	$ 18,871
Inventories		94,014	57,940		151,954
Prepaid expenses	344	1,485	13,847		15,676
Other current assets		16,023	10,231		26,254
Total current assets	3,008	114,916	94,831		212,755
Property and equipment:					
Furniture, fixtures and equipment	5,537	160,128	80,289		245,954
Leasehold improvements	1,315	191,085	117,621		310,021
	6,852	351,213	197,910		555,975
Accumulated depreciation and amortization	(4,455)	(252,181)	(126,698)		(383,334)
	2,397	99,032	71,212		172,641
Leased property under capital lease:					
Land and building		18,055			18,055
Accumulated depreciation and amortization		(5,416)			(5,416)
		12,639			12,639
Intercompany receivables		169,836	43,000	(212,836)	
Investment in subsidiaries	1,836,079	(43,436)		(1,792,643)	
Goodwill		987,517	314,405		1,301,922
Intangible assets, net	257,000	671	212,556		470,227
Other assets	486	3,507	39,378		43,371
	2,093,565	1,118,095	609,339	(2,005,479)	1,815,520
Total assets	$ 2,098,970	$ 1,344,682	$ 775,382	$ (2,005,479)	$ 2,213,555

LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)					
Current liabilities:					
Revolving credit facilities	$ 41,059	$	$	$	$ 41,059
Trade accounts payable	642	27,930	44,561		73,133
Income taxes payable		228	5,937		6,165
Accrued interest payable	67,948		36		67,984
Accrued expenses and other current liabilities	5,657	39,834	39,734		85,225
Total current liabilities	115,306	67,992	90,268		273,566
Intercompany payables	212,836			(212,836)	
Long-term debt	2,351,072				2,351,072
Obligation under capital lease		16,712			16,712
Deferred tax liability		93,626	9,683		103,309
Deferred rent expense		24,815	11,329		36,144
Unfavorable lease obligations and other long-term liabilities		12,977	19		12,996
	2,563,908	148,130	21,031	(212,836)	2,520,233
Stockholder s equity (deficit):					
Common stock		367	2	(369)	
Additional paid in capital	618,831	1,435,909	797,656	(2,233,565)	618,831
Accumulated other comprehensive income (loss), net of tax	(49,239)	(7,390)	(41,341)	48,731	(49,239)
Accumulated deficit	(1,149,836)	(300,326)	(92,234)	392,560	(1,149,836)
	(580,244)	1,128,560	664,083	(1,792,643)	(580,244)
Total liabilities and stockholder s equity (deficit)	$ 2,098,970	$ 1,344,682	$ 775,382	$ (2,005,479)	$ 2,213,555

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Condensed Consolidating Statement of Operations and Comprehensive Loss

For The Three Months Ended July 30, 2016

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	$	$ 179,775	$ 137,397	$	$ 317,172
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	2,861	94,245	73,577		170,683
Gross profit (deficit)	(2,861)	85,530	63,820		146,489
Other expenses:					
Selling, general and administrative	4,794	58,211	49,367		112,372
Depreciation and amortization	243	7,543	6,010		13,796
Severance and transaction-related costs	1		124		125
Other (income) expense	(2,102)	398	(2,834)		(4,538)
	2,936	66,152	52,667		121,755
Operating income (loss)	(5,797)	19,378	11,153		24,734
Interest expense, net	54,717	553	353		55,623
Income (loss) before income taxes	(60,514)	18,825	10,800		(30,889)
Income tax expense (benefit)		563	625		1,188
Income (loss) from continuing operations	(60,514)	18,262	10,175		(32,077)
Equity in earnings (loss) of subsidiaries	28,437	70		(28,507)	
Net income (loss)	(32,077)	18,332	10,175	(28,507)	(32,077)
Foreign currency translation adjustments	(2,340)	(548)	(253)	801	(2,340)
Net gain (loss) on intra-entity foreign currency transactions, net of tax	(6,385)	(768)	(6,514)	7,282	(6,385)
Other comprehensive income (loss)	(8,725)	(1,316)	(6,767)	8,083	(8,725)
Comprehensive income (loss)	$ (40,802)	$ 17,016	$ 3,408	$ (20,424)	$ (40,802)

Condensed Consolidating Statement of Operations and Comprehensive Loss

For The Three Months Ended August 1, 2015

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	$	$ 194,689	$ 152,898	$	$ 347,587
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	29	100,824	78,223		179,076
Gross profit (deficit)	(29)	93,865	74,675		168,511
Other expenses:					
Selling, general and administrative	3,583	60,669	52,117		116,369
Depreciation and amortization	211	9,210	6,213		15,634
Severance and transaction-related costs	226	3	191		420
Other (income) expense	(1,657)	152	(1,101)		(2,606)
	2,363	70,034	57,420		129,817
Operating income (loss)	(2,392)	23,831	17,255		38,694
Interest expense, net	54,261	549	234		55,044
Income (loss) before income taxes	(56,653)	23,282	17,021		(16,350)
Income tax expense (benefit)		696	1,823		2,519
Income (loss) from continuing operations	(56,653)	22,586	15,198		(18,869)
Equity in earnings (loss) of subsidiaries	37,784	366		(38,150)	
Net income (loss)	(18,869)	22,952	15,198	(38,150)	(18,869)
Foreign currency translation adjustments	(516)	(689)	3,321	(2,632)	(516)
Net gain (loss) on intra-entity foreign currency transactions, net of tax	(3,547)	(1,850)	(3,482)	5,332	(3,547)
Other comprehensive income (loss)	(4,063)	(2,539)	(161)	2,700	(4,063)
Comprehensive income (loss)	$ (22,932)	$ 20,413	$ 15,037	$ (35,450)	$ (22,932)

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Condensed Consolidating Statement of Operations and Comprehensive Loss

For The Six Months Ended July 30, 2016

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	$	$ 365,799	$ 251,020	$	$ 616,819
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	5,586	185,497	137,953		329,036
Gross profit (deficit)	(5,586)	180,302	113,067		287,783
Other expenses:					
Selling, general and administrative	9,565	113,624	96,905		220,094
Depreciation and amortization	480	15,857	11,519		27,856
Severance and transaction-related costs	1,349	(3)	352		1,698
Other (income) expense	(3,513)	414	1,506		(1,593)
	7,881	129,892	110,282		248,055
Operating income (loss)	(13,467)	50,410	2,785		39,728
Interest expense, net	108,986	1,093	623		110,702
Income (loss) before income taxes	(122,453)	49,317	2,162		(70,974)
Income tax expense (benefit)		(776)	637		(139)
Income (loss) from continuing operations	(122,453)	50,093	1,525		(70,835)
Equity in earnings (loss) of subsidiaries	51,618	(1,594)		(50,024)	
Net income (loss)	(70,835)	48,499	1,525	(50,024)	(70,835)
Foreign currency translation adjustments	520	938	(2,959)	2,021	520
Net gain on intra-entity foreign currency transactions, net of tax	3,810	1,621	3,764	(5,385)	3,810
Other comprehensive income (loss)	4,330	2,559	805	(3,364)	4,330
Comprehensive income (loss)	$ (66,505)	$ 51,058	$ 2,330	$ (53,388)	$ (66,505)

Condensed Consolidating Statement of Operations and Comprehensive Loss

For The Six Months Ended August 1, 2015

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net sales	$	$ 387,197	$ 280,385	$	$ 667,582
Cost of sales, occupancy and buying expenses (exclusive of depreciation and amortization shown separately below)	82	203,001	148,845		351,928
Gross profit (deficit)	(82)	184,196	131,540		315,654
Other expenses:					
Selling, general and administrative	6,220	120,126	103,041		229,387
Depreciation and amortization	412	17,523	12,253		30,188
Severance and transaction-related costs	361	3	463		827
Other (income) expense	(1,018)	(615)	(833)		(2,466)
	5,975	137,037	114,924		257,936
Operating income (loss)	(6,057)	47,159	16,616		57,718
Interest expense, net	107,889	1,092	483		109,464
Income (loss) before income taxes	(113,946)	46,067	16,133		(51,746)
Income tax expense (benefit)		(495)	3,036		2,541
Income (loss) from continuing operations	(113,946)	46,562	13,097		(54,287)
Equity in earnings (loss) of subsidiaries	59,659	(1,289)		(58,370)	
Net income (loss)	(54,287)	45,273	13,097	(58,370)	(54,287)
Foreign currency translation adjustments	(601)	(287)	876	(589)	(601)
Net gain on intra-entity foreign currency transactions, net of tax	(2,998)	(708)	(2,949)	3,657	(2,998)
Other comprehensive income (loss)	(3,599)	(995)	(2,073)	3,068	(3,599)
Comprehensive income (loss)	$ (57,886)	$ 44,278	$ 11,024	$ (55,302)	$ (57,886)

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Condensed Consolidating Statement of Cash Flows

Six Months Ended July 30, 2016

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
Net income (loss)	$ (70,835)	$ 48,499	$ 1,525	$ (50,024)	$ (70,835)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Loss (equity) in earnings of subsidiaries	(51,618)	1,594		50,024	
Depreciation and amortization	480	15,857	11,519		27,856
Amortization of lease rights and other assets			1,371		1,371
Amortization of debt issuance costs	4,052		170		4,222
Accretion of debt premium	(1,339)				(1,339)
Non-cash in kind interest expense	9,156				9,156
Net accretion of unfavorable lease obligations		(125)	(1)		(126)
Loss on sale/retirement of property and equipment, net		165	5		170
Stock-based compensation expense (benefit)	(13)		10		(3)
(Increase) decrease in:					
Inventories		5,002	(6,145)		(1,143)
Prepaid expenses	(839)	(166)	(2,046)		(3,051)
Other assets	17	105	(403)		(281)
Increase (decrease) in:					
Trade accounts payable	(1,054)	(5,703)	769		(5,988)
Income taxes payable		(264)	223		(41)
Accrued interest payable	262		22		284
Accrued expenses and other liabilities	(124)	(6,524)	(5,349)		(11,997)
Deferred income taxes			(545)		(545)
Deferred rent expense		(973)	(240)		(1,213)
Net cash provided by (used in) operating activities	(111,855)	57,467	885		(53,503)
Cash flows from investing activities:					
Acquisition of property and equipment	(389)	(5,058)	(3,076)		(8,523)
Acquisition of intangible assets/lease rights		(23)	(80)		(103)
Net cash used in investing activities	(389)	(5,081)	(3,156)		(8,626)

Cash flows from financing activities:					
Proceeds from revolving credit facilities	68,000		52,618		120,618
Payments on revolving credit facilities					
Payment of debt issuance costs	(25)		(54)		(79)
Principal payments on capital lease		(116)			(116)
Intercompany activity, net	74,903	(54,661)	(20,242)		
Net cash provided by (used in) financing activities	142,878	(54,777)	32,322		120,423
Effect of foreign currency exchange rate changes on cash and cash equivalents		3,641	(5,534)		(1,893)
Net increase in cash and cash equivalents	30,634	1,250	24,517		56,401
Cash and cash equivalents, at beginning of period	2,664	3,394	12,813		18,871
Cash and cash equivalents, at end of period	$ 33,298	$ 4,644	$ 37,330	$	$ 75,272

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Condensed Consolidating Statement of Cash Flows

Six Months Ended August 1, 2015

(in thousands)

	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
Net income (loss)	$ (54,287)	$ 45,273	$ 13,097	$ (58,370)	$ (54,287)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries	(59,659)	1,289		58,370	
Depreciation and amortization	412	17,523	12,253		30,188
Amortization of lease rights and other assets			1,551		1,551
Amortization of debt issuance costs	3,952		132		4,084
Accretion of debt premium	(1,229)				(1,229)
Net accretion of unfavorable lease obligations		(182)	(7)		(189)
Loss on sale/retirement of property and equipment, net		248			248
Gain on sale of intangible assets/lease rights			(1,596)		(1,596)
Stock-based compensation benefit	(514)		(47)		(561)
(Increase) decrease in:					
Inventories		(15,641)	(10,026)		(25,667)
Prepaid expenses	(535)	103	(1,104)		(1,536)
Other assets	(32)	(2,320)	(2,136)		(4,488)
Increase (decrease) in:					
Trade accounts payable	(1,673)	3,051	10,135		11,513
Income taxes payable		(344)	2,153		1,809
Accrued interest payable	289		(213)		76
Accrued expenses and other liabilities	(1,145)	(1,869)	(2,500)		(5,514)
Deferred income taxes			(134)		(134)
Deferred rent expense		97	2,835		2,932
Net cash provided by (used in) operating activities	(114,421)	47,228	24,393		(42,800)
Cash flows from investing activities:					
Acquisition of property and equipment	(427)	(8,738)	(5,214)		(14,379)
Acquisition of intangible assets/lease rights		(25)	(102)		(127)
Proceeds from sale of intangible assets/lease rights			1,736		1,736

Net cash used in investing activities	(427)	(8,763)	(3,580)		(12,770)
Cash flows from financing activities:					
Proceeds from revolving credit facilities	156,300		93,898		250,198
Payments on revolving credit facilities	(45,000)		(93,898)		(138,898)
Payment of debt issuance costs			(82)		(82)
Principal payments on capital lease		(81)			(81)
Intercompany activity, net	35,848	(35,414)	(434)		
Net cash provided by (used in) financing activities	147,148	(35,495)	(516)		111,137
Effect of foreign currency exchange rate changes on cash and cash equivalents		(1,529)	1,203		(326)
Net increase in cash and cash equivalents	32,300	1,441	21,500		55,241
Cash and cash equivalents, at beginning of period	3,480	4,009	19,897		27,386
Cash and cash equivalents, at end of period	35,780	5,450	41,397		82,627
Restricted cash, at end of period			336		336
Cash and cash equivalents and restricted cash, at end of period	$ 35,780	$ 5,450	$ 41,733	$	$ 82,963

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12. Subsequent Events

Exchange Offer

On August 12, 2016, the Company commenced a private offer to exchange (the Exchange Offer), upon the terms and conditions set forth in a confidential offer to exchange statement dated August 12, 2016 and a related letter of transmittal (together, the Offer to Exchange Statement), any and all of its outstanding Senior Secured Second Lien Notes, 7.75% Senior Notes, and the Senior Subordinated Notes (not held by Claire s Inc.), and collectively (the Exchange Notes) held by eligible holders, for up to $40.0 million of new Senior Secured Term Loans maturing 2021 of the Company (the Claire s Stores Term Loans), up to $130.0 million of new Senior Secured Term Loans maturing 2021 of CLSIP LLC (CLSIP), which is a newly formed unrestricted subsidiary of the Company (the CLSIP Term Loans) and up to $60.0 million of new Senior Term Loans maturing 2021 of Claire s Gibraltar, the holding company of the Company s European operations (the Claire s Gibraltar Term Loans , and collectively, the Term Loans).

On August 29, 2016, the Company announced amended terms of the Exchange Offer as set forth in a confidential amended and restated offer to exchange statement dated August 29, 2016 and a related letter of transmittal. Subject to the satisfaction or waiver of the conditions precedent, the closing of the transactions contemplated by the Exchange Offer is expected to occur promptly after the expiration.

Pursuant to the terms of the Exchange Offer, if the Exchange Offer is not fully subscribed, the Apollo Funds and Claire s Inc., the parent of the Company (Claire s Inc. and together with the Apollo Funds, the Affiliated Holders), agreed to effect a similar exchange of up to approximately $183.6 million aggregate principal amount of Claire s New PIK Subordinated Notes held by the Apollo Funds and up to approximately $58.7 million aggregate principal amount of existing Subordinated Notes held by Claire s Inc., which exchange will count towards satisfaction of the Exchange Offer s $400 million Minimum Tender Condition (the Affiliated Holder Exchange).

Based on the tenders through September 16, 2016 and the Affiliated Holder Exchange, approximately $575 million of the Company s outstanding debt will be exchanged for approximately $179 million of new Term Loans.

Election to Delay Interest Payments

On September 15, 2016, the Company elected to delay making interest payments due September 15, 2016 on its outstanding Senior Secured Second Lien Notes, 6.125% Senior Secured First Lien Notes and 9.0% Senior Secured First Lien Notes (the Secured Notes) pending completion of the Exchange Offer and the Europe Credit Facility Refinancing described below. Non-payment of this interest would become an event of default under the indentures governing the Secured Notes only if the payment is not made within 30 days. The total amount of interest due September 15, 2016 is approximately $77 million. This includes approximately $10 million of interest accrued on the Senior Secured Second Lien Notes that have been tendered in the Exchange Offer, and which will be cancelled upon completion of the Exchange Offer.

Under the indentures governing each series of Secured Notes, the Company has a 30-day period after the interest payment date before an event of default would occur on October 15, 2016. The occurrence of an event of default under the indentures would give the trustee or the holders of at least 30% of principal amount of each series of Secured Notes the option to declare all of the Secured Notes of such series due and payable immediately upon such event of default. Additionally, failure to make the interest payments on the Secured Notes when due at the end of such period would constitute an event of default under certain of the Company s other outstanding indebtedness.

Europe Credit Facility Refinancing

Claire s Gibraltar and certain subsidiaries are party to an unsecured multi-currency revolving credit facility in the amount of $50.0 million that matures August 20, 2017. Consent of the lender under the Europe Credit Facility is required for the consummation of the Exchange Offer, and in addition, consent of the lender is required to allow Claire s Gibraltar to distribute cash to the Company in an amount required to enable the Company to fund its near term debt service and other obligations, including the interest payments due September 15, 2016. As of the date hereof, the lender has not provided such consents. The Exchange Offer is conditioned on (i) the lender agreeing to an amendment satisfactory to Claire s Gibraltar providing the foregoing consents, or (ii) the refinancing of the Europe Credit Facility with new debt arrangements satisfactory to the Company, CLSIP and Claire s Gibraltar that allow the Exchange Offer and distributions of cash from Claire s Gibraltar in amounts sufficient for the Company to fund its near term debt service and other obligations. This condition to the Exchange Offer cannot be waived by the Company, CLSIP and Claire s Gibraltar. The Company, Claire s Gibraltar and certain of its subsidiaries are in advanced discussions with the lender under the Europe Credit Facility with respect to an amended and restated facility that will provide the consents required for the consummation of the Exchange Offer and the distribution of certain cash to the Company.

Upon the delivery of financial statements for the quarter ended July 30, 2016 to the lender under the Europe Credit Facility, the Company would have been in default under the Fixed Charge Cover Ratio covenant contained in the Europe Credit Facility. However, the Company received a waiver of this default from the lender.

U.S. Credit Facility Refinancing

On August 12, 2016, the Company entered into Amendment No. 3 (as supplemented, the Third Amendment) of the U.S. Credit Facility.

Pursuant to the Third Amendment, the Company will complete a refinancing of the U.S. Credit Facility as follows:

the Company, its domestic subsidiaries and Claire s Inc., will be parties to an amendment and restatement of the U.S. Credit Facility (the Second Amended and Restated Credit Facility), pursuant to which, among other things, the availability will be reduced to an amount equal to $75.0 million less any amounts outstanding under the ABL Credit Facility (as defined below), the maturity will be extended to February 4, 2019 and certain covenants will be modified;

the Company s subsidiary Claire s Gibraltar will be party to a new $40.0 million credit agreement maturing February 4, 2019 (the Claire s Gibraltar Credit Facility), the proceeds of which will be used to reduce outstanding amounts under the U.S. Credit Facility by $40.0 million; and

the Company, its domestic subsidiaries and Claire s Inc., will be parties to a new ABL Credit Agreement (the ABL Credit Facility) maturing February 4, 2019, providing for revolving credit loans, subject to borrowing base availability, in an amount up to $75.0 million less any amounts outstanding under the U.S. Credit Facility.

Each of the Second Amended and Restated Credit Facility, the Claire s Gibraltar Credit Facility and the ABL Credit Facility was dated, executed and delivered on August 12, 2016. Nevertheless, the effectiveness of such agreements is subject to the satisfaction or waiver of the respective conditions set out in the Third Amendment upon completion of the Exchange Offer or as provided below.

The Third Amendment provides that, if the Company notifies the Lenders on or before September 23, 2016, that the Exchange Offer will not be completed by September 23, 2016 as a result of the failure to

satisfy any of the conditions to such Exchange Offer, including the failure to obtain the consent of the lender of the Company s current European credit facility or to refinance such European credit facility, or for any other reason, then the Second Amended and Restated Credit Facility, the ABL Credit Facility, and, only if permitted by the lender under the European credit facility, the Claire s Gibraltar Credit Facility, will become effective notwithstanding the fact that the Exchange Offer will not be completed at that time. If the Claire s Gibraltar Credit Facility is not permitted, the Second Amended and Restated Credit Facility will provide for revolving credit loans of up to $115.0 million rather than $75.0 million, in either case, less any amounts outstanding under the ABL Credit Facility.

In addition, upon the delivery of financial statements for the quarter ended July 30, 2016 to the lenders under the U.S. Credit Facility, the Company would have been in default under the Total Net Secured Leverage Ratio covenant contained in the U.S. Credit Facility. The terms of the Third Amendment include a waiver of this default upon the effectiveness thereof.

Item 2. 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 Unaudited Condensed Consolidated Financial Statements and related notes thereto contained elsewhere in this document.

We include a store in the calculation of same store sales once it has been in operation sixty weeks after its initial opening and, 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 rates.

We are highly leveraged, with significant debt service obligations. As of July 30, 2016, we reported net debt (total debt less cash and cash equivalents) of approximately $2.5 billion. In addition, our cash flows from operations have been running at rates lower than in prior years. We are undertaking the Exchange Offer in an effort to significantly reduce the amount of our indebtedness and improve liquidity through the reduction of cash interest expense.

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 be the emporium of choice for all girls (in age or attitude) across the world. We deliver this by offering a range of innovative, fun and affordable products and services that cater to all of her activities, as she grows up, whenever and wherever. Our broad and dynamic selection of merchandise is unique. 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 July 30, 2016, we operated a total of 2,801 company-operated stores of which 1,699 were located in all 50 states of the United States, Puerto Rico, Canada and the U.S. Virgin Islands (North America segment) and 1,102 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*®. As of July 30, 2016, we also had a total of 806 concession stores, of which 244 were located in the United States and Canada (North America segment) and 562 stores were located in the United Kingdom, France, Spain, Austria, Germany, Italy, Portugal, Switzerland, Hungary and Poland (Europe segment).

As of July 30, 2016, we also franchised 596 stores in Japan, the Middle East, Turkey, Greece, Guatemala, Malta, India, Dominican Republic, El Salvador, Panama, Indonesia, Philippines, Costa Rica, Serbia, Sweden, Romania, Martinique, Pakistan, Thailand, Southern Africa and Russia. We account for the goods we sell to third parties under franchising agreements within Net sales and Cost of sales, occupancy and buying expenses (North America segment) in our Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss. The franchise fees we charge under the franchising agreements are reported in Other income, net (North America segment) in our Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss.

Claire s® is our primary global brand that we operate through company-operated, concession stores, 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. *Claire s*® target customer is a girl between 3-18 years old for whom we create three distinct ranges: 3 to 6, 6 to 12 and 12 to 18.

Icing® is our second brand which we currently operate in North America through company-operated stores and in Middle East through franchised stores. *Icing*® offers an inspiring merchandise assortment of fashionable products that helps a young woman to say something about herself, whatever the occasion. 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 provide our target customer groups with a significant selection of fashionable merchandise across a wide range of categories, all with a compelling value proposition. Our major categories of business are:

- Jewelry: Includes earrings as well as our ear piercing service, necklaces, bracelets, body jewelry and rings; and

- Accessories: Includes hairgoods; beauty products; room decor; personal, fashion, and seasonal accessories, including tech accessories such as phone cases, jewelry holders, stationery, key rings, attitude glasses, headwear, legwear, armwear, and sunglasses; and handbags and small leather goods.

In North America, our stores are located primarily in shopping malls. The differentiation of our *Claire s*® and *Icing*® brands allows us to operate multiple stores within a single location. In Europe, our stores are located primarily on high streets, in shopping malls and in high traffic urban areas.

Financial activity for the three and six months ended July 30, 2016 includes the following:

- Net sales decrease of 8.8% and decrease of 7.6%; respectively;

- Same store sales percentages;

	Three Months Ended	**Six Months Ended**

	July 30, 2016	July 30, 2016
Consolidated	(5.7)%	(5.4)%
North America	(4.4)%	(2.6)%
Europe	(7.8)%	(10.1)%

Merchandise margin decreased 160 basis points and was flat, respectively; and

Operating income margin of 7.8 % and 6.4%, respectively.

Operational activity for the three and six months ended July 30, 2016 includes the following:

Opened 75 and 116 concession stores;

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Opened none and two new company-operated stores;

Closed 30 and 68 company-operated stores due to underperformance or lease renewal terms that did not meet our criteria;

Opened three and six new *Icing* ® franchise stores overseas.

A summary of our consolidated results of operations for the three and six months ended July 30, 2016 and August 1, 2015 are as follows (dollars in thousands):

	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015
Net sales	$ 317,172	$ 347,587
Decrease in same store sales	(5.7)%	(1.7)%
Gross profit percentage	46.2%	48.5%
Selling, general and administrative expenses as a percentage of net sales	35.4%	33.5%
Depreciation and amortization as a percentage of net sales	4.3%	4.5%
Operating income	$ 24,734	$ 38,694
Net loss	$ (32,077)	$ (18,869)
Number of company-operated stores at the end of the period	2,801	2,954
Number of concession stores at the end of the period	806	327

	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Net sales	$ 616,819	$ 667,582
Decrease in same store sales	(5.4)%	(2.1)%
Gross profit percentage	46.7%	47.3%
Selling, general and administrative expenses as a percentage of net sales	35.7%	34.4%
Depreciation and amortization as a percentage of net sales	4.5%	4.5%
Operating income	$ 39,728	$ 57,718
Net loss	$ (70,835)	$ (54,287)
Number of company-operated stores at the end of the period	2,801	2,954
Number of concession stores at the end of the period	806	327

Net sales

Net sales for the three months ended July 30, 2016 decreased $30.4 million, or 8.8%, from the three months ended August 1, 2015. The decrease was attributable to a decrease in same store sales of $18.4 million, the effect of store closures of $11.9 million, an unfavorable foreign currency translation effect of our non-U.S. net sales of $5.4 million and decreased shipments to franchisees of $3.4 million, partially offset by an increase in new concession store sales and new store sales of $8.7 million. Net sales would have decreased 7.3% excluding the impact of foreign currency exchange rate changes.

Net sales for the six months ended July 30, 2016 decreased $50.7 million, or 7.6%, from the six months ended August 1, 2015. The decrease was attributable to a decrease in same store sales of $33.7 million, the effect of store closures of $22.5 million, an unfavorable foreign currency translation effect of our non-U.S. net sales of $7.0 million and decreased shipments to franchisees of $4.7 million, partially offset by an increase in new concession store sales and new store sales of $17.2 million. Net sales would have decreased 6.6% excluding the impact of foreign currency exchange rate changes.

For the three months ended July 30, 2016, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 16.8%, partially offset by an increase in average transaction value of 14.4%.

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For the six months ended July 30, 2016, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 17.3%, partially offset by an increase in average transaction value of 15.5%.

The following table compares our sales of each product category for each of the periods presented:

	Percentage of Total		Percentage of Total	
Product Category	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Jewelry	48.1	49.0	48.0	49.1
Accessories	51.9	51.0	52.0	50.9
	100.0	100.0	100.0	100.0

Gross profit

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

During the three months ended July 30, 2016, gross profit percentage decreased 230 basis points to 46.2% compared to 48.5% during the three months ended August 1, 2015. The decrease in gross profit percentage consisted of a decrease in merchandise margin of 160 basis points and an 80 basis point increase in occupancy costs, partially offset by a 10 basis point decrease in buying and buying-related costs. The decrease in merchandise margin percentage resulted primarily from higher markdowns and sales mix. 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 that would materially affect our merchandise margin. The increase in occupancy costs, as a percentage of sales, resulted primarily from the deleveraging effect from a decrease in same store sales.

During the six months ended July 30, 2016, gross profit percentage decreased 60 basis points to 46.7% compared to 47.3% during the six months ended August 1, 2015. The decrease in gross profit percentage consisted of a 70 basis point increase in occupancy costs partially offset by a 10 basis point decrease in buying and buying-related costs. The increase in occupancy costs, as a percentage of sales, resulted primarily from the deleveraging effect from a decrease in same store sales.

Selling, general and administrative expenses

During the three months ended July 30, 2016, selling, general and administrative expenses decreased $4.0 million, or 3.4%, compared to the three months ended August 1, 2015. As a percentage of net sales, selling, general and administrative expenses increased 190 basis points compared to the three months ended August 1, 2015. Excluding a favorable $1.8 million foreign currency translation effect, selling, general, and administrative expenses would have decreased $2.2 million. Besides the foreign currency translation effect, the remainder of the decrease was primarily due to lower compensation and related expenses, partially offset by increased concession store commission expense.

During the six months ended July 30, 2016, selling, general and administrative expenses decreased $9.3 million, or 4.1%, compared to the six months ended August 1, 2015. As a percentage of net sales, selling, general and administrative expenses increased 130 basis points compared to the six months ended August 1, 2015. Excluding a favorable $2.5 million foreign currency translation effect, selling, general, and administrative expenses would have decreased $6.8 million. Besides the foreign currency translation effect, the remainder of the decrease was primarily due to lower compensation and related expenses, partially offset by increased concession store commission expense.

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Depreciation and amortization expense

During the three months ended July 30, 2016, depreciation and amortization expense decreased $1.8 million to $13.8 million compared to $15.6 million for the three months ended August 1, 2015. Excluding a favorable $0.2 million foreign currency translation effect, the decrease in depreciation and amortization expense would have been $1.6 million.

During the six months ended July 30, 2016, depreciation and amortization expense decreased $2.3 million to $27.9 million compared to $30.2 million for the six months ended August 1, 2015. Excluding a favorable $0.2 million foreign currency translation effect, the decrease in depreciation and amortization expense would have been $2.1 million.

Other income, net

The following is a summary of other income activity for the three and six months ended July 30, 2016 and August 1, 2015 (in thousands):

	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Royalty income	$ (1,529)	$ (1,400)	$ (2,632)	$ (2,648)
Foreign currency exchange (gain) loss, net	(3,009)	497	1,044	1,921
Gain on sale of assets		(1,669)		(1,669)
Other income		(34)	(5)	(70)
	$ (4,538)	$ (2,606)	$ (1,593)	$ (2,466)

Interest expense, net

During the three months ended July 30, 2016, net interest expense aggregated $55.6 million compared to $55.0 million for the three months ended August 1, 2015. The increase is primarily due to increased borrowings under our Credit Facilities.

During the six months ended July 30, 2016, net interest expense aggregated $110.7 million compared to $109.5 million for the six months ended August 1, 2015. The increase is primarily due to increased borrowings under our Credit Facilities.

Income taxes

The effective income tax rate for the three and six months ended July 30, 2016 was (3.8)% and 0.2% compared to (15.4)% and (4.9)% for the three and six months ended August 1, 2015. These effective income tax rates differed from the statutory federal income tax rate of 35% primarily from increases in the valuation allowance recorded for additional deferred tax assets generated primarily from operating losses in the three and six months ended July 30, 2016 and August 1, 2015, respectively, by our U.S. operations.

Segment Operations

We have two reportable segments North America and Europe. The following is a discussion of results of operations by reportable segment.

North America

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

	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Net sales	$ 194,774	$ 210,567	$ 394,080	$ 416,295
(Decrease) increase in same store sales	(4.4)%	0.7%	(2.6)%	(0.6)%
Gross profit percentage	46.1%	48.5%	48.0%	47.9%
Number of company-operated stores at the end of the period	1,699	1,808	1,699	1,808
Number of concession stores at the end of the period	244	48	244	48

During the three months ended July 30, 2016, net sales in North America decreased $15.8 million, or 7.5%, from the three months ended August 1, 2015. The decrease was attributable to the effect of store closures of $8.5 million, a decrease in same store sales of $8.4 million, decreased shipments to franchisees of $3.4 million and an unfavorable foreign currency translation effect of our non-U.S. net sales of $0.6 million, partially offset by an increase in new concession store sales and new store sales of $5.1 million. Sales would have decreased 7.2% excluding the impact from foreign currency exchange rate changes.

During the six months ended July 30, 2016, net sales in North America decreased $22.2 million, or 5.3%, from the six months ended August 1, 2015. The decrease was attributable to the effect of store closures of $15.8 million, a decrease in same store sales of $9.9 million, decreased shipments to franchisees of $4.7 million and an unfavorable foreign currency translation effect of our non-U.S. net sales of $1.4 million, partially offset by an increase in new concession store sales and new store sales of $9.6 million. Sales would have decreased 5.0% excluding the impact from foreign currency exchange rate changes.

For the three months ended July 30, 2016, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 17.8%, partially offset by an increase in average transaction value of 18.0%.

For the six months ended July 30, 2016, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 17.7%, partially offset by an increase in average transaction value of 20.0%.

During the three months ended July 30, 2016, gross profit percentage decreased 240 basis points to 46.1% compared to 48.5% during the three months ended August 1, 2015. The decrease in gross profit percentage consisted of a decrease in merchandise margin of 130 basis points, a 90 basis point increase in occupancy costs and a 20 basis point increase in buying and buying-related costs. The decrease in merchandise margin resulted primarily from higher markdowns and increased 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 that would materially affect our merchandise margin. The increase in occupancy costs, as a percentage of sales, resulted primarily from the deleveraging effect from a decrease in same store sales.

During the six months ended July 30, 2016, gross profit percentage increased 10 basis points to 48.0% compared to 47.9% during the six months ended August 1, 2015. The increase in gross profit percentage consisted of an increase in merchandise margin of 70 basis points, partially offset by a 50 basis point increase in occupancy costs and by a 10 basis point increase in buying and buying-related costs. The increase in merchandise margin resulted primarily from lower freight costs and higher initial markups, partially offset by higher markdowns. The decrease in occupancy costs, as a percentage of sales, was primarily caused by the leveraging effect of concession store sales, which do not have associated occupancy costs.

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The following table compares our sales of each product category in North America for each of the periods presented:

	Percentage of Total		Percentage of Total	
Product Category	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Jewelry	53.9	55.8	53.6	55.8
Accessories	46.1	44.2	46.4	44.2
	100.0	100.0	100.0	100.0

Europe

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

	Three Months Ended July 30, 2016	Three Months Ended August 1, 2015	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Net sales	$ 122,398	$ 137,020	$ 222,739	$ 251,287
Decrease in same store sales	(7.8)%	(5.2)%	(10.1)%	(4.4)%
Gross profit percentage	46.3%	48.5%	44.2%	46.3%
Number of company-operated stores at the end of the period	1,102	1,146	1,102	1,146
Number of concession stores at the end of the period	562	279	562	279

During the three months ended July 30, 2016, net sales in Europe decreased $14.6 million, or 10.7%, from the three months ended August 1, 2015. The decrease was attributable to a decrease in same stores sales of $10.0 million, an unfavorable foreign currency translation effect of our non-U.S. net sales of $4.8 million and, the effect of store closures of $3.4 million, partially offset by an increase in new concession store sales and new store sales of $3.6 million. Sales would have decreased 7.4% excluding the impact from foreign currency exchange rate changes.

During the six months ended July 30, 2016, net sales in Europe decreased $28.5 million, or 11.4%, from the six months ended August 1, 2015. The decrease was attributable to a decrease in same stores sales of $23.8 million, the effect of store closures of $6.7 million and an unfavorable foreign currency translation effect of our non-U.S. net sales of $5.6 million, partially offset by an increase in new concession store sales and new store sales of $7.6 million. Sales would have decreased 9.3% excluding the impact from foreign currency exchange rate changes.

For the three months ended July 30, 2016, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 16.1%, partially offset by an increase in average transaction value of 10.3%.

For the six months ended July 30, 2016, the decrease in same store sales was primarily attributable to a decrease in average number of transactions per store of 17.4%, partially offset by an increase in average transaction value of 9.0%.

During the three months ended July 30, 2016, gross profit percentage decreased 220 basis points to 46.3% compared to 48.5% during the three months ended August 1, 2015. The decrease in gross profit percentage consisted of a 200 basis point decrease in merchandise margin and a 70 basis point increase in occupancy costs, partially offset by a 50 basis point decrease in buying and buying-related costs. The decrease in merchandise margin resulted primarily from sales mix and unfavorable foreign exchange rates. The increase in occupancy costs, as a percentage of sales, resulted primarily from the deleveraging effect from a decrease in same store sales.

During the six months ended July 30, 2016, gross profit percentage decreased 210 basis points to 44.2% compared to 46.3% during the six months ended August 1, 2015. The decrease in gross profit percentage consisted of a 150 basis point increase in occupancy costs and a 120 basis point decrease in merchandise

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margin, partially offset by a 60 basis point decrease in buying and buying-related costs. The decrease in merchandise margin resulted primarily from sales mix and unfavorable foreign exchange rates, partially offset by lower freight costs. The increase in occupancy costs, as a percentage of sales, resulted primarily from the deleveraging effect from a decrease in same store sales.

The following table compares our sales of each product category in Europe for each of the periods presented:

	Percentage of Total		Percentage of Total	
Product Category	**Three Months Ended July 30, 2016**	**Three Months Ended August 1, 2015**	**Six Months Ended July 30, 2016**	**Six Months Ended August 1, 2015**
Jewelry	39.1	38.8	38.4	38.3
Accessories	60.9	61.2	61.6	61.7
	100.0	100.0	100.0	100.0

Liquidity and Capital Resources

We are highly leveraged, with significant debt service obligations. As of July 30, 2016, we reported net debt (total debt less cash and cash equivalents) of approximately $2.5 billion with maturities ranging from 2017 through 2020. Our revolving credit facilities were fully drawn. See Note 4 Debt, in the Notes to the accompanying Unaudited Condensed Consolidated Financial Statements for a summary of our outstanding indebtedness as of July 30, 2016. In addition, our cash flows from operations have been running at rates lower than in prior years, requiring a greater portion to be devoted to debt service. See Events Subsequent to July 30, 2016 for a description of certain steps we are taking to address the foregoing, each of which is summarized below.

We are undertaking the Exchange Offer described below in an effort to reduce our outstanding indebtedness and improve liquidity through the reduction of cash interest expense. Based on the tenders through September 16, 2016 and the Affiliated Holder Exchange (as defined below), upon completion of the transactions contemplated by the Exchange Offer, the Company s outstanding debt would be reduced by approximately $396 million, debt maturities would be extended, and the Company estimates it would realize annual cash interest savings of approximately $24 million. We are also completing the U.S. Credit Facility Refinancing described below.

Consent of the lender under our Europe Credit Facility (as defined below) is required for the consummation of the Exchange Offer and to enable us to distribute cash from our European subsidiaries to the Company to fund near term debt service and other obligations. As of the date hereof, the lender has not provided the consents. However, we are in advanced discussions with the lender with respect to an amended and restated facility that will provide such consents.

Pending completion of the Exchange Offer and the amendment and restatement of the Europe Credit Facility, we elected to defer interest payments of approximately $77 million due September 15, 2016 on certain indebtedness. The delayed interest payments include approximately $10 million that will be cancelled upon completion of the Exchange Offer.

If the amendment and restatement of the Europe Credit Facility, the Exchange Offer and the U.S. Credit Facility Refinancing are each completed, then we currently anticipate that cash on hand and cash generated from operations will be sufficient to allow us to satisfy payments of interest on our indebtedness, to fund new store expenditures, and meet working capital requirements over the near-term. However, this will depend, to a large degree, on our operating performance, which may be adversely affected by general economic, political and financial conditions, foreign currency exchange exposures, and other factors beyond our control, including those disclosed in Risk Factors in our Annual Report on Form 10-K for the fiscal year ended January 30, 2016.

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In addition, if we complete the actions described below, all of our debt maturities will have been extended to beyond Fiscal 2017, except for the $50 million Europe Credit Facility and approximately $25 million of Subordinated Notes (as defined below). We expect that repayment of our debt as it matures will require refinancing, and we cannot make assurances that we will have the financial resources required to obtain, or that the conditions of the capital markets will support, any future refinancing, replacement or restructuring of our indebtedness.

A summary of cash flows provided by (used in) operating, investing and financing activities for the six months ended July 30, 2016 and August 1, 2015 is outlined in the table below (in thousands):

	Six Months Ended July 30, 2016	Six Months Ended August 1, 2015
Operating activities	$ (53,503)	$ (42,800)
Investing activities	(8,626)	(12,770)
Financing activities	120,423	111,137

Cash flows from operating activities

For the six months ended July 30, 2016, cash used in operations increased $10.7 million compared to the prior year period. The primary reason for the increase was a decrease in operating income and net other items of $10.2 million and an increase in working capital of $0.5 million, excluding cash equivalents. For the six months ended August 1, 2015, cash used in operations increased $23.1 million compared to the prior year period. The primary reason for the increase was an increase in working capital of $18.1 million and a net decrease in operating income adjusted for non-cash items and other items of $5.0 million, excluding cash equivalents.

Cash flows from investing activities

For the six months ended July 30, 2016, cash used in investing activities was $8.6 million and consisted of $8.6 million for capital expenditures. For the six months ended August 1, 2015, cash used in investing activities was $12.8 million and consisted of $14.5 million for capital expenditures, partially offset by proceeds of $1.7 million for sale of intangible assets. During the remainder of Fiscal 2016, we expect to spend approximately $10.0 million of capital expenditures.

Cash flows from financing activities

For the six months ended July 30, 2016, cash provided by financing activities was $120.4 million, which consisted primarily of net borrowings of $120.6 million under the revolving credit facilities, partially offset by payment of $0.1 million in financing costs and payment of $0.1 million for capital lease. For the six months ended August 1, 2015, cash provided by financing activities was $111.1 million, which consisted of net borrowings of $111.3 million under the revolving U.S. Credit Facility, partially offset by payment of $0.1 million in financing costs and payment of $0.1 million for capital lease.

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

Cash Position

As of July 30, 2016, we had cash and cash equivalents of $75.3 million and all cash equivalents were maintained in one money market fund invested exclusively in U.S. Treasury Securities.

In addition, as of July 30, 2016, our foreign subsidiaries held cash and cash equivalents of $37.3 million. During the six months ended July 30, 2016, we repatriated cash held by foreign subsidiaries but did not accrue U.S. income taxes since the amount of our remaining U.S. net operating loss carryforwards was sufficient to offset the associated income tax liability. During the remainder of Fiscal 2016, 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 July 30, 2016, we do not expect to pay U.S. income tax on future Fiscal 2016 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.

Events Subsequent to July 30, 2016

Exchange Offer

On August 12, 2016, the Company commenced a private offer to exchange (the Exchange Offer), upon the terms and conditions set forth in a confidential offer to exchange statement dated August 12, 2016 and a related letter of transmittal (together, the Offer to Exchange Statement), any and all of its outstanding Senior Secured Second Lien Notes, 7.75% Senior Notes, and the Senior Subordinated Notes (not held by Claire s Inc.), and collectively (the Exchange Notes) held by eligible holders, for up to $40.0 million of new Senior Secured Term Loans maturing 2021 of the Company (the Claire s Stores Term Loans), up to $130.0 million of new Senior Secured Term Loans maturing 2021 of CLSIP LLC (CLSIP), which is a newly formed unrestricted subsidiary of the Company (the CLSIP Term Loans) and up to $60.0 million of new Senior Term Loans maturing 2021 of Claire s Gibraltar, the holding company of the Company s European operations (the Claire s Gibraltar Term Loans , and collectively, the Term Loans).

On August 29, 2016, the Company announced amended terms of the Exchange Offer as set forth in a confidential amended and restated offer to exchange statement dated August 29, 2016 and a related letter of transmittal. Subject to the satisfaction or waiver of the conditions precedent, the closing of the transactions contemplated by the Exchange Offer is expected to occur promptly after the expiration.

Pursuant to the terms of the Exchange Offer, if the Exchange Offer is not fully subscribed, the Apollo Funds and Claire s Inc., the parent of the Company (Claire s Inc. and together with the Apollo Funds, the Affiliated Holders), agreed to effect a similar exchange of up to approximately $183.6 million aggregate principal amount of Claire s New PIK Subordinated Notes held by the Apollo Funds and up to approximately $58.7 million aggregate principal amount of existing Subordinated Notes held by Claire s Inc., which exchange will count towards satisfaction of the Exchange Offer s $400 million Minimum Tender Condition (the Affiliated Holder Exchange).

Based on the tenders through September 16, 2016 and the Affiliated Holder Exchange, approximately $575 million of the Company s outstanding debt will be exchanged for approximately $179 million of new Term Loans.

Election to Delay Interest Payments

On September 15, 2016, the Company elected to delay making interest payments due September 15, 2016 on its outstanding Senior Secured Second Lien Notes, 6.125% Senior Secured First Lien Notes and 9.0% Senior Secured First Lien Notes (the Secured Notes) pending completion of the Exchange Offer and the Europe Credit Facility Refinancing described below. Non-payment of this interest would become an event of default under the indentures governing the Secured Notes only if the payment is not made within 30 days. The total amount of interest due September 15, 2016 is approximately $77 million. This includes approximately $10 million of interest accrued on the Senior Secured Second Lien Notes that have been tendered in the Exchange Offer, and which will be cancelled upon completion of the Exchange Offer.

The Company is continuing to pay employees, suppliers and trade creditors and to fund current operations on an ongoing basis.

Under the indentures governing each series of Secured Notes, the Company has a 30-day period after the interest payment date before an event of default would occur on October 15, 2016. The occurrence of an event of default under the indentures would give the trustee or the holders of at least 30% of principal amount of each series of Secured Notes the option to declare all of the Secured Notes of such series due and payable immediately upon such event of default. Additionally, failure to make the interest payments on the Secured Notes when due at the end of such period would constitute an event of default under certain of the Company s other outstanding indebtedness.

Europe Credit Facility Refinancing

Claire s Gibraltar and certain subsidiaries are party to an unsecured multi-currency revolving credit facility in the amount of $50.0 million that matures August 20, 2017. Consent of the lender under the Europe Credit Facility is required for the consummation of the Exchange Offer, and in addition, consent of the lender is required to allow Claire s Gibraltar to distribute cash to the Company in an amount required to enable the Company to fund its near term debt service and other obligations, including the interest payments due September 15, 2016. As of the date hereof, the lender has not provided such consents. The Exchange Offer is conditioned on (i) the lender agreeing to an amendment satisfactory to Claire s Gibraltar providing the foregoing consents, or (ii) the refinancing of the Europe Credit Facility with new debt arrangements satisfactory to the Company, CLSIP and Claire s Gibraltar that allow the Exchange Offer and distributions of cash from Claire s Gibraltar in amounts sufficient for the Company to fund its near term debt service and other obligations. This condition to the Exchange Offer cannot be waived by the Company, CLSIP and Claire s Gibraltar. The Company, Claire s Gibraltar and certain of its subsidiaries are in advanced discussions with the lender under the Europe Credit Facility with respect to an amended and restated facility that will provide the consents required for the consummation of the Exchange Offer and the distribution of certain cash to the Company. The amended and restated facility is also expected to include certain changes to covenants.

Upon the delivery of financial statements for the quarter ended July 30, 2016 to the lender under the Europe Credit Facility, the Company would have been in default under the Fixed Charge Cover Ratio covenant contained in the Europe Credit Facility. However, the Company received a waiver of this default from the lender.

U.S. Credit Facility Refinancing

On August 12, 2016, the Company entered into Amendment No. 3 (as supplemented, the Third Amendment) of the U.S. Credit Facility

Pursuant to the Third Amendment, the Company will complete a refinancing of the U.S. Credit Facility as follows:

the Company, its domestic subsidiaries and Claire s Inc., will be parties to an amendment and restatement of the U.S. Credit Facility (the Second Amended and Restated Credit Facility), pursuant to which, among other things, the availability will be reduced to an amount equal to $75.0 million less any amounts outstanding under the ABL Credit Facility (as defined below), the maturity will be extended to February 4, 2019 and certain covenants will be modified;

the Company s subsidiary Claire s Gibraltar will be party to a new $40.0 million credit agreement maturing February 4, 2019 (the Claire s Gibraltar Credit Facility), the proceeds of which will be used to reduce outstanding amounts under the U.S. Credit Facility by $40.0 million; and

the Company, its domestic subsidiaries and Claire s Inc., will be parties to a new ABL Credit Agreement (the ABL Credit Facility) maturing February 4, 2019, providing for revolving credit loans, subject to borrowing base availability, in an amount up to $75.0 million less any amounts outstanding under the U.S. Credit Facility.

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Each of the Second Amended and Restated Credit Facility, the Claire s Gibraltar Credit Facility and the ABL Credit Facility was dated, executed and delivered on August 12, 2016. Nevertheless, the effectiveness of such agreements is subject to the satisfaction or waiver of the respective conditions set out in the Third Amendment upon completion of the Exchange Offer or as provided below.

The Third Amendment provides that, if the Company notifies the Lenders on or before September 23, 2016, that the Exchange Offer will not be completed by September 23, 2016 as a result of the failure to satisfy any of the conditions to such Exchange Offer, including the failure to obtain the consent of the lender of the Company s current European credit facility or to refinance such European credit facility, or for any other reason, then the Second Amended and Restated Credit Facility, the ABL Credit Facility, and, only if permitted by the lender under the European credit facility, the Claire s Gibraltar Credit Facility, will become effective notwithstanding the fact that the Exchange Offer will not be completed at that time. If the Claire s Gibraltar Credit Facility is not permitted, the Second Amended and Restated Credit Facility will provide for revolving credit loans of up to $115.0 million rather than $75.0 million, in either case, less any amounts outstanding under the ABL Credit Facility.

In addition, upon the delivery of financial statements for the quarter ended July 30, 2016 to the lenders under the U.S. Credit Facility, the Company would have been in default under the Total Net Secured Leverage Ratio covenant contained in the U.S. Credit Facility. The terms of the Third Amendment include a waiver of this default upon the effectiveness thereof.

Indebtedness as of July 30, 2016

U.S Revolving Credit Facility

We are party to an Amended and Restated Credit Agreement, dated as of September 20, 2012, by and among Claire s Inc. (Parent), the Company, Credit Suisse AG, as Administrative Agent, and the other Lenders named therein, as amended (the U.S. Credit Facility), which provides for a $115.0 million five-year senior secured revolving credit facility maturing September 20, 2017.

Borrowings under the U.S. 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 U.S. Credit Facility whether or not utilized.

All obligations under the U.S. Credit Facility are unconditionally guaranteed by (i) Claire s Inc., our parent corporation, 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 U.S. 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 our 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 U.S. Credit Facility rank equally to the liens securing the 6.125% Senior Secured First Lien Notes and the 9.0% Senior Secured First Lien Notes due 2019 (the 9.0% Senior

Secured First Lien Notes).

The U.S. Credit Facility contains customary provisions relating to mandatory prepayments, voluntary payments, affirmative and negative covenants, and events of default. In addition, so long as the revolving loans and letters of credit outstanding exceed $15 million, we are required to maintain, at each borrowing date measured at the end of the prior fiscal quarter (but reflecting borrowings and repayments under the U.S. Credit Facility through the measurement date) and at the end of each fiscal quarter, a maximum Total Net Secured Leverage Ratio 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. Effective September 10, 2015, we amended the provisions in our U.S. Credit Facility to increase the maximum Total Net Secured Leverage Ratio. Commencing with the third quarter of Fiscal 2015, the maximum ratio is 6.75:1.0 for all quarters through the end of Fiscal 2016 except the fourth quarters of Fiscal 2015 and Fiscal 2016 when the ratio will be 6.35:1.0. As of July 30, 2016, our revolving loans and letters of credit outstanding exceeded $15.0 million, and our Total Net Secured Leverage Ratio was 7.11:1.0. See *Events Subsequent to July 30, 2016 U.S. Credit Facility Refinancing*.

The U.S. Credit Facility also contains various covenants that limit our ability to engage in specified types of transactions. These covenants, subject to certain exceptions and other basket amounts, limit our and our 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 U.S. 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 U.S. Credit Facility could proceed against the collateral granted to them to secure that indebtedness.

As of July 30, 2016, we had $110.2 million of borrowings and $4.7 million of letters of credit outstanding.

See *Events subsequent to July 30, 2016 U.S. Credit Facility Refinancing* for a description of the Third Amendment to the U.S. Credit Facility.

Note Exchange

On May 4, 2016, the Company entered into two exchange agreements, dated as of May 4, 2016 with the Apollo Funds, pursuant to which the Company exchanged (i) $174.4 million aggregate principal amount of its 10.5% Senior Subordinated Notes due 2017 (the Existing Subordinated Notes) held by the Apollo Funds, for (ii) $174.4 million aggregate principal amount of its newly-issued 10.5% PIK Senior Subordinated Notes due 2017 (the New PIK Subordinated Notes). The Existing Subordinated Notes had been acquired by the Apollo Funds in open market transactions. The Company has caused all $174.4 million aggregate principal amount of the acquired Existing Subordinated Notes to be cancelled. The Apollo Funds are the indirect controlling shareholders of the Company.

The terms of the New PIK Subordinated Notes are substantially the same as those of the Existing Subordinated Notes except that interest, which accrues at 10.5% per annum from December 1, 2015, will be paid-in-kind (PIK) with respect to the June 1, 2016 interest payment and may be PIK, paid in cash or paid 50% cash/50% PIK with respect to the December 1, 2016 interest payment. Interest on the New PIK Subordinated Notes and the Existing Subordinated Notes is payable semi-annually in June and December. The New PIK Subordinated Notes and the Existing Subordinated Notes will mature June 1, 2017.

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On June 1, 2016, the Company issued an additional $9.2 million aggregate principal amount of New PIK Subordinated Notes in payment of interest due June 1, 2016. The New PIK Subordinated Notes rank pari passu with the Existing Subordinated Notes, and both series are subordinated to all senior indebtedness of the Company and the Guarantors.

Note Covenants

Our Senior Subordinated Notes, New PIK 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) also contain various covenants that limit our ability to engage in specified types of transactions. These covenants, subject to certain exceptions and other basket amounts, limit our and our subsidiaries ability to, among other things:

- 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.

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 Note covenants, however, require us to maintain any particular financial ratio or other measure of financial performance. As of July 30, 2016, we were in compliance with the covenants under the Notes.

Europe Revolving Credit Facility

Certain of our European subsidiaries are parties to the Europe Credit Facility, entered into in October 2014. In July 2015, we amended the Europe Credit Facility to increase the size from Euro 35 million to USD 50 million. The Europe Credit Facility will terminate on August 20, 2017. Loans under the Europe Credit Facility bear interest at 2.50% per annum plus the Euro Interbank Offered Rate as in effect for interest periods of one, three or six months or any other period agreed upon. The Europe Credit Facility also provides for a facility fee of 0.875% per annum on the unused amount of the facility.

All obligations under the Europe Credit Facility are unconditionally and fully guaranteed by Claire s Gibraltar and certain of its existing direct or indirect wholly-owned European subsidiaries, subject to certain exceptions and limitations.

The Europe Credit Facility contains customary affirmative and negative covenants applicable to Claire s Gibraltar and its subsidiaries, events of default and provisions relating to mandatory and voluntary payments, which include an annual requirement that for at least five successive Business Days in each year no loans under the Europe Credit Facility may be outstanding. The Europe Credit Facility also contains covenants that require Claire s Gibraltar to maintain particular financial ratios so long as any amounts are outstanding under the facility: a Fixed Charge Cover Ratio not lower than 1.5:1.0 based upon the ratio of adjusted earnings before interest, taxes, depreciation, amortization, and rent to net interest and rent for each period of four consecutive fiscal quarters and a Leverage Ratio not more than 1.5:1.0 based upon the ratio of net debt to adjusted earnings before interest, taxes, depreciation and amortization for each period of four consecutive fiscal quarters. As of July 30, 2016, Claire s Gibraltar s Fixed Charge Cover Ratio was 1.47:1.0 and its Leverage Ratio was 0.29:1.0. See *Europe Credit Facility Refinancing*.

As of July 30, 2016, we had $49.3 million of borrowings, which reduces the borrowing availability under the Europe Credit Facility to $0.7 million as of that date.

See *Events Subsequent to July 30, 2016 - Europe Credit Facility Refinancing* .

Europe Bank Credit Facilities

In addition to the Europe Credit Facility, our non-U.S. subsidiaries have bank credit facilities totaling $2.3 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 July 30, 2016, we had a reduction of $2.1 million for outstanding bank guarantees, which reduces the borrowing availability to $0.2 million as of that date.

Critical Accounting Policies and Estimates

Our Unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles. Preparation of these statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these financial statements. A summary of significant accounting policies and a description of accounting policies that are considered critical may be found in our Fiscal 2015 Annual Report on Form 10-K, filed on April 26, 2016, in the Notes to Consolidated Financial Statements, Note 2 Summary of Significant Accounting Policies, and the Critical Accounting Policies and Estimates section contained in the Management s Discussion and Analysis of Financial Condition and Results of Operations therein.

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. These fair value estimates require significant management judgment and are based on the best information available at the time of the analysis. Our principal intangible assets, other than goodwill, are tradenames, franchise agreements, and leases that existed as of the date that the Company was acquired in May 2007, which had terms that were favorable to market at that date. Our annual impairment testing for Fiscal 2015 resulted in a recognition of non-cash impairment charges of $125.0 million, $29.0 million and $1.1 million, relating to goodwill, intangible assets and long-lived assets, respectively. We expect to next perform our annual impairment analysis during the fourth fiscal quarter of Fiscal 2016, and we may be required to recognize additional impairment charges at that time or in the future.

Recent Accounting Pronouncements

See Note 2 Recent Accounting Pronouncements, in the Notes to the Unaudited Condensed Consolidated Financial Statements.

Cautionary Note Regarding Forward-Looking Statements and Risk Factors

We and our representatives may from time to time make written or oral forward-looking statements, including statements contained in this and other filings with the Securities and Exchange Commission and in our press releases and reports we issue publicly. 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 periods, 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. 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. The forward-looking statements may use the words expect, anticipate, plan, intend, project, may, believe, for similar expressions. 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 or promotional sales; inability to grow our Company operated store base in North America and Europe, or expand our international store base through franchise or similar licensing arrangements, or expand our store base through concessions; 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 changes in North America and Europe, or other international laws and regulations governing the sale of our products, particularly regulations relating to heavy metal and chemical content in our products; changes in anti-bribery laws; changes in employment laws, including laws relating to overtime pay, tax laws and import laws; product recalls; loss of key members of management; increase in the costs of healthcare for our employees; increases in the cost of labor; labor disputes; 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. The Company undertakes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances. 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. Additional discussion of these and other risks and uncertainties is contained elsewhere in this Item 2, in Item 3, Quantitative and Qualitative Disclosures About Market Risk and in our Form 10-K for Fiscal 2015 under Statement Regarding Forward-Looking Disclosures and Risk Factors.

Item 3. 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 by maintaining bank accounts with a group of credit worthy financial institutions. As of July 30, 2016, all cash equivalents were maintained in one money market fund that was invested exclusively in U.S. Treasury securities.

Interest Rates

As of July 30, 2016, we had fixed rate debt of $2,381.8 million and variable rate debt of $159.5 million. Based on our variable rate balance as of July 30, 2016, a 1% change in interest rates would increase or decrease our annual interest expense by approximately $1.6 million.

Foreign Currency

We are exposed to market risk from foreign currency exchange rate fluctuations on the United States dollar (USD or dollar) value of foreign currency denominated transactions and our investments in foreign subsidiaries. We manage this exposure to market risk through our regular operating and financing activities, and may from time to time, use foreign currency options. Exposure to market risk for changes in foreign currency exchange rates relates primarily to our foreign operations buying, selling, and financing activities in currencies other than local currencies and to the carrying value of our net

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investments in foreign subsidiaries. As of July 30, 2016, 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 loss are $4.3 million and ($3.6) million, net of tax, reflecting the unrealized gain (loss) on foreign currency translations and intra-entity foreign currency transactions during the six months ended July 30, 2016 and August 1, 2015, 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 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 our 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 foreign currency 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 cannot predict whether, when or the manner in which the economic conditions described above will change. See also Cautionary Note Regarding Forward Looking Statements and Risk Factors.

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Item 4. Controls and Procedures

Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934), as of the end of the period covered by this Quarterly Report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this Quarterly Report our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities Exchange Commission s rules and forms, and that such information is accumulated and communicated to our management, including each of such officers as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls over Financial Reporting

No changes in our internal control over financial reporting have been made during the quarter ended July 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. 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 content in our merchandise; litigation with respect to various employment matters, including wage and hour litigation; litigation with present and 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 financial results.

Item 1A. Risk Factors

There have been no material changes in our risk factors disclosed in our Annual Report on Form 10-K for the year ended January 30, 2016.

Item 6. Exhibits

10.1	Amended and Restated Credit Agreement dated August 12, 2016. (1)
10.2	Offer Letter with Scott Huckins dated September 2, 2016. (2)
10.3	Supplement No. 1 to the Amendment No. 3 and Waiver dated September 9, 2016. (3)
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a). (4)
31.2	Certification of principal financial officer pursuant to Rule 13a-14(a)/15d-14(a). (4)
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (4)
32.2	Certification of principal financial officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (4)
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 Form 8-K on August 15, 2016.
(2) Filed previously as exhibit to Form 8-K on September 9, 2016.
(3) Filed previously as exhibit to Form 8-K on September 15, 2016.
(4) Filed herewith.

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Items 2, 3, 4 and 5 of Part II are not applicable and have been omitted.

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SIGNATURES

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

	CLAIRE S STORES, INC.
September 19, 2016	By: /s/ Ron Marshall Ron Marshall, Chief Executive Officer

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INDEX TO EXHIBITS

EXHIBIT NO.	DESCRIPTION
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).
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